SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **February 2010,** with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

MARY L. SCHAPIRO, CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(36 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59703 / April 3, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2959 / April 3, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13430

In the Matter of **DAN WISE, CPA,** **a/k/a DANNY WISE, CPA,** **Respondent.**	**ORDER OF 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 Dan Wise, CPA ("Wise") 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. Wise has been licensed as a certified public accountant in California since 1983 and in Arizona since 1994.

[1] Rule 102(e)(2) provides in pertinent part: "any person whose license to practice as an accountant . . . has been revoked or suspended in any State . . . shall be forthwith suspended from appearing or practicing before the Commission."

2. On December 10, 2008, the Arizona State Board of Accountancy issued a decision and order, by consent, against Wise, finding that Wise committed ethical violations and failed to respond to client allegations regarding misappropriation of client funds intended as payments to the Internal Revenue Service.

3. As a result of this decision and order, Wise's Arizona license as a certified public accountant was revoked.

III.

In view of the foregoing, the Commission finds that Wise's license as a certified public accountant has been revoked within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED that Dan Wise 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

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61453 / February 1, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13772

In the Matter of **Management Graphics, Inc.,** **Marine Shuttle Operations, Inc.,** **Marketing Specialists Corp.,** **Mas Acquisition XII Corp.,** **MDCM Holdings, Inc. (f/k/a Mortgage.com, Inc.),** **MerchantOnline.com, Inc.,** **Met Capital Corp., and** **Micro-Asi, 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 Management Graphics, Inc., Marine Shuttle Operations, Inc., Marketing Specialists Corp., Mas Acquisition XII Corp., MDCM Holdings, Inc. (f/k/a Mortgage.com, Inc.), MerchantOnline.com, Inc., Met Capital Corp., and Micro-Asi, Inc.

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II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Management Graphics, Inc. (CIK No. 782999) is an Ontario corporation located in Downsview, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Management Graphics is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F on January 31, 1998, which reported a net loss of $346,101 (Canadian) for the prior twelve months.

2. Marine Shuttle Operations, Inc. (CIK No. 1064469) is a permanently revoked Nevada corporation located in Berlin, Germany with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Marine Shuttle 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 $23 million since the company's May 23, 1997 inception. As of January 4, 2010, the company's stock (symbol "ZSUB") was traded on the over-the-counter markets.

3. Marketing Specialists Corp. (CIK No. 1062184) is a delinquent Delaware corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Marketing Specialists 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 over $8.2 million for the prior three months. On May 24, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Texas, which was still pending as of January 4, 2010.

4. Mas Acquisition XII Corp. (CIK No. 1084870) is a dissolved Indiana corporation located in Evansville, Indiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mas 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 September 30, 1999.

5. MDCM Holdings, Inc. (f/k/a Mortgage.com, Inc.) (CIK No. 1081182) is a dissolved Florida corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MDCM 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 over $47.7 million for the prior nine months. As of January 4, 2010, the company's stock (symbol "MDCM") was traded on the over-the-counter markets.

6. MerchantOnline.com, Inc. (CIK No. 1039947) is a dissolved Florida corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MerchantOnline.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended April 30, 2001, which reported a net loss of over $44 million for the prior six months. On October 22, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Florida which was converted to a Chapter 7 petition, and was terminated on December 10, 2004. As of January 4, 2010, the company's stock (symbol "MRTOQ") was traded on the over-the-counter markets.

7. Met Capital Corp. (CIK No. 814085) is a void Delaware corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Met Capital 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, 1992. On December 31, 1991, the company filed a Form 8-K stating that it had a net loss of over $3.9 million for the prior twelve months.

8. Micro-Asi, Inc. (CIK No. 1090293) is a forfeited Texas corporation located in Plano, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Micro-Asi 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, 2000, which reported a net loss of over $10.6 million for the prior twelve months.

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 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
Management Graphics, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Management Graphics, Inc.					
	20-F	01/31/99	08/02/99	Not filed	125
	20-F	01/31/00	07/31/00	Not filed	114
	20-F	01/31/01	07/31/01	Not filed	102
	20-F	01/31/02	07/31/02	Not filed	90
	20-F	01/31/03	07/31/03	Not filed	78
	20-F	01/31/04	08/02/04	Not filed	65
	20-F	01/31/05	08/01/05	Not filed	53
	20-F	01/31/06	07/31/06	Not filed	42
	20-F	01/31/07	07/31/07	Not filed	30
	20-F	01/31/08	07/31/08	Not filed	18
	20-F	01/31/09	07/31/09	Not filed	6
Total Filings Delinquent	10				
Marine Shuttle Operations, Inc.					
	10-K	12/31/01	04/01/02	Not filed	93
	10-Q	03/31/02	05/15/02	Not filed	92
	10-Q	06/30/02	08/14/02	Not filed	89
	10-Q	09/30/02	11/14/02	Not filed	86
	10-K	12/31/02	03/31/03	Not filed	82
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-Q	09/30/03	11/14/03	Not filed	74
	10-K	12/31/03	03/30/04	Not filed	70
	10-Q	03/31/04	05/17/04	Not filed	68
	10-Q	06/30/04	08/16/04	Not filed	65
	10-Q	09/30/04	11/15/04	Not filed	62
	10-K	12/31/04	03/31/05	Not filed	58
	10-Q	03/31/05	05/16/05	Not filed	56
	10-Q	06/30/05	08/15/05	Not filed	53
	10-Q	09/30/05	11/14/05	Not filed	50
	10-K	12/31/05	03/31/06	Not filed	46
	10-Q	03/31/06	05/15/06	Not filed	44

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	06/30/06	08/14/06	Not filed	41
	10-Q	09/30/06	11/14/06	Not filed	38
	10-K	12/31/06	04/02/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-Q	09/30/07	11/14/07	Not filed	26
	10-K	12/31/07	03/31/08	Not filed	22
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-Q	09/30/08	11/14/08	Not filed	14
	10-K	12/31/08	03/31/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	32				
Marketing Specialists Corp.					
	10-Q	06/30/01	08/14/01	Not filed	101
	10-Q	09/30/01	11/14/01	Not filed	98
	10-K	12/31/01	04/01/02	Not filed	93
	10-Q	03/31/02	05/15/02	Not filed	92
	10-Q	06/30/02	08/14/02	Not filed	89
	10-Q	09/30/02	11/14/02	Not filed	86
	10-K	12/31/02	03/31/03	Not filed	82
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-Q	09/30/03	11/14/03	Not filed	74
	10-K	12/31/03	03/30/04	Not filed	70
	10-Q	03/31/04	05/17/04	Not filed	68
	10-Q	06/30/04	08/16/04	Not filed	65
	10-Q	09/30/04	11/15/04	Not filed	62
	10-K	12/31/04	03/31/05	Not filed	58
	10-Q	03/31/05	05/16/05	Not filed	56
	10-Q	06/30/05	08/15/05	Not filed	53
	10-Q	09/30/05	11/14/05	Not filed	50
	10-K	12/31/05	03/31/06	Not filed	46
	10-Q	03/31/06	05/15/06	Not filed	44
	10-Q	06/30/06	08/14/06	Not filed	41

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/06	11/14/06	Not filed	38
	10-K	12/31/06	04/02/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-Q	09/30/07	11/14/07	Not filed	26
	10-K	12/31/07	03/31/08	Not filed	22
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-Q	09/30/08	11/14/08	Not filed	14
	10-K	12/31/08	03/31/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	34				
Mas Acquisition XII Corp.					
	10-KSB	12/31/99	03/30/00	Not filed	118
	10-QSB	03/31/00	05/15/00	Not filed	116
	10-QSB	06/30/00	08/14/00	Not filed	113
	10-QSB	09/30/00	11/14/00	Not filed	110
	10-KSB	12/31/00	04/02/01	Not filed	105
	10-QSB	03/31/01	05/15/01	Not filed	104
	10-QSB	06/30/01	08/14/01	Not filed	101
	10-QSB	09/30/01	11/14/01	Not filed	98
	10-KSB	12/31/01	04/01/02	Not filed	93
	10-QSB	03/31/02	05/15/02	Not filed	92
	10-QSB	06/30/02	08/14/02	Not filed	89
	10-QSB	09/30/02	11/14/02	Not filed	86
	10-KSB	12/31/02	03/31/03	Not filed	82
	10-QSB	03/31/03	05/15/03	Not filed	80
	10-QSB	06/30/03	08/14/03	Not filed	77
	10-QSB	09/30/03	11/14/03	Not filed	74
	10-KSB	12/31/03	03/30/04	Not filed	70
	10-QSB	03/31/04	05/17/04	Not filed	68
	10-QSB	06/30/04	08/16/04	Not filed	65
	10-QSB	09/30/04	11/15/04	Not filed	62
	10-KSB	12/31/04	03/31/05	Not filed	58

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	03/31/05	05/16/05	Not filed	56
	10-QSB	06/30/05	08/15/05	Not filed	53
	10-QSB	09/30/05	11/14/05	Not filed	50
	10-KSB	12/31/05	03/31/06	Not filed	46
	10-QSB	03/31/06	05/15/06	Not filed	44
	10-QSB	06/30/06	08/14/06	Not filed	41
	10-QSB	09/30/06	11/14/06	Not filed	38
	10-KSB	12/31/06	04/02/07	Not filed	33
	10-QSB	03/31/07	05/15/07	Not filed	32
	10-QSB	06/30/07	08/14/07	Not filed	29
	10-QSB	09/30/07	11/14/07	Not filed	26
	10-KSB	12/31/07	03/31/08	Not filed	22
	10-Q [1]	03/31/08	05/15/08	Not filed	20
	10-Q [1]	06/30/08	08/14/08	Not filed	17
	10-Q [1]	09/30/08	11/14/08	Not filed	14
	10-K [1]	12/31/08	03/31/09	Not filed	10
	10-Q [1]	03/31/09	05/15/09	Not filed	8
	10-Q [1]	06/30/09	08/14/09	Not filed	5
	10-Q [1]	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	40				
MDCM Holdings, Inc. (f/k/a Mortgage.com, Inc.)					
	10-K	12/31/00	04/02/01	Not filed	105
	10-Q	03/31/01	05/15/01	Not filed	104
	10-Q	06/30/01	08/14/01	Not filed	101
	10-Q	09/30/01	11/14/01	Not filed	98
	10-K	12/31/01	04/01/02	Not filed	93
	10-Q	03/31/02	05/15/02	Not filed	92
	10-Q	06/30/02	08/14/02	Not filed	89
	10-Q	09/30/02	11/14/02	Not filed	86
	10-K	12/31/02	03/31/03	Not filed	82
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-Q	09/30/03	11/14/03	Not filed	74
	10-K	12/31/03	03/30/04	Not filed	70
	10-Q	03/31/04	05/17/04	Not filed	68

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	06/30/04	08/16/04	Not filed	65
	10-Q	09/30/04	11/15/04	Not filed	62
	10-K	12/31/04	03/31/05	Not filed	58
	10-Q	03/31/05	05/16/05	Not filed	56
	10-Q	06/30/05	08/15/05	Not filed	53
	10-Q	09/30/05	11/14/05	Not filed	50
	10-K	12/31/05	03/31/06	Not filed	46
	10-Q	03/31/06	05/15/06	Not filed	44
	10-Q	06/30/06	08/14/06	Not filed	41
	10-Q	09/30/06	11/14/06	Not filed	38
	10-K	12/31/06	04/02/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-Q	09/30/07	11/14/07	Not filed	26
	10-K	12/31/07	03/31/08	Not filed	22
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-Q	09/30/08	11/14/08	Not filed	14
	10-K	12/31/08	03/31/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	36				
MerchantOnline.com, Inc.					
	10-QSB	07/31/01	09/14/01	Not filed	100
	10-KSB	10/31/01	01/29/02	Not filed	96
	10-QSB	01/31/02	03/18/02	Not filed	94
	10-QSB	04/30/02	06/14/02	Not filed	91
	10-QSB	07/31/02	09/16/02	Not filed	88
	10-KSB	10/31/02	01/29/03	Not filed	84
	10-QSB	01/31/03	03/17/03	Not filed	82
	10-QSB	04/30/03	06/16/03	Not filed	79
	10-QSB	07/31/03	09/15/03	Not filed	76
	10-KSB	10/31/03	01/29/04	Not filed	72
	10-QSB	01/31/04	03/16/04	Not filed	70
	10-QSB	04/30/04	06/14/04	Not filed	67
	10-QSB	07/31/04	09/14/04	Not filed	64

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-KSB	10/31/04	01/31/05	Not filed	60
	10-QSB	01/31/05	03/17/05	Not filed	58
	10-QSB	04/30/05	06/14/05	Not filed	55
	10-QSB	07/31/05	09/14/05	Not filed	52
	10-KSB	10/31/05	01/30/06	Not filed	48
	10-QSB	01/31/06	03/17/06	Not filed	46
	10-QSB	04/30/06	06/14/06	Not filed	43
	10-QSB	07/31/06	09/14/06	Not filed	40
	10-KSB	10/31/06	01/29/07	Not filed	36
	10-QSB	01/31/07	03/19/07	Not filed	34
	10-QSB	04/30/07	06/14/07	Not filed	31
	10-QSB	07/31/07	09/14/07	Not filed	28
	10-KSB	10/31/07	01/29/08	Not filed	24
	10-QSB	01/31/08	03/17/08	Not filed	22
	10-QSB	04/30/08	06/16/08	Not filed	19
	10-QSB	07/31/08	09/15/08	Not filed	16
	10-KSB	10/31/08	01/29/09	Not filed	12
	10-Q[1]	01/31/09	03/18/09	Not filed	10
	10-Q[1]	04/30/09	06/15/09	Not filed	7
	10-Q[1]	07/31/09	09/14/09	Not filed	4
Total Filings Delinquent	31				
Met Capital Corp.					
	10-K	12/31/92	03/31/93	Not filed	202
	10-Q	03/31/93	05/17/93	Not filed	200
	10-Q	06/30/93	08/16/93	Not filed	197
	10-Q	09/30/93	11/15/93	Not filed	194
	10-K	12/31/93	03/31/94	Not filed	190
	10-Q	03/31/94	05/16/94	Not filed	188
	10-Q	06/30/94	08/15/94	Not filed	185
	10-Q	09/30/94	11/14/94	Not filed	182
	10-K	12/31/94	03/31/95	Not filed	178
	10-Q	03/31/95	05/15/95	Not filed	176
	10-Q	06/30/95	08/14/95	Not filed	173
	10-Q	09/30/95	11/14/95	Not filed	170
	10-K	12/31/95	04/01/96	Not filed	165
	10-Q	03/31/96	05/15/96	Not filed	164
	10-Q	06/30/96	08/14/96	Not filed	161

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/96	11/14/96	Not filed	158
	10-K	12/31/96	03/31/97	Not filed	154
	10-Q	03/31/97	05/15/97	Not filed	152
	10-Q	06/30/97	08/14/97	Not filed	149
	10-Q	09/30/97	11/14/97	Not filed	146
	10-K	12/31/97	03/31/98	Not filed	142
	10-Q	03/31/98	05/15/98	Not filed	140
	10-Q	06/30/98	08/14/98	Not filed	137
	10-Q	09/30/98	11/16/98	Not filed	134
	10-K	12/31/98	03/31/99	Not filed	130
	10-Q	03/31/99	05/17/99	Not filed	128
	10-Q	06/30/99	08/16/99	Not filed	125
	10-Q	09/30/99	11/15/99	Not filed	122
	10-K	12/31/99	03/30/00	Not filed	118
	10-Q	03/31/00	05/15/00	Not filed	116
	10-Q	06/30/00	08/14/00	Not filed	113
	10-Q	09/30/00	11/14/00	Not filed	110
	10-K	12/31/00	04/02/01	Not filed	105
	10-Q	03/31/01	05/15/01	Not filed	104
	10-Q	06/30/01	08/14/01	Not filed	101
	10-Q	09/30/01	11/14/01	Not filed	98
	10-K	12/31/01	04/01/02	Not filed	93
	10-Q	03/31/02	05/15/02	Not filed	92
	10-Q	06/30/02	08/14/02	Not filed	89
	10-Q	09/30/02	11/14/02	Not filed	86
	10-K	12/31/02	03/31/03	Not filed	82
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-Q	09/30/03	11/14/03	Not filed	74
	10-K	12/31/03	03/30/04	Not filed	70
	10-Q	03/31/04	05/17/04	Not filed	68
	10-Q	06/30/04	08/16/04	Not filed	65
	10-Q	09/30/04	11/15/04	Not filed	62
	10-K	12/31/04	03/31/05	Not filed	58
	10-Q	03/31/05	05/16/05	Not filed	56
	10-Q	06/30/05	08/15/05	Not filed	53
	10-Q	09/30/05	11/14/05	Not filed	50
	10-K	12/31/05	03/31/06	Not filed	46
	10-Q	03/31/06	05/15/06	Not filed	44

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	06/30/06	08/14/06	Not filed	41
	10-Q	09/30/06	11/14/06	Not filed	38
	10-K	12/31/06	04/02/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-Q	09/30/07	11/14/07	Not filed	26
	10-K	12/31/07	03/31/08	Not filed	22
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-Q	09/30/08	11/14/08	Not filed	14
	10-K	12/31/08	03/31/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	68				
Micro-Asi, Inc.					
	10-QSB	03/31/01	05/15/01	Not filed	104
	10-QSB	06/30/01	08/14/01	Not filed	101
	10-QSB	09/30/01	11/14/01	Not filed	98
	10-KSB	12/31/01	04/01/02	Not filed	93
	10-QSB	03/31/02	05/15/02	Not filed	92
	10-QSB	06/30/02	08/14/02	Not filed	89
	10-QSB	09/30/02	11/14/02	Not filed	86
	10-KSB	12/31/02	03/31/03	Not filed	82
	10-QSB	03/31/03	05/15/03	Not filed	80
	10-QSB	06/30/03	08/14/03	Not filed	77
	10-QSB	09/30/03	11/14/03	Not filed	74
	10-KSB	12/31/03	03/30/04	Not filed	70
	10-QSB	03/31/04	05/17/04	Not filed	68
	10-QSB	06/30/04	08/16/04	Not filed	65
	10-QSB	09/30/04	11/15/04	Not filed	62
	10-KSB	12/31/04	03/31/05	Not filed	58
	10-QSB	03/31/05	05/16/05	Not filed	56
	10-QSB	06/30/05	08/15/05	Not filed	53
	10-QSB	09/30/05	11/14/05	Not filed	50
	10-KSB	12/31/05	03/31/06	Not filed	46
	10-QSB	03/31/06	05/15/06	Not filed	44

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	06/30/06	08/14/06	Not filed	41
	10-QSB	09/30/06	11/14/06	Not filed	38
	10-KSB	12/31/06	04/02/07	Not filed	33
	10-QSB	03/31/07	05/15/07	Not filed	32
	10-QSB	06/30/07	08/14/07	Not filed	29
	10-QSB	09/30/07	11/14/07	Not filed	26
	10-KSB	12/31/07	03/31/08	Not filed	22
	10-Q [1]	03/31/08	05/15/08	Not filed	20
	10-Q [1]	06/30/08	08/14/08	Not filed	17
	10-Q [1]	09/30/08	11/14/08	Not filed	14
	10-K [1]	12/31/08	03/31/09	Not filed	10
	10-Q [1]	03/31/09	05/15/09	Not filed	8
	10-Q [1]	06/30/09	08/14/09	Not filed	5
	10-Q [1]	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent 35

[1] 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.

Chairman Schapiro not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61449 / February 1, 2010

Admin. Proc. File No. 3-13279

In the Matter of the Application of

JANET GURLEY KATZ
c/o Richard C. Fooshee, Esq.
20 North Van Brunt Street, Suite 2
Englewood, NJ 07631

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE -- REVIEW OF DISCIPLINARY PROCEEDINGS

Misappropriation of Customers' Funds

Misstatements to Customer

Unsuitable Trading

Unauthorized Trading

Discretionary Trading Without Written Authorization

Record Keeping Violations

Failure to Know the Customer

National securities exchange found that registered representative, while associated with member firm, misappropriated customer funds, made misstatements to a customer, made unauthorized and unsuitable trades in customer accounts, exercised discretion in customer accounts without written authorization, and caused record keeping inaccuracies. *Held*, exchange's findings of violations are *sustained in part* and *vacated in part*, and sanctions imposed are *sustained*.

APPEARANCES:

Richard C. Fooshee, Esq., for Janet Gurley Katz.

Richard R. Best, *Linda Riefberg*, *Penny J. Rosenberg*, *Allen Boyer*, *Marc B. Minor*, and *Bettina M. Sacklowski*, for FINRA, on behalf of NYSE Regulation, Inc.

Appeal filed: October 24, 2008
Last brief received: March 3, 2009

I.

Janet Gurley Katz, formerly a registered representative associated with Wachovia Securities, Inc. ("Wachovia" or the "Firm"), a member of the New York Stock Exchange LLC, appeals from NYSE Regulation, Inc. ("NYSE") disciplinary action.[1] The NYSE found that Katz engaged in conduct that was inconsistent with just and equitable principles of trade by (i) causing customer funds to be transferred to other customers' accounts without authorization, (ii) making misstatements to a customer, (iii) effecting unsuitable transactions in customers' accounts, and (iv) engaging in unauthorized trading in customers' accounts.[2] The NYSE further found that Katz violated NYSE Rule 408(a) by exercising discretionary power in customer accounts without written authorization and that she violated NYSE Rule 405 by causing Wachovia to fail to learn

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[1] On July 26, 2007, the Commission approved proposed rule changes in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Pursuant to this consolidation, the member firm regulatory and enforcement functions and employees of NYSE Regulation were transferred to NASD, and the expanded NASD changed its name to Financial Industry Regulatory Authority, Inc., or FINRA. *See* Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Because this proceeding was initiated by NYSE Regulation, we use the designation "NYSE" in this opinion.

[2] NYSE Rule 476(a)(6) provides that members and their employees may be disciplined for conduct that is "inconsistent with just and equitable principles of trade." A violation of another NYSE or Commission rule or regulation also automatically constitutes a violation of Rule 476(a). *Thomas W. Heath, III*, Exchange Act Rel. No. 59223 (Jan. 9, 2009), 94 SEC Docket 13242, 13247 n.8 ("It is well-established that a violation of another self-regulatory organization ("SRO") or Commission rule or regulation will also automatically constitute a violation of the J&E Rule [*i.e.*, NYSE Rule 476(a)(6)]."), *aff'd*, 586 F.3d 122 (2d Cir. 2009).

essential facts about certain customers.[3] Finally, the NYSE found that Katz caused or permitted violations of NYSE Rule 440 and Section 17(a) of the Securities Exchange Act of 1934 and Rules 17a-3 and 17a-4 thereunder by entering (or causing to be entered) inaccurate information on customers' new account forms.[4]

The NYSE censured Katz and imposed a permanent bar from membership, allied membership, and approved person status and from employment or association in any capacity with any member or member organization.[5] We base our findings on an independent review of the record.

II.

This appeal concerns Katz's handling of accounts for seven customers at Wachovia's Morristown, New Jersey office. Katz began work in the securities industry in 1980 and, after working for several other firms, joined Wachovia in December 1997. Katz, by her own admission, "was an active manager," whose philosophy was, if customers "had very, very conservative money, that money should either stay in the bank or Treasury bills or someplace else."

A. Wachovia's Supervisory Procedures

Katz was supervised at Wachovia by Lawrence Ennis, the Firm's office manager, and Nicole Kramlick, the Firm's operations manager. Ennis's supervision of salespersons such as Katz involved, among other things, reviewing customer documents and various daily, weekly, and monthly reports. When a Wachovia salesperson opened a new customer account, the salesperson would complete a new account form, which asked for information such as the

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3 NYSE Rule 408 requires a customer's written authorization before a member or an employee thereof can exercise discretionary power in that customer's account. NYSE Rule 405 requires every member organization to use due diligence to learn the essential facts about every customer, every order, or every margin account that the member organization accepts or carries.

4 15 U.S.C. § 78q(a); 17 C.F.R. §§ 240.17a-3, -4. NYSE Rule 440 requires brokers and dealers to make and preserve books and records prescribed by the NYSE and by Exchange Act Rules 17a-3 and 17a-4. In turn, Exchange Act Rules 17a-3 and 17a-4 require brokers and dealers to keep current books and records regarding executed securities transactions and customer accounts. 17 C.F.R. §§ 240.17a-3, -4.

5 On November 3, 2008, the Commission denied Katz's motion to stay the NYSE's final disciplinary sanction and the NYSE's imposition of a permanent bar. *See* Order Denying Stay, Admin. Proc. File No. 3-13279 (Nov. 3, 2008). On November 25, 2008, we denied Katz's motion for reconsideration of our order denying her request for a stay. *See* Order Denying Motion for Reconsideration of Denial of Stay, Admin. Proc. File No. 3-13279 (Nov. 25, 2008).

customer's net worth, age, income, investment objectives, and whether anyone else would have control over the account. Ennis explained that he relied on the salesperson to complete these forms accurately because the information determined whether the Firm approved certain trading levels for the customer.[6]

Wachovia's compliance department would periodically ask Ennis to review a customer's account more closely if, for example, the customer filed a complaint or an account was incurring unusually high commissions or an unusually high number of trades. Ennis testified that the Firm's compliance department asked him to conduct such a heightened review of Katz's customer accounts "[o]n a regular basis" because "[s]he was pretty active, from a turnover standpoint."

This heightened scrutiny first required the salesperson to complete an account questionnaire, which Ennis described as "just a review of the account at that point in time." If Wachovia concluded that a high level of trading was occurring in an account, the Firm would mail a letter asking the customer to confirm that he or she was aware of commissions paid, level of activity, and profits and losses that were occurring in the account.

If Wachovia's compliance department determined that a particular account required even greater scrutiny, Ennis would contact the customer directly. As Ennis explained at the hearing, he would "call the client and go through, speak to them about their account, speak to them about some of the issues that may have been of concern" and then memorialize the conversation on a "Client Service Dialogue." Ennis also testified that he occasionally had less formal conversations with clients, just to ensure that everything was "okay" with their accounts. At times, Ennis would also follow up these conversations with letters to the client, summarizing their conversation. Kramlick was responsible for reviewing all of the Firm's outgoing mail (such as confirmation letters), while the operations department received all incoming mail, which was supposed to be copied and then sent to the appropriate salesperson..

B. Investigation into Katz's Conduct

The alleged misconduct at issue here began to come to light on November 25, 2002, when Thomas Ashbahian, the son of two of Katz's customers (Harry and Irene Ashbahian), contacted Ennis about Katz's handling of his parents' accounts. Ennis subsequently met with the

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6 An element of the new account forms that received particular attention during Katz's disciplinary hearing was the investment objective section. Although several different forms were used, they typically listed ten different options that could be checked: (i) Income (quality emphasis), (ii) Income (return emphasis), (iii) Growth & Income (quality emphasis), (iv) Growth & Income (return emphasis), (v) Growth (quality emphasis), (vi) Growth (return emphasis), (vii) Trading & Speculation, (viii) Not Applicable, (ix) High Income, and (x) FundAdvantage. Most of the new account forms at issue indicated that a "page 2" provided definitions for these investment options, but that page does not appear to have been included for most of the forms in the record.

Ashbahians and Thomas, during which meeting the Ashbahians stated, among other things, that their money had been moved out of their accounts without their knowledge and that their signatures on certain documents appeared to be forged. Ennis began looking into these accusations, reported the matter to Wachovia's compliance department, and asked Katz to leave the office for a few days.

Sometime shortly thereafter, a Wachovia salesperson told Ennis that he had seen Katz the previous night removing boxes of files from the office with her daughter. The Firm, at the time, had a prohibition against taking client files, and Ennis "believed" that placing Katz on administrative leave meant "not to come into the office until further notice." Katz, however, claimed that she had removed only copies – not originals – of client files and that she had done so because her mother-in-law was concerned that her account files were missing. Ennis demanded that Katz return the files, which she did, albeit in a disorganized state.

Katz was also dealing with a series of personal issues during this time. Her stepson was diagnosed with cancer in 2000 and passed away on December 31, 2001. Katz's husband was then diagnosed with terminal cancer. Katz and her husband subsequently traveled to Scotland for what they expected to be a final vacation together, during which Katz's husband passed away on October 4, 2002.

Approximately two months after Katz's husband's death, Ennis telephoned Katz on or about December 6, 2002 to inform her that he was placing her on paid administrative leave because of concerns related to the Ashbahians' complaint. Katz voluntarily resigned from Wachovia a little over a week later.[7] On August 11, 2006, the NYSE initiated this disciplinary action by filing a Charge Memorandum, which alleged that Katz had engaged in actionable conduct with respect to the accounts of the Ashbahians and five other clients. These customers are described below.

1. Harry and Irene Ashbahian

Harry and Irene Ashbahian (the "Ashbahians"), a married couple, met Katz through their son, Gregory ("Greg") Ashbahian, who maintained several accounts with Katz. The Ashbahians subsequently opened several accounts with Katz in or around 2000, including a joint account, individual retirement accounts ("IRAs"), individual living trust accounts and a gifting trust account. The Ashbahians were both in their mid-70s at the time and had high school educations. Harry had been retired for nearly twenty years from a career as a dry-cleaning store owner, and Irene had been a homemaker for approximately fifty years.

Several new account forms were completed when the Ashbahians opened their accounts with Katz. At least two of those forms indicated that the Ashbahians' net worth exceeded one

[7] According to her attorney, Katz was working as an investment advisor registered with the state of New Jersey at the time of her NYSE disciplinary hearing.

million dollars. The Ashbahians testified that this information was incorrect, but Katz introduced an unsigned, undated document purporting to list the Ashbahian's investments as slightly more than one million dollars. Harry Ashbahian confirmed that the list was in his handwriting, but he thought it might have been created sometime after he first met Katz.[8]

The new account forms also showed the Ashbahians' investment objectives as, variously, "Growth (return emphasis)," "Growth (quality emphasis)," or "Growth" with a "Moderate" risk tolerance.[9] When asked during the disciplinary hearing what his investment goals had been when he invested with Katz, Harry testified, "There was really no goals. The main thing was to make sure that we have constant income because we didn't have any retirement at all." Harry added, "I told Janet, Ms. Katz, you have to be very careful how you invest our money because we are going to live on this. Not to make any fancy investments where we may lose money." Harry also testified, however, that he and his wife "were more concerned about getting growth" and that he was looking for a broker "who could give me the most income in investing."

Katz testified that she understood the Ashbahian's investment objective to be to "[m]ake as much money as we can" and to have "[a]s much growth as possible." Katz acknowledged, however, that Ashbahians' objective for their IRA accounts was "a little less aggressive than the joint accounts and the trusts."

Initially, the Ashbahians appeared pleased with Katz's handling of their account. Ennis testified that the Ashbahians told him during a meeting they were satisfied with their account,

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8 Harry also testified that the new account form incorrectly listed his birthday as April 21, 1921, instead of his actual birthday, April 21, 1924.

9 Some of the Ashbahians' new account forms are slightly different from the other account forms at issue. These forms use slightly different terminology regarding investment objectives and, unlike most of the forms, include definitions for those objectives. According to the forms, a "Growth" investment objective, as listed for the Ashbahians, "[s]eeks capital appreciation through market price increases in investments. Dividend and interest returns may be important but are not primary considerations." By comparison, an "income" objective "seeks regular and consistent returns on investment in the form of interest and dividend payments. Little consideration is given to capital appreciation."

These other forms also state that a "moderate" risk profile "[g]enerally reflects an investor who has the financial resources and investment experience to accept a modest amount of risk in order to achieve capital appreciation or higher income returns. Such an investor can accept some loss of capital in seeking to meet his or her goals." The forms state that a "conservative" profile, by comparison, "[g]enerally reflects an investor who has a low tolerance for risk. Preservation of capital is often a major consideration. Such an investor is willing to limit or forego capital appreciation opportunities or higher income returns in order to protect his or her investment capital."

and the record contains a letter dated May 13, 2002, in which the Ashbahians purportedly confirmed "that we have examined all confirmations and monthly statements relating to our accounts. We are aware of all activity, commissions and interest charges, if any, and overall profits and losses."

The May 2002 confirmation letter also contained blanks for the Ashbahians to write their total net worth, liquid net worth, and household income. Handwriting on the document listed the Ashbahians' net worth as $1,500,000, their liquid net worth as $900,000, and their household income as $150,000. The Ashbahians, however, did not recall signing such a letter and claimed that the signatures did not look like theirs. Harry, for instance, testified that the letter "doesn't look like my handwriting" and added that their "[h]ousehold income is not $150,000. Not even half."

The Ashbahians also testified that they began to notice that Katz was effecting trades in their accounts without first consulting them. They testified that, after questioning Katz about this activity, Katz responded, "[D]on't worry about it. I know what I'm doing." Katz disputed this and claimed that Harry was "very much" aware of what was going on in his account. Katz testified that she obtained the Ashbahians' approval before each trade and asserted that she spoke with the Ashbahians "185 times in a two and a half year period" and met with them eighteen or twenty times.

The Ashbahians testified that they became even more concerned after their account value began falling and that they asked their son Thomas to look into it. Sometime thereafter, the Ashbahians complained to Ennis that trades had been placed without their authorization, that certain signatures on documents were not their signatures, and that they were misled about how their investments were doing. Their complaint, as discussed earlier, led Ennis to ask Katz to leave the office for a few days.

After making their initial complaint to Ennis, the Ashbahians discovered that $26,000 had been transferred from Irene's living trust account to their son Greg's individual account between March 2001 and October 2002. The money was transferred in twenty-six transactions, ranging in size from $134 to $4,000. A $4,000 transfer was also made out of Harry's living trust account on April 12, 2002, with $2,000 going into Greg's Roth IRA and the other $2,000 going into an IRA of Greg's wife, Janet Ashbahian.

Katz does not dispute that these transfers occurred. She instead claims to have had nothing to do with several of them and that she had written authorization for the others. For example, Katz claims to know nothing about the trades that occurred on October 2, 4, and 8, 2002, because they occurred while she and her husband were on their trip to Scotland. Katz also denies knowing anything about a transfer out of Irene's living trust account that took place on May 7, 2002 or the transfer out of Harry's living trust account on April 12, 2002. Katz's assistant, Doreen Steup, testified, however, that Katz had "total control over the accounts" and "was always aware of everything going on in all the accounts."

As for the remaining transfers, Katz acknowledges transferring the funds to Greg's account, but claims to have made the transfers pursuant to telephonic authorization from the Ashbahians and standing letters of authorization. As Katz explained during her testimony, letters of authorization were forms that salespeople used to memorialize a client's verbal authorization to perform certain actions, such as transferring funds. Letters of authorization either could be for a specific transaction or could be "standing" letters of authorization, which, according to Katz, were valid for one year. Katz further testified that, when a client or associated person relied on a standing letter of authorization, a "journal request form" would be attached to the letter of authorization "to clearly define what was being done from what account, how much, to what account."

The record contains two letters of authorization, as Katz asserts, but the Ashbahians questioned their authenticity at the hearing. Irene did not recall signing the first letter of authorization dated May 30, 2001 (which had only one signature, for Irene Ashbahian), and her husband confirmed that the signature did not look like his wife's. The second letter of authorization, dated July 1, 2002, contained what appears on its face to be both Ashbahians' signatures, but neither Ashbahian could "recall signing anything like this." As Harry explained, "[W]e were living on the income. Why would I send my money to my son? He didn't need it. Why would I give it to that son, not the whole family? We never did anything like that." Furthermore, two of the transfers at issue (totaling $5,000) predated either letter.[10]

2. Paul Pinajian

Paul Pinajian opened two accounts with Katz (an individual account and IRA) after his father, Charles Pinajian, introduced him to Katz. Pinajian was thirty-three years old at the time of his initial investment and part owner and vice president of Treasure Island, a retailer of outdoor furniture and seasonal merchandise. Pinajian had a B.S. in accounting and, before working at Treasure Island, had run one of his father's dry cleaning stores for approximately three years, after which he became a merchandise controller, or department manager, at another retail business.

Pinajian's investment goals for his Wachovia accounts are somewhat unclear. Pinajian testified that he wanted to "put aside" any cash that he took out of Treasure Island's business and use it as "a safety net." He also testified, however, that the reason he invested his money with Katz was that his father was making twenty-five or thirty percent with Katz, while Pinajian had only been making a more conservative six or seven percent with his previous broker. Katz, for her part, described Pinajian as "always an aggressive investor," who shared his father's philosophy that conservative money belonged in real estate. Katz claimed not only that Pinajian

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[10] The record contains a third standing letter of authorization, which purports to authorize $1,610.00 to be transferred out of Irene Ashbahian's living trust on the second of every month, beginning September 2, 2001. Only one of the transfers at issue, however, took place on the second of a month, and that was for $134.

shared his father's investment philosophy, but also that Pinajian authorized his father to instruct Katz on what trades to make in Pinajian's account.

New account forms completed for Pinajian's accounts listed his investment objective as "Growth (return emphasis)," and Pinajian received various letters from Wachovia attempting to confirm this investment objective. For example, Pinajian received a letter in February 1999 asking him to confirm that he had examined all trade confirmations and monthly statements related to his account and that "[a]ll transactions have been made with my prior approval and in accordance with my overall investment/trading objectives." Pinajian acknowledged signing this confirmation letter, but testified that Katz, in reality, was executing "a lot" of trades in his account and that he "was not approving every single trade."

Katz acknowledged that she did not speak with Pinajian very often, but claimed that she was trading in Pinajian's account at the direction of his father pursuant to a power of attorney. The record contains a power of attorney, but it was neither witnessed nor notarized, which Ennis, Steup, and Kramlick all testified was required before the form could become effective. Pinajian also testified that he did not recognize the power of attorney and that the signature on it did not look like his. Pinajian explained that he would never have allowed his father to have a power of attorney over his account because his father was "at a different point in his life" and had a different approach to investing.

Pinajian's new account forms also indicated that Pinajian was the only person who would have authority over his account, and Kramlick confirmed that new account forms would indicate whether a power of attorney had been executed. Katz attempted to explain this discrepancy by claiming that she typically had clients complete powers of attorney sometime after their new account forms were completed. Pinajian, however, signed an updated new account form several months after the power of attorney was supposedly executed, and that form did not show that a power of attorney existed. Katz also testified that she instructed her assistant to "always" indicate "no" in response to the question of whether anyone else would exercise control over a client's account, but Wachovia's files appear to contain no indication that a power of attorney ever became effective in Pinajian's account.

Sometime around March 2000, Pinajian received another letter from Wachovia, this time purporting to summarize a meeting Ennis had with Pinajian. In that letter, Ennis wrote to confirm "that your account is a very active trading account" and that Pinajian understood "the risks associated with using margin and the interest charges that are incurred." At Katz's disciplinary hearing, however, Pinajian claimed that he had "never heard of" Ennis, although he recalled a meeting with Katz during which somebody else could "have come in and shaken my hand and said 'hello,' maybe."

Pinajian also testified that, while the March 2000 confirmation letter had mentioned "the risks associated with using margin," he did not realize until sometime around August 2000 that his account was actually being traded on margin. Pinajian explained that his account value began "dropping drastically," which prompted him to take his account statement to one of Treasure Island's accountants. According to Pinajian, the accountant was the person who "discovered margin on my account and said, 'what are you doing with margin?'" Pinajian testified that Katz subsequently promised to take Pinajian off margin, but that she could only do so "over time."

Early the next year, Pinajian noticed that his account was still being traded on margin and that his February 2001 account statement showed an unexpected, sharp decline in his individual account from approximately $316,719 to approximately $217,124. Pinajian testified that he again asked Katz for an explanation, to which she allegedly responded that Wachovia was changing computer systems and several customers had received incorrect statements. Pinajian testified that Katz told him a margin debit of roughly $74,394 had accidentally been deducted twice and that the actual value of his account should be $291,517. Pinajian testified further that he took contemporaneous notes of Katz's explanation, writing on his statement: "SB [should be] 291,517" and "came out twice by accident."

Pinajian's next statement (for March 2001) again showed that his account was being traded on margin and that his account value had continued to decline, down to $145,664.62. Pinajian testified that he again called Katz and that she told him that the statement was still incorrect, that the previous month's error had not yet been corrected, and that the correct balance was $236,960. Pinajian again wrote the number Katz gave him on his account statement. According to Pinajian, Katz also told him that she would arrange for Pinajian to receive corrected statements while she straightened out the problems with the computer system.

Pinajian testified that he subsequently received another March 2001 account statement, which showed a supposedly correct balance of $268,045.78. Although the format and color of this supposedly revised statement were different from the first March 2001 statement, Pinajian said he was not concerned.[11] Katz had told him that the old computer system was responsible for the errors on his statements, so Pinajian assumed Katz was getting the revised statements "from another source or another computer."

According to Pinajian, he continued to receive the inaccurate account statements until he finally decided to close his accounts at Wachovia in December 2002. Although these false account statements bore Pinajian's name and account number, they were apparently altered copies of statements of one or more of Katz's other clients, with address labels showing Pinajian's home address covering the original addresses on the statements. Kramlick and Steup both recalled during their testimony that Katz had asked a receptionist to type up address labels for Pinajian's account.

Whether Pinajian also received accurate account statements during this time is unclear. The record contains several trade confirmations and account statements listing Pinajian's correct

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[11] Ennis agreed during his testimony that the February 2001 and June 2002 statements that Pinajian testified he had received were "obviously phony."

home address, but the record does not establish whether Pinajian actually received these documents. Pinajian testified that, regardless, he would have dismissed any statements that showed the lower – although, as it turned out, correct – balance, because he would have assumed that the supposed computer error "was not fixed yet."

The record also suggests that at least some of Pinajian's actual account statements were diverted to another of Katz's customers. Kramlick and Steup both testified that Katz had instructed them to send Pinajian's account statements to an address in Hackettstown, New Jersey, because Pinajian had moved there with a girlfriend. That address, however, was for another of Katz's clients, who also occasionally cleaned Katz's house. Pinajian denied having any connection to that address.

Katz denies that she ever told Pinajian that his margin debit balance had been accidentally deducted twice or that his account balance was incorrect. Katz also denies having anything to do with the false account statements. She claims instead that Pinajian fabricated the statements to extort a settlement from Wachovia; that she was out of the office during several of the months in which Pinajian allegedly received the false statements; and that she became "irate" and "went ballistic" when she learned that Pinajian's address had been changed in the files because, she explained, "how could a client's address be changed without me being told about it." Katz claims she discussed the matter with Steup, Kramlick, and Ennis, but none of them recalled ever having such a conversation with her, nor did they recall a "ballistic" reaction by Katz to the address changes.

Pinajian eventually decided he had "had enough" and moved his Wachovia account to a different broker in early 2003. One of the last account statements he claimed to have received from Wachovia listed his account balance as $214,067.60. When Pinajian transferred his account, however, the new firm informed him that his Wachovia account held only $36,946.46.

Pinajian also discovered that $8,300 had been transferred from his account to the account of his uncle, Edward Dorian, on March 15, 2001, apparently to help satisfy a margin call in Dorian's account. This transfer had appeared on Pinajian's first, allegedly incorrect, March 2001 statement, but not on the second, allegedly corrected, March 2001 statement. Pinajian testified that he neither authorized nor discussed such a transfer with Katz or his father. Instead, Pinajian described this transfer as "crazy," explaining he "had nothing to do with Ed Dorian. I never speak with him. There is no reason for any money to change hands." Although Katz was the registered representative on Dorian's account, Katz testified that she was not responsible for the transfer to Dorian's account and that the first time she heard about it was from NYSE Enforcement.

3. Agnes Voskian

Agnes Voskian opened an individual account and a trust account with Katz in or about February 2000. As with the Ashbahians, Voskian was introduced to Katz by Greg Ashbahian, who is Voskian's son-in-law. Voskian was an eighty-year-old widow and retired secretary when she opened her accounts with Katz. She had a high school education and described herself as having limited experience with investing because, she explained, her husband had always managed their finances.

Voskian's new account forms, however, showed that Voskian had twenty years of investment experience with stocks, bonds, and mutual funds. The forms also indicated that her annual income was $100,000 - $199,999; that her net worth (excluding residence) was $500,000 - $999,999; and that her net liquid assets were $200,000 - $499,000. Voskian testified that much of this financial information was incorrect, claiming, for instance, that her net worth before investing with Katz had only been approximately $175,000,[12] and that her income consisted of Social Security and approximately $300 per month from her husband's Air Force pension.

Voskian also testified that she considered the stock market "very dangerous" because her husband "took a tremendous loss" after selling some stock they had received from the sale of a business. As a result, Voskian emphasized to Katz that "no matter what she [Katz] did it had to be a safe investment of my principal" because "that is all I had." Voskian added that "I kept saying all the time, every time I talked to Janet Katz, the principal must be protected." Katz's recollection of Voskian's goals was that she wanted "growth with a little income" and to invest in "basically everything except individual stocks because she had been burnt that once with that one individual stock." Voskian's new account forms listed her investment objective as "Growth & Income (return emphasis)."

Katz apparently recommended a fairly aggressive investment strategy for Voskian. Although Voskian's individual account consisted primarily of mutual funds and preferred stocks, the holding periods in Voskian's account were some of the shortest of any of the investors at issue. In one instance, Katz sold a security in Voskian's account just two days after purchasing it, netting Voskian a loss of approximately two percent. When selling mutual funds in Voskian's account, Katz also made little apparent effort to replace a security with another within the same fund family, which would have avoided deferred sales charges.[13]

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[12] Voskian testified that her net worth consisted largely of a $50,000 life insurance payment, a $20,000 payment from the military that she received as a result of her husband's death, and $70,000 she received from selling a condominium shortly after her husband's death. Voskian also apparently had a brokerage account with Dean Witter worth approximately $35,000.

[13] Mutual funds generally consist of different classes of shares that each have different sales charges and operating expenses associated with them. *See* Rule 18f-3 under the Investment Company Act of 1940, 17 C.F.R. § 270.18f-3; Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares, 60 Fed. Reg. 11875, 11876 (Mar. 2,

(continued...)

Katz also made recommendations to buy and sell below-investment-grade securities and to buy and sell securities where the newly purchased security had a lower rating than the security it replaced. The NYSE introduced charts at Katz's disciplinary hearing showing that, although the lower-rated securities sometimes yielded Voskian a higher annual dividend than the prior security, the commissions from the transaction largely offset any future gain. In some instances, Voskian would never have made up for the transaction costs, as the newly acquired security yielded a lower dividend than the previous security. In other instances, Voskian would have to hold the new securities for at least thirteen – and in one case at least twenty-three – more years to make up for the commissions charged in the transaction.

While Voskian was at least somewhat aware of the holdings in her accounts, the extent to which she was happy with that makeup is unclear. Ennis testified that he met with Voskian to discuss her account in July 2001. During this meeting, Voskian initially told Ennis that her primary goal was to preserve her capital. Ennis responded that, if she wanted to pursue such a conservative strategy, Voskian would have to give up her preferred stock holdings, but, if she wanted a greater return, she could accept more risk and keep the preferred stock. Ennis testified that, by the end of the conversation, Voskian decided she was "okay" with keeping her present, more aggressive, portfolio. Ennis later confirmed their conversation by writing to Voskian that "I understand you are comfortable with Janet Katz and her recommendations. Your primary objective is safety of principal and moderate growth."

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[13] (...continued)
1995). For example, the major cost associated with purchasing Class A shares is a sales charge known as a "front-end load." *See, e.g.*, *Raghavan Sathianathan*, Exchange Act Rel. No. 54722 (Nov. 8, 2006), 89 SEC Docket 774, 775 (barring respondent for making unsuitable mutual fund recommendations and for unauthorized trading), *petition denied*, No. 07-1002, slip op. (D.C. Cir. Dec. 2, 2008) (citing Mutual Fund Regulation § 18:4.1 (Clifford E. Kirsch ed., 2d ed. 2005)). This sales charge is paid when the shares are bought and it is deducted from the amount invested (effectively reducing the quantity of mutual fund shares purchased).

By contrast, Class B shares, which are at issue here, have a back-end sales charge (the "CDSC"), but no front-end load. *See Sathianathan*, 89 SEC Docket at 776; *see generally* Investment Company Act Rule 6c-10, 17 C.F.R. § 270.6c-10; Exemption for Certain Open-End Management Investment Companies to Impose Contingent Deferred Sales Loads, 60 Fed. Reg. 11887 (Mar. 2, 1995). The CDSC is collected from the investor when the mutual fund shares are sold rather than at the time of purchase. *Sathianathan*, 89 SEC Docket at 776. Typically, the CDSC is reduced for each year that an investor holds Class B shares, phasing out entirely after a certain number of years. *Id.* According to the NYSE's expert witness, Katz could have deferred these sales charges by buying another Class B share within the same fund family.

Approximately a year later, in May 2002, Wachovia sent Voskian a letter asking her to confirm that she "[had] the resources to bear any losses," that she was "aware that there is risk associated with equity investments or corporate bond investments," and that she had "opted for the potential higher yield associated with such securities over more safety." The letter also asked Voskian to provide her total net worth, liquid net worth, and household income. The record contains two different, and somewhat contradictory, versions of what Voskian supposedly returned to Wachovia.

The first version contains none of the information requested about Voskian's income or assets, but instead contains a handwritten note at the bottom of the letter: "I have instructed my financial advisor Janet Katz that security of my principal is the most important part of my investment plan and I do not want that at risk for any higher yield." Voskian explained during her testimony that, instead of providing her financial information, she wrote the note because she "felt they were asking for a lot of information that they did not need to have. . . . So I just wrote this on it [referring to the note] and sent it back to them."

Ennis acknowledged receiving this letter and testified that he had a subsequent "conversation with [Voskian] telling her that her account was not invested that way." Ennis again explained to Voskian that her account was mostly invested in preferred stock and the difference between those types of investments and more conservative options. Ennis testified that, "[a]t the end of my conversation I felt that she was comfortable with the preferred, with owning the preferred."

The second version of the letter in the record does not contain Voskian's note and instead provides the information that Voskian testified that she did not feel Wachovia needed. Specifically, the second version lists Voskian's total net worth as $200,000, her liquid net worth as $500,000, and her household income as $70,000. Voskian testified that she neither signed nor filled out this second letter and that the figures were not accurate.

Voskian testified that sometime after her husband died she began to receive trade confirmations from Wachovia about securities that were being bought and sold out of her account. Voskian stated that she asked Katz about these transactions, to which Katz allegedly responded that "a lot of the things that my husband had bought at the time were not the best investment for me now." Voskian testified that she otherwise spoke with Katz very rarely, noting that they met three times in person and that they spoke on the phone "two or three times, the most, that I can remember . . . [o]ver the whole span of time." Katz, by comparison, claims that she met with Voskian a total of seven times and that she had more than seventy-five telephone conversations with Voskian.

Sometime after the NYSE began investigating the Ashbahians' complaints against Katz, Voskian discovered that $5,000 had been transferred from one of her accounts to one of Greg Ashbahian's accounts on November 27, 2000, and an additional $4,000 had been transferred on each of January 8, 2001 and February 23, 2001.

Katz acknowledged these transfers were made, but claims they were done pursuant to standing letters of authorization. The record contains two letters of authorization, which appear on their face to authorize the $4,000 transfers, but neither letter covers the first $5,000 transfer. Voskian testified that, although she had a close relationship with her son-in-law, she was "shocked" to discover Greg had authority to effect transactions in her account. Voskian added that the signatures on the letters of authorization were not hers and that the letters contained two obvious mistakes: (1) they incorrectly identified Greg Ashbahian as Voskian's son rather than her son-in-law, which she testified she would never have done, and (2) one letter showed her living in a town she had not lived in for years. Katz did not dispute signing the two letters of authorization as Voskian's "Financial Advisor," but Katz could not recall anything during her disciplinary hearing about the transfers from Voskian's account or the circumstances under which the letters of authorization were created.

4. Sandra Griffin

Sandra Griffin, who is Voskian's daughter, opened an individual account and an IRA with Katz in 2000. At the time, Griffin was fifty-four years old, the single mother of two adult children, and employed by an insurance company.

Griffin testified that she told Katz that she wanted "growth, but careful growth" because she was approaching retirement age and was concerned about preserving principal. Griffin also explained that "I did not look at it as money that I was going to use . . . I just wanted it to sit and grow" (ellipses in original). Katz's recollection, by comparison, was that Griffin "really wanted growth" and that Griffin "had money in the bank if there were any emergencies." Griffin's new account forms described her investment objective as "Growth (return emphasis)."

Griffin testified that, while Katz would occasionally call her to "discuss[] things, you know, about what she maybe wanted to do," Katz did not always call her before effecting transactions in her account. At one point, Griffin noticed from an account statement that "a fund that I knew I had had previously months back, and then it was gone and now it was back again, and I called [Katz] to discuss that with her." According to Griffin, Katz explained "that at the time that I had [the security] previously, it had been doing well, and then it was not doing as well, and so she sold it off and then it came up again and she repurchased it for me." Katz disputed this testimony by denying that she ever effected a transaction in Griffin's account without first obtaining authorization.

5. May Kapakjian

May Kapakjian, who is Voskian's sister and Griffin's aunt, also had an account with Katz. Kapakjian did not testify at the disciplinary hearing because, according to Griffin, "she is 92 and she is physically and emotionally incapable of handling this type of stress." Instead, Griffin, who had a power of attorney over her aunt's account, testified on Kapakjian's behalf.[14]

According to Griffin, Kapakjian was a retired hairdresser, whose income consisted of Social Security, and who had been living in a rent-controlled apartment in New York. Sometime in 2000, Kapakjian decided to move to a retirement facility in New Jersey to be closer to her family. At the time, Kapakjian was eighty-five and, according to Griffin, "a person of limited means [who] has had a very Spartan life-style." Although Griffin had never known her aunt to have had a brokerage account previously, she testified that Kapakjian decided to open an account with Katz so that her investments would be "with the same person the rest of the family was with."

Griffin was present at Kapakjian's first meeting with Katz, which took place in or around June 2000. According to Griffin, Kapakjian decided to entrust her entire savings, approximately $130,000, with Katz. Griffin testified that her aunt's primary investment concern was preserving that capital and that her aunt told Katz she was "fearful of something going wrong" with her money because of her lack of other means of support.

Katz had a different recollection of their initial meeting. Kapakjian, according to Katz, never told her that the money she was investing was all that she had or that preserving her principal was her primary concern. Instead, Katz claims that Kapakjian told her that she was moving only half of her savings and that "she was looking to make the absolute maximum she could make on that money." Katz asserts that Kapakjian's investment goal was to receive $1,100 per month in distributions and that Kapakjian "realized that she had to take risks in order to make the type of return she wanted on the money she was placing with me." The new account form that Katz completed for Kapakjian indicated that Kapakjian had an annual income of at least $50,000 and net worth of at least $200,000. The form also listed Kapakjian's investment objective as "Growth & Income (return emphasis)."

Katz described Kapakjian as an involved investor who would occasionally call with investment recommendations. Katz testified, for example, that Kapakjian called Katz sometime in 2002 to discuss "if there was some way to make some money out of this market volatility" at a time when "the corporate bond market had been hit hard and you had price differentials between corporate bonds and Treasury bonds and lesser corporate bonds." Ennis corroborated some of Katz's description of Kapakjian, as he testified that he "got the impression that [Voskian and Kapakjian] were accepting of a little bit of volatility to get a better return from preferred [stock investments]." He also acknowledged, however, that Voskian and Kapakjian "were not savvy market people, I am not going to pretend that."

Kapakjian received several confirmation letters from Wachovia, including one dated July 21, 2001, which asked Kapakjian to confirm that "[i]t is my trading objective

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14 Voskian also testified briefly about her sister, Kapakjian.

(notwithstanding previously stated or recorded account objective) to effect short-term transactions in securities, recognizing that such trading involves risk of financial loss and may generate substantial commission charges." The letter also stated that "[a]ll transactions have been made with my prior approval and in accordance with my overall investment/trading objectives." The letter contains what appears to be Kapakjian's signature, but Griffin testified that it would be unusual for Kapakjian to sign such a document, because "she is not only financially, but in all walks of life she is fearful of something going wrong and this would – if she understood the whole thing, this would absolutely terrify her."

The record contains another signed confirmation letter, dated May 13, 2002, purporting to confirm that Kapakjian had "opted for the potential higher yield associated with [equity investments or corporate bond investments] over more safety and plan[ned] to continue our current strategy in the future." The letter also contained the representation that Kapakjian "was aware of all activity, commissions and interest charges, if any, and overall profits and losses." Finally, the letter contained blanks in which Kapakjian was to write her total net worth, liquid net worth, and household income, and which were filled out to indicate that Kapakjian's total net worth was "1 Million," her liquid net worth was "400 M," and her household income is "100 M."

As with Voskian's account, Katz never exchanged shares within the same mutual fund family, which would have avoided certain fees. Katz also frequently purchased or sold securities in Kapakjian's account within short periods, incurring substantial costs. For example, on February 22, 2001, Katz bought 1,000 shares of the Van Kampen Senior Income Trust for Kapakjian's account at $8.08 per share and then sold those same shares five days later at the same price, generating approximately $542 in commissions. In some cases, Katz bought and sold below-investment-grade securities for Kapakjian's account. For example, on April 17, 2001, Katz purchased 350 shares of a below-investment-grade bond on margin for Kapakjian's account. Katz sold the bonds ten days later for an approximately $558 loss, which included approximately $436 in costs related to the transaction.

All told, Katz effectuated twenty-three transactions in the two months after Kapakjian first opened her account and eighty-two total trades (not including reinvested dividends) in the approximate two and one-half years at issue. Kapakjian's account value during this time dropped from approximately $130,000 to $108,000, while Kapakjian paid approximately $15,651 in costs, which represented more than 12% of Kapakjian's opening principal. Katz's expert acknowledged that the costs of trading in Kapakjian's account were "high," but Katz defended the above trading strategy by arguing that all the trades were done at Kapakjian's direction.

6. Mary Ann Smith

Mary Ann Smith and her husband began investing with Katz in 1993, before Katz had joined Wachovia. When Katz changed firms to Wachovia, the Smiths also transferred their accounts, opening an individual account and an IRA. Mary Ann Smith's husband handled the family's finances while he was alive, and she testified that he did so "in a conservative manner and that is the way he felt that our – that his retirement funds and IRAs should be handled as much as possible." The Smiths' new account forms, which were completed when they first transferred their money to Wachovia in 1997, showed an investment objective of "Growth & income (return emphasis)." When Mary Ann's husband died in 1998, she moved their joint account into an individual account in her own name, and the new account form completed as part of that transfer continued to list her investment objective as "Growth & Income (return emphasis)."

Smith testified that the information on these forms was correct, as far as she knew. She also testified that she understood her investment objectives, stating that the form was "checked in growth and income with return emphasis. I would think it says exactly what it means, does it not, growth and income?" Smith added that she believed her account "would be continued pretty much the way it had been handled in the past." She explained that she was depending on her investments to be as "conservative as possible," although later added, "I really didn't know whether they were, nor did I ask, whether they were conservative or not."

Sometime after her husband passed away, Smith began to notice that Katz was trading in her account without her approval. Smith testified, for example, that Katz made nine trades in her account in June 1999 and eight trades in her account in April 2001, but that Smith had not spoken with Katz a corresponding number of times. Smith claimed that she asked Katz at one point about why she had executed so many trades, to which Katz responded "that she was repositioning the accounts, slowly but surely."

Smith testified that she "just took it for granted" that Katz would execute trades without Smith's express authorization and that "I didn't know you were supposed to contact with each issue." Smith added, "I really just was not – financially this was not my bailiwick and so I was busy doing other things and as I said before, I trusted Mrs. Katz to take care of my – take care of my account."

By 2001, Smith noticed that her account had begun to lose value. Smith testified that she asked Katz about this drop, but "Katz assured me that this correction would be over with soon and not to worry about it." When her account value continued to fall, Smith asked Katz to "stop buying and selling in order to keep a certain amount of income coming in to my account." According to Smith, Katz nevertheless continued to buy and sell securities without her permission, which caused Smith to worry that "I was going to lose absolutely everything." Smith contacted Larry Ennis and "asked him to tell [Katz] to please stop," and Katz eventually complied.

* * *

An NYSE hearing panel (the "Hearing Panel") conducted a sixteen-day hearing between October 30, 2007 and March 4, 2008. The Hearing Panel found that Katz (i) misappropriated funds from the Ashbahians, Voskian, and Pinajian, (ii) made misstatements to Pinajian,

(iii) effected unsuitable transactions in Voskian's and Kapakjian's accounts, (iv) engaged in unauthorized trading in the Ashbahians', Voskian's, Griffin's, and Smith's accounts, and (v) engaged in discretionary trading in Voskian's, Kapakjian's, Griffin's, Pinajian's, and Smith's accounts without written authorization. The Hearing Panel also found, with respect to all of the investors at issue, that Katz caused or permitted the Firm's books and records to reflect inaccurate information and that she caused the Firm to fail to learn essential facts about its customers. In making these findings, the Hearing Panel largely discredited Katz's testimony, while crediting her customers' testimony. The Hearing Panel censured Katz and imposed a permanent bar from membership, allied membership, and approved person status and from employment or association in any capacity with any member or member organization. On October 15, 2008, the NYSE Board of Directors affirmed the Hearing Panel's decision in all respects. This appeal followed.

III.

Pursuant to Section 19(e) of the Exchange Act, we will sustain the NYSE's decision if the record shows that Katz engaged in the alleged violative conduct and that the NYSE applied its rules in a manner consistent with the purposes of the Exchange Act.[15]

Katz argues that the standard of proof we should apply in reviewing the NYSE's decision is "substantial evidence" by pointing to our holdings that, "where the record contains 'substantial evidence' providing a basis for disregarding a credibility determination we will do so."[16] "Substantial evidence," however, is the standard Katz must meet when asking us to disregard the Hearing Panel's credibility findings.[17] "Preponderance of the evidence" is the standard we use to review the underlying disciplinary violations.[18]

In asking us to set aside the NYSE's decision, Katz also appears to misinterpret the nature of our review. Her opening brief consists primarily of sixty-six "exceptions" to the NYSE's

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[15] 15 U.S.C. § 78s(e).

[16] *Warren R. Schreiber*, 53 S.E.C. 912, 914 (1998) (citing *Anthony Tricarico*, 51 S.E.C. 457, 460 (1993), and cases cited therein).

[17] *Schreiber*, 53 S.E.C. at 914.

[18] *See, e.g.*, *David M. Levine*, 57 S.E.C. 50, 73 n.42 (2003) (holding that preponderance of the evidence is the standard of proof in self-regulatory organization disciplinary proceedings); *Kirk A. Knapp*, 51 S.E.C. 115, 130 n.65 (1992) (stating that "[t]he correct standard is preponderance of the evidence" in an NASD proceeding); *cf. David Disner*, 52 S.E.C. 1217, 1221 & n.13 (1997) (noting that law judge's credibility determinations may be overcome only by "substantial evidence" while underlying violation must be demonstrated by "a preponderance of the evidence").

decision. The substantial majority of these exceptions complain only that the NYSE's decision failed to consider certain evidence, but Katz does not explain the significance of that evidence. Any such error by the NYSE is not grounds for reversal, because our *de novo* review of the NYSE's decision cures any failure by the NYSE to consider evidence.[19]

Where possible, this opinion groups Katz's remaining, related arguments together. Based on our independent review of the record, we find that a preponderance of the evidence supports the NYSE's findings of violation, with certain exceptions noted below.

A. Just and Equitable Principles of Trade

NYSE Rule 476(a)(6) prohibits persons under the NYSE's jurisdiction from engaging in conduct inconsistent with just and equitable principles of trade.[20] The NYSE concluded that Katz violated these principles by (i) causing customer funds to be transferred to other customers' accounts without authorization, (ii) making misstatements to a customer, (iii) effecting unsuitable transactions in customer accounts, and (iv) engaging in unauthorized trading in customer accounts. We discuss each in turn.

1. Misappropriation

Misappropriation of client funds constitutes conduct inconsistent with just and equitable principles of trade.[21] Here, the NYSE found that Katz misappropriated funds from the Ashbahians, Voskian, and Pinajian by causing funds to be transferred, without authorization, from their accounts to other accounts owned by Katz's customers.

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19 *See Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009) ("[B]ecause the SEC conducted a thorough, de novo review of the record, any procedural errors that may have been committed by the [NYSE's] Chief Hearing Officer are cured."); *see also First Jersey Sec., Inc. v. Bergen*, 605 F.2d 690, 694 (3d Cir. 1979) (noting that NASD disciplinary decisions can be appealed to the Commission for *de novo* review); *Gregory M. Dearlove*, Exchange Act Rel. No. 57244 (Jan. 31, 2008), 92 SEC Docket 1867, 1884 & n.42 (concluding that *de novo* review cured any error by the law judge to support his findings properly), *petition denied*, 573 F.3d 801 (D.C. Cir. 2009).

20 *See Gregory W. Gray, Jr.*, Exchange Act Rel. No. 60361 (July 22, 2009), 96 SEC Docket 19038, 19047.

21 *Cathy Jean Krause Kirkpatrick*, 53 S.E.C. 918, 925 (1998) (concluding that applicant had misappropriated customer funds in violation of NYSE Rule 476(a) by withdrawing customer funds to cover losses in other customers' accounts); *cf. Wheaton D. Blanchard*, 46 S.E.C. 365, 366 (1976) (noting that misappropriation and misuse of customer funds is "patently antithetical" with just and equitable principles of trade).

a. The Ashbahians to Greg Ashbahian

Between March 2001 and September 2002, approximately $26,357 was transferred from the Ashbahians' accounts to the accounts of their son Greg and his wife in a series of transactions ranging in size from $500 to $4,000. The Hearing Panel, "[b]ased on its assessment of the credibility of the witnesses . . . concluded that [Katz] made transfers from the [Ashbahians'] accounts without authorization." Although Katz challenges her customers' credibility in a number of respects, "[c]redibility determinations of an initial fact finder are entitled to considerable weight because they are based on hearing the witnesses' testimony and observing their demeanor."[22] We see no basis here to overturn the Hearing Panel's credibility determination.

The Ashbahians both testified that they never authorized transferring money to their son Greg and that they had no reason to do so. Katz claims this testimony is undercut by two letters of authorization purportedly giving Greg authority over their accounts, but neither Ashbahian could recall signing the letters of authorization. The Hearing Panel also reasonably expressed "grave doubts as to the validity of the documents purporting to give [Greg Ashbahian] authority over his parents' accounts," and credited the Ashbahians' testimony that they never intended for money to be transferred to Greg's account. Furthermore, the first two transfers at issue – totaling $5,000 – took place before either letter of authorization was allegedly executed. Katz offers no explanation for these first two transfers and testified only that she was "not sure" whether a letter of authorization existed at the time.[23]

Katz also challenges the Ashbahians' credibility by claiming "[t]hey frequently answered that they didn't remember, and they often contradicted each other." In particular, Katz points to two documents about which she claims the Ashbahians testified inconsistently: (1) the July 1, 2002 letter of authorization and (2) a letter in which the Ashbahians asked Wachovia to remove Greg Ashbahian as power of attorney over their accounts. The alleged inconsistency regarding the confirmation letter was the Ashbahians' disagreement about whether the signatures looked like theirs (Harry testified that the signatures looked like theirs, while his wife testified that they did not). The Ashbahians were consistent, however, that regardless of whether the signatures looked like theirs, neither recalled actually signing the documents. Regarding the

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[22] *Joseph Abbondante*, Exchange Act Rel. No. 53066 (Jan. 6, 2006), 87 SEC Docket 203, 209 n.21, *petition denied*, 209 Fed. Appx. 6 (2d Cir. 2006) (unpublished). Such determinations generally "can be overcome only where the record contains substantial evidence for doing so." *Laurie Jones Canady*, 54 S.E.C. 65, 78 (1999) (citing *Anthony Tricarico*, 51 S.E.C. 457, 460 (1993)), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000).

[23] Katz also argues that the Hearing Panel erred by concluding that Greg Ashbahian did not have a valid power of attorney over his parents' accounts. That alleged power of attorney, however, has no apparent relevance to this proceeding. Katz admitted during the hearing that she did not rely on it to effect any of the transactions at issue.

document removing Greg as power of attorney, Katz implies that the Ashbahians' testimony that Greg never had power of attorney over their accounts is inconsistent with signing a letter to remove him as power of attorney. Harry Ashbahian testified, however, that their son Thomas had them sign such a document to make sure that Greg did not have authority over their accounts. Thus, while the Ashbahians' testimony may not match up perfectly, any inconsistencies are, at worst, minor and fall well short of the substantial evidence needed to overturn the Hearing Panel's credibility determinations.[24]

Katz further argues that she could not have been responsible for three of the transfers at issue because she was in Scotland at the time. The Hearing Panel, however, rejected Katz's argument, and we agree with that assessment. As the Hearing Panel explained, Katz's assistant Steup testified that Katz had "total control over the accounts," and that, even when out of the office, Katz would call in "[a]t least once a day while she was gone." Steup explained that "nothing was happening without [Katz's] knowledge" with respect to her customers' accounts. Katz's husband's illness and death while in Scotland are thus not inconsistent with the evidence suggesting that Katz effected these transactions.

We are similarly unpersuaded by Katz's argument that Thomas Ashbahian "was not happy that Greg [Ashbahian] was the POA [power of attorney] over the parent's account and started to cause some problems." As discussed above, evidence shows that Katz transferred money from the Ashbahians' accounts to their son Greg's account without proper authorization. That Thomas Ashbahian may have encouraged his parents to complain does not undermine this evidence.

b. Agnes Voskian to Greg Ashbahian

Between November 2000 and February 2001, $13,000 was transferred from Voskian's account to the account of her son-in-law, Greg Ashbahian. In concluding that Katz was responsible for these transfers, the Hearing Panel "credited [Voskian's] testimony that she did not authorize the transfer in question and found [Katz's] testimony lacking in credibility."

In an attempt to discredit Voskian's testimony, Katz points to two standing letters of authorization purportedly giving Katz the authority necessary to effect the transfers at issue. Voskian, however, denied signing the letters and noted that they contained several obvious inaccuracies, including identifying Greg as her son, rather than her son-in-law, something she testified she would never have done. Moreover, the letters of authorization were allegedly executed after $5,000 had already been transferred out of Voskian's account.

Katz also points to evidence that "Greg Ashbahian had a very close relationship [with] Agnes Voskian" and that Voskian made gifts from her Wachovia account to her children and

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[24] *See John Montelbano*, 56 S.E.C. 76, 88-89 (2003) (declining to overturn hearing panel's credibility determination regarding various witnesses whose testimony contained "minor differences").

grandchildren, including in the same month that $4,000 was transferred to Greg. Voskian acknowledged that she had a close relationship with her son-in-law, but she also testified that she had no reason to give Greg authority to authorize transactions in her account. Voskian's relationship with various family members is not a sufficient basis to reject the Hearing Panel's decision to credit Voskian's testimony that Katz transferred money without authorization.

c. Paul Pinajian to Edward Dorian

On March 15, 2001, $8,300 was transferred from Pinajian's account to satisfy, in part, a margin call in Edward Dorian's account. This transfer appeared on Pinajian's initial March 2001 account statement, but was not included in the subsequent, false account statement that Pinajian testified he received from Wachovia. Pinajian described the transfer as "crazy," noting that he "had nothing to do with Ed Dorian. I never speak with him." Katz, for her part, denied any knowledge of the transfer.

The NYSE "accepted [Pinajian's] testimony that he did not authorize the transfer to [Dorian's] account and found incredible [Katz's] assertion that she did not know about the transfer." We find no evidence to overturn the Hearing Panel's credibility determination regarding Pinajian. Katz was responsible for both Pinajian's and Dorian's accounts, she admitted that she was aware of margin calls in Dorian's account, and, as noted earlier, Katz appeared to have "total control over the accounts" and was "aware of everything going on in all accounts." We therefore conclude that Katz misappropriated Pinajian's funds for Dorian's benefit.

* * *

Katz argues that none of the above transfers amounted to misappropriation because (i) she derived no personal benefit from the transfers and (ii) there was "no relationship between the broker and either account." We disagree. Katz had a relationship with all of the account holders to and from whom funds were transferred: she was their registered representative. She also derived a personal benefit by keeping the clients who received the transfers happy and retaining their business. Furthermore, we have held in similar circumstances that a registered representative misappropriates funds by transferring assets from one customer account to another without authorization.[25] Misuse of customer funds "is serious misconduct," and Katz's conduct would violate NYSE Rule 476(a) regardless of whether she gave the money to another customer, kept it herself, or eventually gave it back to her customers.[26]

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[25] *See Kirkpatrick*, 53 S.E.C. at 921, 925 (finding that a registered representative had misappropriated $34,000 of a customer's account "for her own purposes" where $31,944 of those funds were used "to cover losses in the brokerage account of another customer").

[26] *See Bernard D. Gorniak*, 52 S.E.C. 371, 373-74 (1995) (concluding, in part, that failure to return funds promptly to a customer violated just and equitable principles of trade and warranted a bar).

Katz also argues that the NYSE lacked sufficient evidence to conclude that she misappropriated her clients' funds. She points to Wachovia's procedures for transferring funds between accounts and the NYSE's failure to produce certain letters of authorization and the related journal request forms. Katz contends that, without the above-mentioned letters of authorization and journal request forms, the NYSE lacked sufficient evidence to find her guilty of the alleged charges. In support, Katz cites *Rooney A. Sahai*, in which we found insufficient evidence to conclude that an applicant had forged signatures on certain documents.[27]

In *Sahai*, however, the "record [wa]s devoid of any evidence that Sahai performed any act that 'caused' the alleged forgeries."[28] Here, the record contains a variety of evidence that Katz effected transfers between her customers' accounts without their knowledge, such as testimony from her customers, testimony about Katz's control over her customers' accounts, and Katz's own admission that she effected certain transfers. Although testimony "may be 'circumstantial' in the sense that a witness did not actually see the respondent engage in the violative conduct," that testimony can still be persuasive evidence that the respondent engaged in the alleged conduct.[29] Moreover, the absence of the letters of authorization is consistent with the conclusion that Katz lacked the necessary authorization to effect the transfers at issue. Therefore, viewing the record as a whole, we conclude sufficient evidence exits to find that Katz effected unauthorized transfers from the Ashbahians', Voskian's, and Pinajian's accounts.

2. Misstatements

Making material misstatements is inconsistent with the just and equitable principles of trade.[30] The NYSE concluded that Katz made such material misstatements by telling Pinajian that his account balances were incorrect because his margin debit had accidently been deducted twice due to a computer error. In reaching this conclusion, the NYSE considered Pinajian's testimony about his conversations with Katz and his contemporaneous notes of those conversations. Although Katz denied making these statements, the Hearing Panel did not credit

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27 Exchange Act Rel. No. 51549 (Apr. 15, 2005), 85 SEC Docket 862, 871-72.

28 *Id.* at 871.

29 *John D. Audifferen*, Exchange Act Rel. No. 58230 (July 25, 2008), 93 SEC Docket 8129, 8134 n.9 (citing *Donald M. Bickerstaff*, 52 S.E.C. 232, 238 (1995)); *see also Eliezer Gurfel*, 54 S.E.C. 56, 62 (1999) (concluding that applicant had forged company president's signature where the hearing panel had credited the president's testimony that he had not signed the documents at issue); *Kirkpatrick*, 53 S.E.C. at 926-27 (concluding that applicant had forged documents despite lack of direct evidence of such forgery).

30 *See Stephen Michael Sohmer*, 57 S.E.C. 240, 257 (2004) (finding that material misstatements violated just and equitable principles of trade).

those denials and instead concluded that "the only reasonable conclusion the Panel could reach is that [Katz] made false statements in order to conceal the losses in [Pinajian's] account."

Katz seeks to discredit Pinajian by arguing that the trade confirmations listing Pinajian's correct home address "proved that Paul Pinajian was a liar." Katz adds that certain change of address forms and letters of notification for Pinajian's accounts are missing and that any Wachovia employee could have accessed the necessary documents to falsify Pinajian's statements. Katz goes on to allege that Pinajian "created the false monthly statements himself to extort a settlement from Wachovia."

We see no reason, however, to discredit Pinajian's claim that he received at least some fabricated account statements. Pinajian may have been wrong about receiving certain statements in the mail or about when he stopped receiving his actual monthly statements. However, as the Hearing Panel accurately noted, Katz "offered no contrary evidence or plausible explanation for how one of her customers, who happened to be losing large amounts of money through her management of his account, happened to receive statements of another of her customers with a greater amount, or why that customer would lie about her false assurances to him." Furthermore, evidence suggests Katz was misdirecting Pinajian's actual account statements, as both Steup and Kramlick testified that Katz asked them to send at least some of Pinajian's statements to an address that turned out to be that of Katz's house cleaner and to which Pinajian had no apparent connection. We thus find insufficient evidence to overturn the Hearing Panel's credibility determinations regarding Pinajian's testimony and conclude that such testimony provides sufficient evidence to find that Katz made oral misstatements.

Katz also argues that the NYSE's finding that she created the false monthly account statements amounted to finding her guilty of conduct that the NYSE had not charged in its Charge Memorandum. We disagree. The NYSE did not make additional, uncharged findings of violations. Rather, the NYSE made findings of fact about the monthly account statements, which the NYSE used to support its ultimate legal conclusion that Katz made oral misstatements. The various false account statements also suggested that Katz attempted to conceal her oral misstatements, a factor the NYSE appropriately considered when determining sanctions.[31] More significant, however, is that Pinajian's testimony and contemporaneous notes, along with the

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[31] *See, e.g.*, *Gray*, 96 SEC Docket at 19053 (affirming the NYSE's imposition of sanctions by considering aggravating factors, including that applicant sought to conceal his conduct); *Geoffrey Ortiz*, Exchange Act Rel. No. 58416 (Aug. 22, 2008), 93 SEC Docket 8977, 8989-90 (concluding that attempting to conceal misconduct by supplying false information during an investigation presents a "risk of harm to investors and the markets" and "renders the violator presumptively unfit for employment"); *Fox & Co. Invs.*, Exchange Act Rel. No. 52697 (Oct. 28, 2005), 86 SEC Docket 1895, 1912-13 (finding imposition of a bar to be neither excessive or oppressive where applicants, among other things, concealed their conduct); *Robin Bruce McNabb*, 54 S.E.C. 917, 929 (2000) (sustaining bar where applicant attempted to conceal his misconduct), *aff'd*, 298 F.3d 1126 (9th Cir. 2002).

Hearing Panel's assessment of witness credibility, are alone sufficient evidence to conclude that Katz made oral misstatements.

3. Unsuitable Trading

A registered representative is obligated to make "a customer-specific determination of suitability and to tailor his recommendations to the customer's financial profile and investment objectives."[32] Failing to recommend such suitable transactions is inconsistent with just and equitable principles of trade.[33] Here, the NYSE found that Katz failed to tailor her recommendations to Voskian's and Kapakjian's profiles and concluded that her conduct, therefore, was inconsistent with just and equitable principles of trade.[34] We agree.

As Ennis described them, Voskian and Kapakjian "were not savvy market people." They lived on modest retirement incomes, their investments with Katz were relatively modest, and their Wachovia accounts appeared to represent a significant portion of their net worth.[35] All of this left them with little margin for error or loss.[36] Despite this, Katz recommended that Voskian and Kapakjian invest in individual securities, some of which were below-investment-grade. As the NYSE's expert witness testified, these holdings involved a much higher risk of loss than more conservative, diversified investment choices, such as high-yield or high-income mutual funds.[37] The NYSE's expert also noted the short holding periods in Voskian's and Kapakjian's accounts

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[32] *F.J. Kaufman & Co. of Virginia*, 50 S.E.C. 164, 168 (1989).

[33] *Luis Miguel Cespedes*, Exchange Act Rel. No. 59404 (Feb. 13, 2009), 95 SEC Docket 14272, 14280 ("By recommending unsuitable transactions, a registered representative acts inconsistently with just and equitable principles of trade."); *Clinton Hugh Holland, Jr.*, 52 S.E.C. 562, 566 (1995) (finding that applicant's unsuitable recommendations were inconsistent with just and equitable principles of trade), *aff'd*, 105 F.3d 665 (9th Cir. 1997) (Table).

[34] The NYSE found that Katz did not make unsuitable recommendations with respect to the Ashbahians, Griffin, Pinajian, or Smith.

[35] The record is unclear about whether Kapakjian invested all or half of her savings with Katz. *See* discussion *supra* pp.15-16. Katz's recommendations, however, would be unsuitable whichever amount Kapakjian invested with Katz.

[36] *Cespedes*, 95 SEC Docket at 14281 (noting that modest investments, which represented "all or substantially all" of a customer's liquid net worth, left "little margin for error or loss").

[37] *See also, e.g.*, *Stephen Thorlief Rangen*, 52 S.E.C. 1304, 1308 (1997) (finding that investing in particular securities, rather than investing in a more diversified portfolio, was inconsistent with the objective of safe, non-speculative investing).

(often less than one year and, in some cases, as short as a few days) and that Katz failed to recommend that, when exchanging investments, Voskian and Kapakjian should do so within the same mutual fund family. As a result, Katz's strategy for Voskian's and Kapakjian's accounts generated the highest transaction costs of any of the accounts at issue. These extra expenses increased the amount by which their investments had to appreciate before they would realize a net gain.

Katz defends her investment recommendations by claiming that her rationale was to get her clients "better income with some greater risk of volatility." Katz argues, for example, that the below-investment-grade securities at issue had a default rate of only 1%; that the concentration of below-investment-grade securities in Voskian's and Kapakjian's accounts was below the concentration that the NYSE found to be unsuitable in other NYSE cases;[38] and that one of Katz's recommendations yielded Kapakjian a return of approximately 39%. Katz's expert witness also testified that the class of below-investment-grade bonds in Voskian's and Kapakjian's accounts had "a very stable record" with "an acceptable amount of risk with the low default rate." None of this, however, persuades us that Katz's recommendations were suitable. As Katz's expert testified when acknowledging that he could not conclusively determine the suitability of Katz's recommendations, one must "match the security and the recommendation to that person's characteristics." Here, Katz's recommendations may have yielded some positive returns, but they still represented risky and costly investment choices given Voskian's and Kapakjian's investment profiles.[39]

Katz also argues that Ennis confirmed Kapakjian's and Voskian's willingness to assume risk, but Kapakjian's and Voskian's apparent willingness to take on some risk does not change

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[38] Katz cites *Stephen M. Moore*, NYSE Hearing Board Decision 04-82 (consent) (May 19, 2004) (consenting to penalty for unsuitable recommendations where clients had between approximately 44% and 100% of their accounts in below-investment-grade or other high-risk securities); *Douglas Smith*, NYSE Hearing Panel Decision 04-60 (consent) (April 20, 2004) (consenting to finding that registered representative had made unsuitable recommendations where clients had between approximately 42% and 98% of their accounts in below-investment-grade or other high-risk securities); and *Bradley Todd Glasman*, NYSE Hearing Panel Decision 03-216 (consent) (Nov. 25, 2003) (consenting to a finding that registered representative had made unsuitable recommendations where clients had between approximately 33% and 99% of their accounts in below-investment-grade securities).

[39] *See, e.g.*, *Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009) 95 SEC Docket 13833, 13852 (finding that registered representative had "abdicated his responsibility for fair dealing" where the registered representative had, in part, "failed to recommend cheaper mutual fund alternatives within the same fund family"); *Sathianathan*, 89 SEC Docket at 786 (noting that "the overall performance of the stock market [did not] change the fact that Sathianathan's recommendations were unsuitable because they involved unnecessary costs and were too risky given the investment objectives and investment experience of his customers").

our conclusion that Katz 's recommendations were unsuitable for Kapakjian and Voskian. A client's awareness of – or even desire for – risk does not relieve a registered representative of the obligation to tailor recommendations to each customer's financial profile.[40] Katz did not meet this obligation. She instead admitted that she essentially followed the same investment strategy for all of her clients, testifying that "if you are looking for safety of principal, you go to the bank, put your money in the bank, you should not be talking to me." For these reasons, we conclude that Katz's recommendations were unsuitable.

On appeal, Katz argues that the NYSE failed to produce "her extensive research files" during discovery, which documents she claims "would explain why she sold stocks at certain times." However, those documents no longer existed by the time the parties began discovery, as Wachovia only retained research files in the normal course of business for three years. Katz nevertheless argues that, because of these and "many other documents" that were never produced, she "was severely prejudiced in the defense of her case." We disagree.

When asserting prejudice because of missing documents, "[t]he burden is on a respondent to put forward evidence of actual prejudice."[41] Katz makes no such showing other than to assert generally that the research files would have explained her recommendations and to imply that the documents would have implicated others in the violations the NYSE accuses her of committing. Other than her own speculation, however, the record contains no evidence supporting Katz's allegations, and Katz cannot shift the blame for her violations to others or claim that others' misconduct somehow excuses her own misdeeds.[42] Moreover, despite the unavailability of her research files, Katz had the opportunity during the hearing to show that the NYSE failed to establish the unsuitability of her recommendations by putting on other evidence, and she

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40 *Cespedes*, 95 SEC Docket at 8-9; *see also Rafael Pinchas*, 54 S.E.C. 331, 342 (1999) ("[E]ven if [the customer] had desired Pinchas to double her money, that desire would not have relieved Pinchas from his duty to recommend only those trades suitable to [the customer's] situation."); *Rangen*, 52 S.E.C. at 1307-08 (finding that, even if customers "were aware of the risks" of using margin, registered representative of NYSE member firm still made unsuitable recommendations for unsophisticated investors seeking income-producing investments); *John M. Reynolds*, 50 S.E.C. 805, 809 (1992) (concluding that even if a customer wanted to engage in aggressive and speculative trading, the representative was obligated to abstain from making recommendations inconsistent with the customer's financial situation).

41 *Jacob Wonsover*, 54 S.E.C. 1, 22 (1999) (finding no merit in respondent's "generalized assertion" that the Division of Enforcement's case "relies upon faded memories, lost witnesses and discarded documents"), *aff'd*, 205 F.2d 408 (D.C. Cir. 2000).

42 *See Audifferen*, 93 SEC Docket at 8141 (noting that applicant "cannot shift the blame for his violations to his firm"); *Barry C. Wilson*, 52 S.E.C. 1070, 1073 n.12 (1996) (noting that "failings on the part of certain firm personnel do not excuse misconduct by others").

presented an expert witness, cross-examined the NYSE's witnesses, elicited testimony that such research files existed, and testified about why she made certain trades.

Regarding the other documents Katz claims are missing (such as letters of authorization and the related journal request forms), the NYSE's counsel represented in a letter dated April 18, 2007 that the NYSE had provided Katz with "copies of all relevant, discoverable and non-privileged documents in the custody of Enforcement related to the [Katz] matter." This production, the NYSE attested, "included, among other things, correspondence, documents produced by Wachovia Securities LLC and transcripts of on-the-record testimony."[43] The record provides no reason to disbelieve the NYSE's representation, nor does the record contain any evidence to suggest that Wachovia withheld documents. We therefore find no basis to conclude that the NYSE or Wachovia improperly withheld documents or that Katz was prejudiced in the defense of her case.[44]

4. Unauthorized Trading

"Unauthorized trades are a serious breach of the duty to observe high standards of commercial honor and just and equitable principles of trade."[45] This type of misconduct goes "to the heart of the trustworthiness of a securities professional,"[46] and "is a fundamental betrayal of the duty owed by a sales[person] to his [or her] customers" (alteration in original).[47] The NYSE

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43 The record suggests that Katz withdrew her request for the journal request forms when Wachovia apparently represented during a conference call that such journal request forms would neither indicate which salesperson authorized the transactions at issue nor whether a customer had approved the transaction.

44 *Cf. Epstein*, 95 SEC Docket at 13858 (concluding that NASD had complied with its discovery rules by attesting that it had provided all discoverable materials).

45 *Wanda P. Sears*, Exchange Act Rel. No. 58075 (July 1, 2008), 93 SEC Docket 7395, 7398 (quoting *Bradley Kanode*, 49 S.E.C. 1155, 1156 (1989)), *aff'd*, 101 F.3d 108 (2d Cir. 1996) (Table)); *see also Gray*, 96 SEC Docket at 19047 (noting that it "is well established" that unauthorized trading is inconsistent with the just and equitable principles of trade contained in NYSE Rule 476(a)(6)); *Michael G. Keselica*, 52 S.E.C. 33, 37 (1994) (concluding that effecting unauthorized trades "constituted conduct inconsistent with just and equitable principles of trade").

46 *Adam Stuart Levine*, 51 S.E.C. 395, 397 (1993) (affirming imposition of a bar where registered representative effected unauthorized trades in customer accounts).

47 *Sears*, 93 SEC Docket at 7398 (quoting *Keith L. DeSanto*, 52 S.E.C. 316, 323 (1995)), *aff'd*, 101 F.3d 108 (2d Cir. 1996) (Table).

concluded that Katz betrayed these duties by effecting unauthorized trades in the accounts of the Ashbahians, Voskian, Griffin, and Smith, and we agree.[48]

The Ashbahians, Voskian, Griffin, and Smith all testified that Katz executed trades in their accounts without their prior authorization and that they were, at times, confused or alarmed to discover that Katz had been trading in their accounts. The Ashbahians and Smith also noted that, when they called to complain, Katz would be dismissive, telling them "not to worry about it." Although the Hearing Panel did not make an explicit credibility finding regarding this testimony, the Hearing Panel noted that the customers all testified similarly and that "[w]hile several of the customers were related through [Greg Ashbahian], who had introduced each of them to [Katz], [Smith] did not know any of the other customers in question." Such "substantial corroborative effect of the customers' testimony taken as a whole" is persuasive evidence that Katz effected unauthorized trades.[49]

Katz, for her part, claims she had authority to effect trades she made in her customers' accounts and points to the various confirmations her customers made about being satisfied with Katz's handling of their accounts. The Hearing Panel, however, refused to credit Katz's testimony, and, while the confirmations may have provided post-trade approval, ratification of a transaction after the fact does not establish that trades were authorized before being executed.[50]

Katz additionally points to testimony by Smith that Katz did not pressure her to accept trade recommendations. The issue, however, is not whether Smith felt pressured to accept certain recommendations. The issue is whether Katz was effecting trades without first seeking Smith's permission, which Smith testified Katz was doing. Katz also points to Griffin's testimony that Griffin would discuss her investment choices with Katz when she deposited money into her Wachovia accounts. However, not all trades occurred at the same time Griffin deposited her money, and Griffin's testimony that she had periodic conversations with Katz does

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48 The NYSE also concluded that Katz exercised discretion in her customer accounts without written authorization in violation of NYSE Rule 408(a), which we discuss below. *See infra* Part III.C.

49 *Frank J. Custable, Jr.*, 51 S.E.C. 643, 648 n.14 (1993) (finding similarities in customer testimony to be "compelling").

50 *Justine Susan Fischer*, 53 S.E.C. 734, 742 (1998) (finding that applicant had violated Rule 408 regardless of whether the customer complained about the transactions at issue); *Neil C. Sullivan*, 51 S.E.C. 974, 976 & n.1 (1994) (finding that applicant had engaged in unauthorized trading and noting that "[t]he fact that a customer ultimately accepts an unauthorized trade does not transform it into an authorized purchase"); *Custable*, 51 S.E.C. at 650 ("As we have recently emphasized, the fact that a customer ultimately accepts an unauthorized trade by paying for it does not transform it into an authorized trade.").

not contradict Griffin's testimony that Katz nevertheless effected transactions without her approval at other times.

In addition to these factual issues, Katz also asks us to dismiss this proceeding because she "never had notice of which trades were allegedly unauthorized." We decline to do so. "As long as a party to an administrative proceeding is reasonably apprised of the issues in controversy and is not misled, notice is sufficient."[51] Here, the NYSE specified that Katz had engaged in unauthorized trades "in most cases" or "regularly" with respect to the Voskian, Griffin, and Ashbahian accounts (although the NYSE did not similarly characterize the number of unauthorized trades in the Smith account). Katz was thus aware that the NYSE would challenge most of the trades in her customers' accounts, and she had a full opportunity to defend against this allegation and to cross-examine the witnesses who testified that Katz had effected transactions in their accounts without proper authorization.[52]

B. Discretionary Power Without Written Authorization

NYSE Rule 408(a) prohibits members or employees thereof from exercising discretionary power in a customer account without first obtaining written authorization from that customer.[53] Here, the parties do not dispute that Katz lacked written authorization to exercise discretionary

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[51] *Steven E. Muth*, Exchange Act Rel. No. 52551 (Oct. 3, 2005), 86 SEC Docket 1217, 1233 n.40 (finding that allegation provided sufficient notice where it alleged applicant "engaged in various sales practices," but "did not specify unauthorized trades"); *see also Rita J. McConville*, Exchange Act Rel. No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3149 (noting that, although the NYSE must inform a respondent of enough detail for the respondent to prepare a defense, the NYSE "need not disclose to the respondent the evidence upon which [it] intends to rely"); *Blair & Co.*, 7 S.E.C. 977, 980 (1940) (denying motion for bill of particulars by noting that respondents "have generally been apprised of the nature of this proceeding; any uncertainty that may exist at the present time as to particular contentions . . . will be dissipated during the course of the proceedings by the evidence introduced").

[52] *See William C. Piontek*, 57 S.E.C. 79, 90-91 (2003) (finding that respondent who "understood the issue[s]" and "'was afforded full opportunity' to litigate" them had sufficient notice of the charges against him (quotations and citations omitted)); *KPMG Peat Marwick*, 55 S.E.C. 1, 4 (2001) ("As long as a party to an administrative proceeding is reasonably apprised of the issues in controversy and is not misled, notice is sufficient."), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002); *Jonathan Feins*, 54 S.E.C. 366, 378 (1999) (holding that "[a]dministrative due process is satisfied where the party against whom the proceeding is brought understands the issues and is afforded a full opportunity to meet the charges during the course of the proceeding").

[53] *See Ivan M. Kobey*, 51 S.E.C. 204, 211 (1992) ("Rule 408(a) prohibits an exchange member or an employee thereof from exercising discretionary power in a customer's account without first obtaining written authorization from the customer.").

trading in Kapakjian's, Voskian's, Griffin's, Pinajian's, and Smith's accounts. The issue is whether Katz ever exercised such discretionary power.

Regarding Voskian, Griffin, Pinajian, and Smith, we conclude the record contains sufficient evidence to find that Katz exercised discretionary power over their accounts. All four customers testified that Katz had exercised such discretionary power, and the Hearing Panel credited this testimony. We see no basis for overturning that credibility determination, and Katz does not provide any reason to do so other than to cross reference her various attempts to discredit her customers' testimony, arguments that we address and reject elsewhere in this opinion.

Regarding Kapakjian, however, we cannot find sufficient evidence that Katz exercised discretion over her account. As noted earlier, the evidence regarding Kapakjian's account comes largely from Griffin's testimony about her aunt. Although Griffin noted that authority figures intimidated Kapakjian (implying that Kapakjian may have been inclined to let Katz exercise discretion over her account), Griffin did not appear to know whether Katz actually exercised such discretionary power over her aunt's account. In fact, Griffin testified that she and her aunt never discussed what was going on in Kapakjian's account during the time at issue and that Griffin had not exercised her power of attorney to review her aunt's accounts until she began to become concerned about her own accounts at Wachovia. Griffin also testified that, even after she began reviewing Kapakjian's statements, she still did not discuss the accounts with Kapakjian for fear of upsetting her. We accordingly dismiss the NYSE's finding that Katz exercised discretion over Kapakjian's account without written authorization, but affirm the NYSE's findings with respect to Voskian, Griffin, Pinajian, and Smith.

C. Books and Records and Causing the Firm to Learn Inaccurate Information

NYSE Rule 405 requires all member organizations to "use due diligence to learn the essential facts relative to every customer." A person associated with a member firm can violate this rule by failing to learn specific facts about a customer or by failing to fill out a new account form accurately.[54] NYSE Rule 440 and Exchange Act Rules 17a-3 and 17a-4 require brokers and

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[54] *See, e.g., Dan Adlai Druz*, 52 S.E.C. 416, 422 (1995) (finding that branch manager of NYSE member firm violated NYSE Rule 405 by failing to learn facts about the types of trading permitted for a firm account); *Kobey*, 51 S.E.C. at 211 (concluding that employee of NYSE member firm violated Rule 405 by falsifying information on new account forms, which caused the firm to be unable to "accurately assess the suitability of specific options trading strategies").

dealers to make and preserve books and records,[55] and the requirement to keep records includes the requirement that those records be accurate.[56]

The NYSE concluded that Katz violated these provisions with respect to all of the customers at issue by filling out new account forms (or causing such forms to be filled out) for the investors with inaccurate information, which, in turn, caused the Firm to fail to learn essential facts about those customers. For the reasons below, we agree with the NYSE's conclusion with respect to Voskian, but set aside the other findings of violations.

Regarding Voskian, her new account forms indicated that (i) her investment objectives involved some variation of "growth and income," (ii) she had twenty years of experience investing in stock, bonds and mutual funds, (iii) her annual income was between \$100,000 and \$499,999, and (iv) her net worth, excluding residence, was between \$500,000 and \$999,999. Voskian testified that none of this was true. She claimed to have told Katz that she was not seeking growth and was instead primarily concerned with preserving capital. In fact, Voskian wrote a letter to Wachovia emphasizing this point. Voskian also testified that her income consisted of Social Security payments and \$300 per month of her husband's Air Force pension (well below the \$100,000 or more indicated on her new account forms) and that her net worth had been approximately \$175,000 (also much lower than the \$500,000 or more recorded on her new account forms). Voskian also testified that she had only been managing her own finances for the approximately three years since her husband died, not for the twenty years indicated on the new account forms.

Katz disputes Voskian's testimony, claiming that the new account forms accurately reflected what Voskian told her. In doing so, Katz points to Wachovia's supervisory system and "[t]he numerous documents in which the investment objectives of [Katz's] customers were reaffirmed again and again."[57] In Voskian's case, however, Wachovia's mechanisms for confirming customer investment objectives – primarily confirmation letters and follow-up interviews – validate, rather than discredit, Voskian's testimony. Voskian wrote a note on her confirmation letter that "security of principal is the most important part of my investment plan and I do not want that at risk for any higher yield" and testified that she had never seen or signed

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55 *See supra* note 4.

56 *See Anthony A. Adonnino*, 56 S.E.C. 1273, 1288 (2003) (finding that "instances of inaccuracy and falsity . . . caused violations of Exchange Rule 440 and Exchange Act Rules 17a-3 and 17a-4").

57 Katz also argues that the Hearing Panel "failed to address the impact of Wachovia's mail procedures on the Activity Letters," such as testimony that ingoing and outgoing mail was routed through Wachovia's operations department. Katz does not explain, however, what the impact of those procedures might be, and we fail to see how those mail procedures impact our conclusions.

a second confirmation letter that contained incorrect net worth and income figures. Although Voskian apparently agreed to a more aggressive investment approach after speaking with Ennis, that conversation was held after the new account forms were completed and, if anything, suggests Voskian did not want such an aggressive approach until after she spoke with Ennis. Moreover, any confirmation regarding Voskian's investment objectives does not explain the inaccuracies in the new account forms about Voskian's income and net worth.

Whether the other customers' new account forms were accurate, however, is less clear. The Ashbahians, Pinajian, and Griffin all had new account forms that listed their investment objective as one of the apparently more aggressive options: "Growth (return emphasis)." The Ashbahians, Griffin, and Pinajian all testified that, while they were concerned with preserving their principal, they also wanted growth. Pinajian testified, for instance, that while he was concerned with protecting his money, part of his reason for investing with Katz was to increase his returns. Harry Ashbahian similarly testified that he was looking for a broker "who could give me the most income in investing," and Griffin testified that she wanted her money "to sit and grow." Given the record's failure to include a definition for most of the investor objectives listed on the new account forms and the customers' stated desire to obtain at least some growth, we find insufficient evidence to conclude that their new account forms were incorrect or that Katz failed to use reasonable efforts to learn specific facts about the Ashbahians, Pinajian, or Griffin.[58]

We similarly find insufficient evidence to conclude that the new account forms were inaccurate for Kapakjian or Smith. Their forms listed their investment objective as "Growth & Income (return emphasis)." Again, the record does not include a definition of this term, and while Smith testified that she wanted her money handled conservatively, she added that she wanted her money handled in the same way it had been handled previously – which was a time when her account forms also indicated "Growth & Income (return emphasis)." Smith additionally testified that she wanted to continue to receive the same monthly income stream as before, without giving much thought to how that income could be achieved, and that she understood the investment objectives listed on her form.

Regarding Kapakjian, Griffin testified that her aunt "stressed preservation of principal" to Katz. Given the lack of a definition in the record of the investment goals listed on Kapakjian's new account forms, however, we cannot conclude that Griffin's testimony that her aunt "stressed preservation of principal," without more, was necessarily inconsistent with her aunt wanting "Growth & Income (return emphasis)." Kapakjian's new account form also indicated that her income was at least $50,000 and her net worth was at least $200,000. These amounts seem inconsistent with Griffin's description of her aunt, but Griffin also testified that "I honestly don't know" whether Kapakjian had other savings accounts at the time she opened her account with

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[58] As noted earlier, some of the Ashbahians' new account forms did include definitions of their investment choices. Even for those forms, however, we cannot conclude that the Ashbahians' stated desire for some growth was necessarily inconsistent with the investment objectives listed on their new account forms. *See supra* note 9.

Katz. Therefore, while we do not reject the Hearing Panel's credibility findings regarding Griffin's testimony, we conclude that testimony was insufficiently detailed to find that Kapakjian's new account forms were incorrect or that Katz failed to use reasonable efforts to learn specific facts about Kapakjian.

IV.

The NYSE censured Katz and imposed a permanent bar from membership, allied membership, and approved person status and from employment or association in any capacity with any member or member organization. Exchange Act Section 19(e)(2) directs us to sustain the NYSE's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive, or impose an unnecessary or inappropriate burden on competition.[59] Although we have not sustained each of the NYSE's findings of violation, we nevertheless sustain the NYSE's imposition of sanctions.[60]

In deciding that a censure and bar were appropriate sanctions, the NYSE focused almost exclusively on Katz's misappropriation of client funds and her misstatements to Pinajian. The NYSE described these actions as "extremely serious," noting that Katz's "unauthorized transfers constituted, at best, reckless misuse of customer money, and at worst, deliberate theft from one customer to benefit another" and that Katz's misstatements to Pinajian were an attempt "to conceal additional misconduct." As the NYSE noted, "many of [Katz's] actions appear to have stemmed from desperation – stealing money from one customer to cover a margin call in the account of another, creating and sending false statements to conceal the mounting losses in that customer's account, taking Firm documents out of the office under cover of night." The NYSE concluded that Katz's "clumsy attempts to hide what may have been mere incompetence caused great harm to her customer and to the trust that investors place in those who making a living in the securities industry." We agree with these characterizations of Katz's conduct.

Misappropriating client funds and making misstatements are serious misconduct, and we have sustained bars as appropriate sanctions in the past for such conduct.[61] Here, Katz not only

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[59] 15 U.S.C. § 78s(e)(2). Katz does not allege, and the record does not show, that NYSE's sanctions imposed an undue burden on competition.

[60] *Cf. McNabb*, 54 S.E.C. at 929 (affirming imposition of bar despite not affirming every finding of violation).

[61] *See, e.g.*, *Gorniak*, 52 S.E.C. at 373 (sustaining bar where applicant delayed making trades and returning client's funds); *Ernest A. Cipriani, Jr.*, 51 S.E.C. 1004, 1006, 1008 (1994) (sustaining bar for applicant's misappropriation of at least six client payments); *Daniel Turov*, 51 S.E.C. 235, 239-40 (1992) (sustaining bar for applicant's "pattern of violations," that included misappropriation); *Stephen M. Carter*, 49 S.E.C. 988, 990 (1988) (sustaining bar for

(continued...)

misappropriated her clients' funds, but also made unsuitable recommendations, engaged in unauthorized trades, and exercised unauthorized discretion in customer accounts. She also attempted to conceal her misconduct and caused Wachovia's books and records to reflect inaccurate information. These violations represented a pattern of dishonesty that extended over several years.

On appeal, Katz argues that the NYSE improperly based the sanctions on conduct that was not charged (particularly the NYSE's finding that Katz was responsible for falsifying documents and that she used invalid letters of authorization to effect certain transactions). For support, Katz cites *Leonard John Ialeggio*, in which we remanded NASD's finding of sanctions. There, the NASD National Committee, in determining sanctions, had "highlighted" certain alleged misconduct that was not charged in NASD's complaint and was not explored before either the hearing panel or the National Committee.[62] We therefore remanded *Ialeggio* to NASD "to ensure that [the National Committee's] sanction determination was confined to the record before it."[63]

Here, by comparison, there is no evidence that the Board of Directors considered evidence outside the record. The findings with which Katz takes issue are part of the overall facts and circumstances that the NYSE appropriately considered when imposing a censure and bar.[64] Moreover, neither the Hearing Panel nor the Board of Directors "highlighted" these additional findings when determining Katz's sanctions. The NYSE instead focused on Katz's misappropriation and misstatements – conduct clearly alleged in the Charge Memorandum. We therefore see no basis for remanding the NYSE's determination of sanctions.

Katz next contends that the NYSE erred by failing to address certain mitigating factors, such as Katz's claims that she was a nice person who did a good job for her clients and that she did not receive any financial benefit from the unauthorized transfers between her clients' accounts. In making this argument, Katz points to our decision in *Paul K. Grassi, Jr.*, in which we remanded a finding of violations because, in part, we were unable to determine whether the

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61 (...continued)
applicant's pattern of misconduct, including misappropriation, that occurred over an approximately ten-month period); *Raymond M. Ramos*, 49 S.E.C. 868, 871 (1988) (affirming bar and stating that "[t]here can be no justification for the misappropriation of a customer's funds").

62 *Leonard John Ialeggio (Ialeggio I)*, 52 S.E.C.1085, 1090 (1996).

63 *Leonard John Ialeggio (Ialeggio II)*, 53 S.E.C. 601, 604 (1998) (affirming same sanctions as imposed in *Ialeggio I*), *aff'd*, 185 F.3d 867 (9th Cir. 1999) (Table).

64 *See supra* note 31; *see also Paul K. Grassi, Jr.*, Exchange Act Rel. No. 52858 (Nov. 30, 2005), 86 SEC Docket 2494, 2500 ("The appropriate sanction depends on the facts and circumstances of each particular case.").

NYSE considered certain mitigating factors.[65] Here, however, the NYSE expressly considered – and rejected – Katz's mitigation claims, noting that "[c]ontrary to [Katz's] contention that she was acting in the best interests of her customers, she showed complete disregard for the well-being of some customers, while benefitting others and trying to cover her own misdeeds."

Moreover, we agree with the NYSE's conclusion that Katz's claims of mitigation provide no basis for leniency. Katz may not have profited directly from misappropriating some of her clients' funds, but she did benefit by keeping her clients happy and retaining their business.[66] Katz's assertions that she was nice person who did a good job for her clients similarly do not warrant a lesser sanction, as her misconduct demonstrated a readiness to put her own interests ahead of her clients'.

The imposition of a censure and bar are necessary here to protect the investing public.[67] Katz's behavior – particularly her failure to take responsibility for her misconduct and her attempt to attribute her violations to other Wachovia customers and employees – provides no assurance that she will not repeat her violations. A censure and bar will therefore prevent Katz from putting additional customers at risk and will serve as a deterrent against others in the securities industry from engaging in similar misconduct.

For the above reasons, we see no basis for concluding that the sanctions imposed by the NYSE are excessive or oppressive.

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65 *Grassi*, 86 SEC Docket at 2501.

66 *See* discussion *supra* p. 23; *see also Gray*, 96 SEC Docket at 19053 (affirming censure and bar where applicant had made no profit from the misconduct at issue); *Conrad P. Seghers*, Investor Advisers Act Rel. No. 2656 (Sept. 26, 2007), 91 SEC Docket 2293, 2307 (affirming bar by noting that "[a]ccepting *arguendo* that [applicant] did not profit from his violations, this fact does not negate his conduct of his fiduciary duties, and therefore does not justify a reduced sanction in the public interest"), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008); *Howard R. Perles*, 55 S.E.C. 686, 707 n.31 (2002) (noting that "the absence of profit from manipulative conduct does not negate that conduct"); *Ramos*, 49 S.E.C. at 871-72 (affirming bar despite applicant's "otherwise spotless" record and noting that "[t]here can be no justification for the misappropriation of a customer's funds, and the fact that [applicant] ultimately paid the money back does not warrant permitting his return to the securities business").

67 *See, e.g.*, *Kirkpatrick*, 53 S.E.C. at 931-32 (affirming a bar where applicant misappropriated client funds and engaged in unauthorized trades); *Gorniak*, 52 S.E.C. at 373 (affirming a bar where applicant misused customer funds).

An appropriate order will issue.[68]

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

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

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68 We have considered all of the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No.

Admin. Proc. File No. 3-13279

In the Matter of the Application of

JANET GURLEY KATZ
c/o Richard C. Fooshee, Esq.
20 North Van Brunt Street, Suite 2
Englewood, NJ 07631

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that the disciplinary action taken by the New York Stock Exchange, Inc. against Janet Gurley Katz be, and 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 Act of 1933
Release No. 9105/February 2, 2010

Securities Exchange Act of 1934
Release No. 61468/February 2, 2010

ORDER REGARDING REVIEW OF FASB ACCOUNTING SUPPORT FEE FOR 2010 UNDER SECTION 109 OF THE SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 (the "Act") provides that the Securities and Exchange Commission (the "Commission") may recognize, as generally accepted for purposes of the securities laws, any accounting principles established by a standard setting body that meets certain criteria. Consequently, Section 109 of the Act provides that all of the budget of such a standard setting body shall be payable from an annual accounting support fee assessed and collected against each issuer, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard setting body, and to provide for an independent, stable source of funding, subject to review by the Commission. Under Section 109(f) of the Act, the amount of fees collected for a fiscal year shall not exceed the "recoverable budget expenses" of the standard setting body. Section 109(h) amends Section 13(b)(2) of the Securities Exchange Act of 1934 to require issuers to pay the allocable share of a reasonable annual accounting support fee or fees, determined in accordance with Section 109 of the Act.

On April 25, 2003, the Commission issued a policy statement concluding that the Financial Accounting Standards Board ("FASB") and its parent organization, the Financial Accounting Foundation ("FAF"), satisfied the criteria for an accounting standard setting body under the Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" under Section 108 of the Act.[1] As a consequence of that recognition, the Commission undertook a review of the FASB's accounting support fee for calendar year 2010. In connection with its review, the Commission also reviewed the budget for the FAF and the FASB for calendar year 2010.

Section 109 of the Act also provides that the standard setting body can have additional sources of revenue for its activities, such as earnings from sales of publications, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual or perceived independence of the standard setter. In this regard, the Commission also considered the interrelation of the operating budgets of the FAF, the FASB and the Governmental Accounting Standards Board ("GASB"), the FASB's sister organization, which sets accounting standards used by state and local governmental entities. The Commission has been advised by the FAF that neither the FAF, the FASB nor the GASB accept contributions from the accounting profession.

After its review, the Commission determined that the 2010 annual accounting support fee for the FASB is consistent with Section 109 of the Act. Accordingly,

IT IS ORDERED, pursuant to Section 109 of the Act, that the FASB may act in accordance with this determination of the Commission.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

[1] Financial Reporting Release No. 70.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61472 / February 2, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13774

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

I.

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

II.

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

III.

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

1. Respondent, age 48, resides in Spain.

2. On January 21, 2010, a final judgment was entered against Respondent in the civil action entitled *Securities and Exchange Commission v. Shehyn, et al.*, Civil Action Number 04-cv-02003, by the United States District Court for the Southern District of New York, enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

3. The Commission's Complaint alleged that during the years 2001 through 2002, defendant Donald L. Marr worked for an entity known as Millennium Financial, Ltd., which operated in several countries, including the United States and Spain, and defrauded over 700 investors in connection with the sale of U.S. securities, including several U.S. citizens, in more than 20 countries (primarily in Europe). All told, the Commission alleges that Millennium raised more than $20 million over the period of the scheme.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Donald L. Marr be, and hereby is barred from association with any broker or dealer.

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

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61484 / February 3, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13775

In the Matter of **Tostel Corp.,** **Respondent.**	**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 Respondent Tostel Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Tostel Corp. (CIK No. 721309) is a dissolved Colorado corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tostel 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, 1995, which reported a net loss of $181,001 for the prior three months. As of February 2, 2010, the company's stock (symbol "TSTLF") was traded on the over-the-counter markets.

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B. DELINQUENT PERIODIC FILINGS

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

3. 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.

4. As a result of the foregoing, Respondent 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 Respondent 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 Respondent 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 Respondent 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 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, 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9107 / February 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13776

In the Matter of **STATE STREET BANK AND TRUST COMPANY,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The United States Securities and Exchange Commission (the "Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against State Street Bank and Trust Company ("State Street" or "Respondent").

II.

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

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

Summary

1. During the subprime mortgage crisis in 2007, State Street engaged in a course of business that misled investors about the extent of subprime mortgage-backed securities held in certain unregistered funds under its management. As a result of State Street's conduct, investors in State Street's funds lost hundreds of millions of dollars during the subprime market meltdown in mid-2007.

2. State Street offered investments in certain collective trust funds to institutional investors, including pension funds, employee retirement plans, and charities. These funds included two substantially identical funds – referred to together as the Limited Duration Bond Fund (the "Fund") – made available to different categories of investors. Other actively-managed bond funds and a commodity futures index fund managed by State Street ("the related funds") also invested in the Fund. State Street established the Fund in 2002 and marketed the Fund by saying it utilized an "enhanced cash" investment strategy that was an alternative to a money market fund for certain types of investors. By 2007, however, the Fund was almost entirely invested in or exposed to subprime residential mortgage-backed securities ("subprime investments"). Nonetheless, State Street continued to describe the Fund to prospective and current investors as having better sector diversification than a typical money market fund, while failing to disclose the extent of its exposure to subprime investments.

3. When the subprime market collapsed in mid-2007, many investors in the Fund and the related funds were unaware that the Fund had such significant exposure to subprime investments. In fact, the Fund's offering materials, such as quarterly fact sheets, presentations to current and prospective investors, and responses to investors' requests for proposal, contained misleading statements and/or omitted material information about the Fund's exposure to subprime investments and use of leverage. As a result, many investors either had no idea that the Fund held subprime investments and used leverage, or believed that the Fund had very modest exposure to subprime investments and used little or no leverage.

4. Beginning on July 26, State Street sent a series of shareholder communications concerning the effect of the turmoil in the subprime market on the Fund and the related funds that misled investors and continued State Street's failure to disclose the Fund's concentration in subprime investments. At the same time, State Street provided certain investors with accurate and more complete information about the Fund's subprime concentration. These other investors included clients of State Street's internal advisory groups, which provided advisory services to some of the investors in the Fund and the related funds. During 2007, State Street's advisory groups became aware, based on internal discussions and internally available information, that the Fund was concentrated in subprime investments. Prior to July 26, 2007, at least one internal advisory group also learned that State Street was going to sell a significant amount of the Fund's distressed assets to meet significant anticipated redemptions. State Street's internal advisory groups subsequently decided to redeem or recommend redemption from the Fund and the related funds for their clients. State Street Corporation's pension plan was one of those clients. State Street sold the Fund's most liquid holdings and used the cash it received from these sales to meet the redemption demands of these better informed investors, leaving the Fund with largely illiquid holdings.

Respondent

5. **State Street**, a subsidiary of publicly-traded State Street Corporation, is a Massachusetts trust company and a bank that is a member of the Federal Reserve System. The principal place of business of State Street and State Street Corporation is Boston, Massachusetts. Because State Street is a bank, it relies on the exclusion from the definition of investment adviser contained in Section 202(a)(11) of the Investment Advisers Act of 1940. The unregistered collective trust funds State Street advises, such as the Fund and the related funds, similarly rely on the exclusion from the definition of investment company under Section 3(c)(11) of the Investment Company Act of 1940.

Background

Background – The Limited Duration Bond Fund ("the Fund")

6. State Street established the Fund in February 2002 as an actively-managed fund targeting a return of one-half to three-quarters of one percent per year over the London Inter-Bank Offer Rate (LIBOR), the interest rate that banks charge each other for short-term loans. Like a mutual fund, the Fund offered daily redemptions, and investors purchased or sold units of the Fund based on the Fund's daily net asset value. As a bank-managed collective trust fund, State Street only offered the Fund and the related funds to certain investors. According to the Fund's offering materials, the Fund's minimum credit quality was BBB, but its average credit quality was always AA or AA+. In mid-June 2007, the Fund had assets of approximately $3 billion.

7. Over the years, the Fund consistently achieved its target performance by heavily concentrating in bonds backed by first lien mortgages to subprime borrowers. The Fund's consistent outperformance of its benchmark and low volatility resulted in State Street's decision to permit its portfolio managers of the related funds to invest up to 25% of those funds' assets in the Fund so those funds could beat their benchmarks. As it became harder to achieve benchmark performance by investing in other segments of the bond market, State Street decided to concentrate an even greater percentage of the Fund in subprime investments.

8. In 2006 and early 2007, State Street magnified the Fund's exposure to subprime investments by increasing the Fund's use of reverse repurchase agreements, credit default swaps, and total return swaps tied to the outperformance of subprime investments. All of these investments had the effect of leveraging the Fund, and, ultimately, exposed the Fund to more risk and volatility.

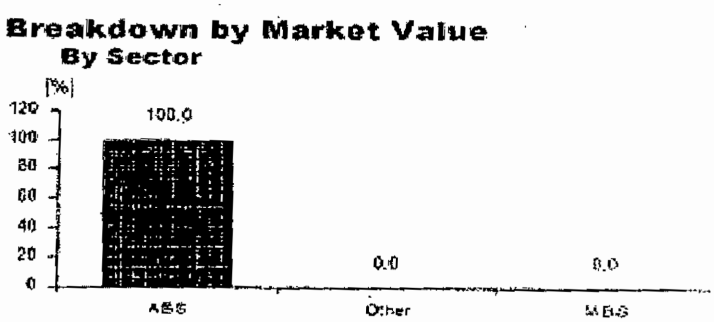
Misrepresentations Regarding Subprime Investments, Use of Derivatives, and Leverage

9. In its offering documents and other communications with investors and prospective investors, State Street stated that the Fund was sector-diversified and was an enhanced cash portfolio (or slightly more aggressive than a money market fund). In fact, the Fund was concentrated in subprime bond investments and derivatives tied to subprime investments. From inception to June 30, 2007, the Fund's quarterly fact sheet for prospective and current investors stated:

The Limited Duration Bond Strategy utilizes an expanded universe of securities that goes beyond typical money markets including: Treasuries, agencies, collateralized mortgage obligations, adjustable rate mortgages, fixed rate mortgages, corporate bonds, asset backed securities, futures, options, and swaps.... When compared to a typical 2 A-7 regulated money market portfolio, the Strategy has better sector diversification, higher average credit quality, and higher expected returns. The tradeoff is this fund purchases issues that are less liquid than money market instruments and these instruments will have more price volatility. This Strategy should not be used for daily liquidity. Returns to the Strategy are more volatile over short horizons than traditional cash alternatives and may not benefit the short-term investor.

In 2006 and 2007, this language misled investors into believing that the Fund had better sector diversification and higher average credit quality than a typical money market portfolio, when in reality by that time the Fund held primarily subprime investments and had a lower average credit quality.

10. In its offering materials, State Street also misrepresented the Fund's exposure to subprime investments. Through July 2007, the fact sheets, investor presentations, and account statements for the Fund and the related funds presented market value sector exposures for "ABS" (asset backed securities), "MBS" (mortgage-backed securities), etc. For example, the standard Fund presentation and Fund fact sheet that State Street used during the second quarter of 2007 reflected the following exposures in the Fund:



Although some other industry participants also included subprime investments within the "ABS" category, State Street did not define these sector categories in its investor materials. As a result, many investors and State Street client service personnel believed that the Fund and the related funds had very little or no exposure to subprime investments when the subprime turmoil commenced in 2007 because State Street's materials showed little or no "MBS" in the funds. Moreover, State Street also failed to explain that virtually all the Fund's ABS exposure was subprime investments.

11. Investors' misunderstanding concerning the extent of the Fund's subprime investments was further exacerbated by the fact that many of State Street's client service personnel who answered client questions during the period of market turmoil related to subprime investments, like State Street's clients, did not understand that State Street's undisclosed definition of "ABS" included subprime securities and its definition of "MBS" did not. In fact,

most of the Fund's investors and State Street's own client service personnel were unaware that the Fund's ABS investments were almost wholly comprised of subprime MBS.

12. State Street's investor marketing materials and presentations in 2006 and 2007 also misrepresented the extent of the Fund's exposure to subprime investment risk, including the Fund's exposure to leveraged subprime investments. During this period, the Fund was leveraged through reverse repurchase agreements on its subprime bonds and through derivative contracts whose value rose and fell based on changes in the value of other subprime investments. The notional value of a derivative contract is the total value of the derivative contract's assets, and a small amount invested in a derivative contract often controls a much larger notional value. Therefore, where a portfolio of assets includes derivative investments, information about a portfolio's notional value relative to its market value may be necessary to determine a portfolio's exposure to leverage.

13. Up until 2005, State Street's investor marketing materials and presentations reflected the impact of derivative positions on the Fund's sector exposures by reporting total exposure to various asset sectors in excess of 100% of the net assets of the Fund. In 2005, however, State Street changed these materials to describe the Fund's sector exposures by using a presentation based on only the market value of exposures. This form of reporting displayed exposures totaling 100% (see chart in paragraph 10) without also disclosing that, on a notional basis, the Fund's exposure to subprime investments often exceeded 100% because of the Fund's investment in various subprime derivatives. As a result of State Street's change in disclosure, State Street failed to inform investors in many of its descriptions of the Fund's sector exposures that the Fund's investment performance was tied to subprime and that its use of leverage magnified its exposure to subprime.

14. In addition to representations of sector diversification in fact sheets, investor presentations, and other State Street offering documents, the investors in the Fund and the related funds had investment management agreements with State Street concerning the investment of their assets in State Street's funds. Some of those agreements included guidelines limiting the use of leverage and requiring diversification. State Street's agreement to comply with those guidelines misled investors concerning the diversification of the Fund and its use of leverage.

15. State Street's template response to investors' requests for proposal ("RFP") for the Fund to the question "Describe your use of derivatives," stated:

> Approximately 20-30% of the portfolio is comprised of derivative securities. These securities are used because they provide the portfolio with low risk and excellent yields. These securities also dampen the price volatility of the fund. These issues are structurally transparent. We do not maintain a leveraged exposure. Our competitive advantage at State Street is the use of our large passive funds and the returns they generate to enter into total return swaps, which provide a nice yield to our Limited Duration Bond Strategy with minimal risks. Derivative securities used include financial futures contracts, options and swaps.

16. This statement misled purchasers of the Fund because: 1) the Fund's derivatives typically exceeded 20-30% of the Fund's portfolio; 2) the Fund maintained a leveraged exposure; and 3) the Fund's derivative investments exposed the Fund to greater risk and

increased its price volatility. Nonetheless, State Street utilized this answer in a communication with at least two prospective investors of the Fund, one of whom invested in the Fund, representing that the Fund does "not maintain a leveraged exposure," and that there was "no leverage at the product level."

17. In a standard investor presentation concerning the Fund, State Street represented that one of the Fund's objectives was "[m]odest use of leverage to manage risk and enhance returns." However, in 2007, the Fund's use of leverage often resulted in exposure to the subprime market in excess of 150% of the Fund's market value. This leverage exposed the Fund to significant risks and, by July 2007, the Fund's leveraged investments far exceeded the Fund's risk budget based on the expected volatility of the Fund and its benchmark. As a result of State Street's representations regarding leverage, many of the Fund's investors and State Street's client service personnel did not know the Fund had leveraged positions that magnified the Fund's exposure to subprime investments until long after the Fund began a precipitous decline in mid-2007.

18. After a brief period of subprime market turmoil in February 2007, State Street circulated an internal alert to its client service personnel. State Street adapted the internal alert into a nearly identical letter it sent to some investors in the Fund and the related funds in early March 2007. The internal alert and letter stated that the Fund's recent underperformance was caused by the Fund's small position in a certain subprime derivative investment. The February internal alert and investor letter focused on the Fund's "modest" exposure to a small position in this BBB rated subprime derivative investment: "One of the alpha drivers in State Street's active strategies has been taking modest exposure in the investment grade triple B asset-backed securities market, specifically the sub-prime home equity market." State Street reiterated this statement in an update sent to certain investors in April. As a result of State Street's internal and external communications in the February to April 2007 timeframe, many of State Street's client service personnel and investors in the funds believed that the Fund had a very small exposure to subprime investments.

<u>State Street's Internal Advisory Groups Caused Their Investors to Redeem the Fund</u>

19. Beginning in mid-June 2007, as the market for the Fund's subprime investments was in crisis, the Fund began a precipitous decline in value. In late July 2007, State Street's internal advisory groups recommended to their clients that they withdraw from those funds while State Street continued encouraging others to stay invested and to continue to invest.

20. In late July 2007, three of State Street's internal advisory groups that oversaw client investments in actively-managed bond funds decided that their clients should redeem their investments in the Fund and the related funds. Those groups were aware of the Fund's exposure to subprime investments and other problems with the Fund that had not been disclosed to other investors because: 1) employees of two of the advisory groups were voting members on State Street's confidential Investment Committee that discussed at length actions to be taken in the Fund in response to the market crisis and anticipated redemptions; 2) the advisory groups had regular access to the Fixed Income trading desk and portfolio managers; and 3) the advisory groups received versions of the internal use only subprime alerts, including State Street's early July 2007 internal subprime alert described in paragraph 28 below, which caused these groups to seek out and receive more information about the Fund's subprime holdings. The clients in these

groups were invested in the Fund and 14 of the related funds. As of July 25, 2007, the clients of these internal advisory groups held approximately 20 percent of the shares in these funds. By early August 2007, because of State Street's actions, virtually all of the advisory groups' clients had redeemed out of the Fund and the related funds.

21. On the morning of July 25, 2007, an advisory group manager attended State Street's Investment Committee meeting where the main topic was a "strictly confidential" discussion about subprime problems in the actively-managed bond funds. The Investment Committee, which had fiduciary oversight responsibility for all of State Street's funds, discussed major liquidity concerns with the Fund and the need to meet anticipated investor redemptions by selling a significant percentage of the Fund's subprime investments. At the conclusion of the discussion, the Investment Committee voted unanimously to direct the Fund's portfolio managers to sell assets to increase liquidity in the Fund in anticipation of investor redemptions of 25-50% at month end.

22. Between July 26 and August 1, as a result of the directions from the July 25 Investment Committee meeting, State Street raised almost $700 million in cash to meet anticipated investor redemption demands. Approximately 75 percent of this cash came from the sale of almost all of the Fund's highest rated AAA bonds, even though the Fund's AAA bonds were only 20 percent of the Fund's net asset value at the time of the July 25 Investment Committee meeting. During this same period, the Fund experienced significant redemptions, including redemptions from clients of State Street's internal advisory groups. Therefore, after State Street met the redemption demands of the Fund's more informed clients, average credit quality of the Fund's bonds decreased.

23. State Street imposed no information barriers on the internal advisory groups and had no policies prohibiting their attendance at the Investment Committee meeting. State Street also had no policies prohibiting the internal advisory groups from making investment decisions about the Fund and the related funds after learning material information about the Fund and the related funds at an Investment Committee meeting.

24. Certain employees of one advisory group also learned through internal State Street meetings that: 1) Fixed Income managers believed the primary cause of the Fund's July underperformance was Lehman Brothers' repricing of its subprime indices, and that further declines in these indices were likely (which would exacerbate the Fund's underperformance issues); 2) the Fund was selling assets to raise cash in anticipation of investor redemptions; and 3) the Fixed Income managers expected a potential maximum loss in the Fund of another 3% or 4% of the Fund's value. With that knowledge, the advisory group decided to recommend redemption from the Fund and shortly thereafter recommended redemption from the related funds.

25. On July 25, 2007, a second advisory group decided to redeem or recommend to its clients that they redeem all of their holdings in the Fund and the related funds. In March 2007, those managers had learned that subprime investments were a core part of the Fund strategy, the Fund held at least 75% of its assets in subprime investments, and the Fund had exposure to subprime investments besides the small subprime derivative position described in State Street's internal February alert. A manager of that advisory group also attended State Street's Investment Committee meetings throughout 2007 and learned that the Fund and the related funds were

investing more in higher rated subprime tranches.

26. After that group's decision on July 25, a group member drafted a summary that attributed its decision to recommend redemption to the recent stress on the subprime market and the potential for continued stress on that market. All of the clients who received the recommendation followed it.

27. On July 27, a third State Street advisory group decided to redeem or recommend to its clients that they redeem all of their holdings in State Street's actively-managed bond funds. That group's decision was prompted by hearing that State Street's largest advisory group had decided to get clients out of the Fund.

Mid-2007 Communications About The Fund

28. In early July 2007, State Street circulated an internal "client at risk" alert to its internal advisory groups and its other client service personnel that stated that the "the cause" of "substantial underperformance in the month of June... was our exposure to the subprime mortgage market, specifically our exposure to the triple B ABX and, in certain funds such as the Limited Duration [ERISA] Fund, exposure to the high quality CDO market."

29. In mid-July 2007, as the subprime market situation continued to worsen, State Street's Fixed Income group developed answers to Frequently Asked Questions (FAQs) concerning the subprime situation. On July 26, State Street distributed the first set of FAQs to State Street's client service personnel and its internal advisory groups. Senior managers instructed that the FAQs were "to assist you with client/consultant questions" but were "for internal use only" and should only be used for oral discussions with investors. The FAQs enabled State Street's client service personnel to disclose information to certain investors who requested it, including that the Fund was concentrated in subprime investments and that State Street's largest internal advisory group had decided to redeem its clients out of the Fund and the related funds. Many investors who received information from the FAQs redeemed their investments shortly after receiving the information. In late July and early August, in response to requests from certain investors or their outside consultants, State Street also provided the Fund's holdings and disclosed the fact that State Street had decided to reprice some of the Fund's securities to reflect market prices that were lower than the vendor prices State Street had been using to arrive at the Fund's net asset value. All but one of these investors immediately sold their investments before the Fund experienced its most significant losses in August.

30. In late July and early August 2007, as State Street was preparing to redeem investments by investors in the Fund and the related funds (including the clients of State Street's internal advisory groups) to whom State Street had provided information about the Fund's subprime concentration and other risks, State Street also was sending letters to all investors in the Fund and the related funds that continued to keep many investors in the dark. Investors who only received State Street's offering materials plus its late July and early August letters continued to be misinformed about the risks of the Fund and the related funds and the actions State Street was taking in response to the market crisis. As a result, most of these investors experienced significant investment losses as they continued to hold or purchase shares of the Fund and the related funds after State Street had made disclosures to other investors that caused these more informed investors in the Fund and the related funds to redeem their investments.

A. On July 26, 2007, State Street sent a letter to all investors in the Fund and related funds concerning the impact of turmoil in the subprime market on those funds. The letter was originally based on the internal "client at risk" alert from early July, but the five-paragraph letter that investors finally received did not include any of the information from that alert regarding the extent of exposure to subprime investments in the Fund. Nor did the letter include the information State Street disclosed to its internal advisory groups and certain other investors described above in paragraphs 19 to 29. The letter disclosed little more than the fact that recent events in the subprime market "are impacting performance in some of our active fixed income portfolios in which you are invested directly or indirectly."

B. As for State Street's view of the subprime situation and what it would do in response to the situation, the July 26 letter stated:

> We believe that what has occurred in June, and thus far in July, has been more driven by liquidity and leverage issues than long term fundamentals... We have been seeking to reduce risk in those portfolios where we believe it is appropriate by taking advantage of liquidity in the market when it exists, and will continue to do so, while seeking to avoid putting undue pressure on asset valuations.

However, in conveying that it was seeking to reduce risk, State Street omitted that the steps it was taking to take advantage of liquidity would result in the Fund holding bonds of lower average credit quality and greater illiquidity. As described above, after the July 25 Investment Committee meeting, State Street sold almost all of the Fund's highest rated bonds to meet investor redemptions. To meet the early redemption demands of the more informed investors, including State Street's internal advisory group clients, State Street depleted the cash it raised from the sale of the Fund's highest rated assets at a much faster rate than it sold the Fund's lower rated bonds, resulting in a Fund that held bonds of lower average credit quality and greater illiquidity for investors who remained in the Fund after the anticipated redemptions. Therefore, after receiving State Street's subprime update on July 26, investors relying on State Street's written materials still had no idea they were in a subprime concentrated fund, or that the Fund would soon be concentrated in lower-rated subprime bonds.

C. On August 2, 2007, State Street asked its client service personnel to send another letter to all affected investors concerning the subprime situation and preliminary July performance returns. The letter did not disclose the information described in paragraphs 19 to 29 above that State Street had provided to its internal advisory groups and certain other investors who requested the information. In the August 2 letter, State Street again stated it had taken actions to reduce risk, including the sale of certain subprime bonds, while maintaining the Fund's average credit quality. However, State Street had sold almost all of the Fund's highest rated subprime bonds, and, upon meeting anticipated investor redemptions in late July and early August, the Fund's bonds were increasingly lower credit quality. Those investors who remained in the dark concerning the Fund's risks invested in or continued to hold their investment as the Fund became concentrated in lower-rated subprime bonds.

31. On August 14, 2007, State Street sent a third letter concerning the subprime

situation to all affected investors except the clients of State Street's advisory groups. However, once again, the letter did not include the information State Street disclosed to its internal advisory groups and certain other investors described in paragraphs 19 to 29 above. The August 14 letter stated: "While we will continue to liquidate assets for our clients when they demand it, we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come," despite the fact that State Street knew that many of the Fund's investors, including its internal advisory groups and State Street Corporation's pension plan, had redeemed their entire investment in the Fund. In addition, the letter failed to disclose that State Street had already sold the Fund's most liquid investments and used the cash from those sales to meet investor redemptions.

32. On October 5, 2007, State Street sent another letter to all of its clients concerning a recent lawsuit filed by an investor for losses in funds invested in the Fund. This letter represented:

> Unfortunately, due to certain client redemptions, we were obligated to sell otherwise unimpaired assets into a market which was largely illiquid creating realized losses. These redemptions were a contributing factor in the negative returns. They were not the result of any failure on the part of SSgA's investment management...

However, these redemptions, which included State Street Corporation's pension plan's redemption, in part resulted from State Street's own actions that led to decisions by State Street's internal advisory groups to redeem or recommend redemption of the Fund and the related funds.

Violations

33. As a result of the conduct described above, State Street violated Section 17(a)(2) and Section 17(a)(3) of the Securities Act in that, in the offer and sale of securities and by the use of the means and instruments of transportation or communication in interstate commerce or by use of the mails, it directly or indirectly has obtained money or property by making untrue statements of material fact and/or by omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. In addition, in violation of Section 17(a)(3) of the Securities Act, State Street engaged in the transactions, practices, or courses of business described above that operated or would operate as a fraud or deceit upon the purchasers of such securities.

Respondent's Cooperation and Remedial Acts

34. In determining to accept State Street's settlement offer, the Commission took into account the company's remediation and its cooperation. Among other things, State Street: (a) replaced key senior personnel and portfolio managers; (b) conducted a review of its procedures and revised its risk controls; (c) entered into private settlements agreeing to pay over $300 million to investors; (d) agreed to pay an additional $250 million to compensate investors; and (e) recently agreed – pursuant to a limited privilege waiver – to provide information it was not otherwise obligated to provide to enable the Commission to assess the potential liability of individuals with respect to certain investor communications.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, it is hereby ORDERED that State Street shall cease and desist from committing or causing any violations, and any future violations of Section 17(a)(2) and Section 17(a)(3) of the Securities Act.

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. 61502 / February 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13777

In the Matter of

Granite Financial Group, LLC,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Granite Financial Group, LLC ("Granite" 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, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Granite, a Delaware limited liability company located in San Diego, California, is a registered broker-dealer. From 2003 to 2005, Granite provided securities brokerage services to several investment advisers to hedge funds, including JLF Asset Management, LLC ("JLF").

2. On January 19, 2010, a final judgment was entered by consent against Granite, permanently enjoining it from future violations of Section 17(a)(2) and (3) of the Securities Act of 1933, in the civil action entitled Securities and Exchange Commission v. Travis, et al., Civil Action Number 09-CV-2288 (PKC), in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that, Granite paid for the personal expenses of two JLF employees in exchange for the JLF employees directing a significant amount of the JLF Funds' securities trades through Granite. The personal expenses included rent for a JLF employee's residence and car service. Granite received commissions for executing the JLF Funds' trades. The JLF employees concealed the scheme, and the material conflicts of interest that it created, from the investment adviser's hedge fund clients, which operated as a fraud and deceit on investors.

Undertakings

Respondent has undertaken to:

4. Respondent Granite shall retain, within 30 days of the date of this Order, the services of an Independent Compliance Consultant not unacceptable to the staff of the Commission. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by Granite and Granite shall require the Independent Compliance Consultant to conduct a comprehensive review of Granite's supervisory, compliance, and other policies and procedures designed to detect and prevent breaches of the firm's policies and the federal securities laws with respect to the provision of gifts, travel, and entertainment by Granite and its employees. This review shall include, but shall not be limited to, a review of Granite's travel and entertainment of, and gifts to, customers and prospective customers; the provision of training for employees regarding travel and entertainment of, and provision of gifts to, customers; and supervisory review and approval of travel and entertainment expenses submitted by Granite's employees. Granite shall cooperate fully with the Independent Compliance Consultant and shall provide the Independent Compliance Consultant with access to its files, books, records, and personnel as reasonably requested for the review.

   a. Granite shall require that, at the conclusion of the review, which in no event shall be more than 120 days after the date of entry of this Order, the Independent Compliance Consultant shall submit a

Report to Granite and to the staff of the Commission. Granite shall require the Independent Compliance Consultant to address in the Report the issues described in the above paragraph of these undertakings, and to include a description of the review performed, the conclusions reached, the Independent Compliance Consultant's recommendations for changes in or improvements to Granite's policies and procedures, and a procedure for implementing the recommended changes in or improvements to Granite's policies and procedures.

b. Granite shall adopt all recommendations contained in the Report of the Independent Compliance Consultant; provided, however, that within 150 days from the date of the entry of this Order, Granite shall in writing advise the Independent Compliance Consultant and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Granite considers unnecessary or inappropriate, Granite need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose.

c. As to any recommendation with respect to Granite's policies and procedures on which Granite and the Independent Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 180 days of the date of the entry of this Order. In the event Granite and the Independent Compliance Consultant are unable to agree on an alternative proposal acceptable to the staff of the Commission, Granite will abide by the determinations of the Independent Compliance Consultant.

d. Granite (i) shall not have the authority to terminate the Independent Compliance Consultant, without prior written approval of the staff of the Commission; (ii) shall compensate the Independent Compliance Consultant, and persons engaged to assist the Independent Compliance Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; and (iii) shall not be in and shall not have an attorney-client relationship with the Independent Compliance Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Compliance Consultant from transmitting any information, reports, or documents to the staff of the Commission.

e. Granite shall require the Independent Compliance 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 Compliance Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Granite, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Compliance Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Compliance Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Commission's New York Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Granite, 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.

f. No later than twelve months after the date of entry of this Order, the chief executive officer of Granite shall certify to the Commission in writing that Granite has fully adopted and complied in all material respects with the undertakings set forth in section III herein and with the recommendations of the Independent Compliance Consultant or, in the event of material non-adoption or non-compliance, shall describe such material non-adoption and non-compliance.

g. Granite shall preserve for a period not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of Granite' compliance with the undertakings set forth in section III herein.

h. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above.

i. Other Obligations and Requirements. Nothing in this Order shall relieve Granite of any other applicable legal obligation or requirement, including any rule adopted by the Commission subsequent to this Order.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(4) of the Exchange Act, that Respondent Granite be, and hereby is censured.

Respondent shall comply with the undertakings enumerated in Section III above.

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. 61503 / February 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13778

In the Matter of **David Harrison Baker,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

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

III.

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

1. Baker, age 42, is a resident of Los Angeles, California. From October 2004 to August 2005, he was associated with broker-dealer Schonfeld Securities, LLC ("Schonfeld"). During that time, Baker acted as a sales trader, providing securities trade execution for several investment advisers to hedge funds, including JLF Asset Management, LLC ("JLF").

2. On January 19, 2010, a final judgment was entered by consent against Baker, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940, in the civil action entitled Securities and Exchange Commission v. Travis, et al., Civil Action Number 09-CV-2288 (PKC), in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that: While associated with Schonfeld, Baker entered into an agreement with employees of JLF whereby Baker agreed to pay certain personal expenses of the JLF employees, in exchange for the JLF employees directing JLF Funds' trades to Baker. Baker earned a portion of the commission that Schonfeld charged the JLF Funds for each executed trade. In 2004 and 2005, the JLF employees directed a substantial number of trades through Baker; and at the request of one of JLF's employees, Baker paid personal travel expenses for JLF employees. The JLF employees concealed the bribery scheme, and the material conflicts of interest that it created, from the investment advisor's hedge fund clients, which operated as a fraud and deceit on investors.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Baker be, and hereby is barred from association with any broker or dealer.

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

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61506 / February 4, 2010

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2984 / February 4, 2010

Admin. Proc. File No. 3-13280

In the Matter of DON WARNER REINHARD 174 Watercolor Way, Suite 232 Santa Rosa, Florida 32459	ORDER DENYING SUMMARY AFFIRMANCE AND REMANDING FOR ADDITIONAL PROCEEDINGS

I.

The Division of Enforcement has moved for summary affirmance of an administrative law judge's decision barring Don Warner Reinhard, an associated person with registered investment adviser Magnolia Capital Advisors, Inc. ("Magnolia") and with registered broker-dealer Paragon Financial Group, Inc. ("Paragon"), from associating with any broker or dealer or any investment adviser.[1] The law judge based her decision on the fact that Reinhard had been enjoined from violations of antifraud provisions of the securities laws, Section 17(a) of the Securities Act of 1933,[2] Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder,[3] Sections 206(1), 206(2), 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-4(a)(2) thereunder,[4] and Advisers Act Section 207;[5] and from aiding and abetting violations of books-and-records provisions of Advisers Act Section 204 and Advisers Act Rule

[1] *Don Warner Reinhard*, Initial Decision Rel. No. 370 (Feb. 12, 2009), 95 SEC Docket 14,218.

[2] 15 U.S.C. § 77q(a).

[3] 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5.

[4] 15 U.S.C. §§ 80b-6(1), (2), and (4); 17 C.F.R. § 275.206(4)-4(a)(2).

[5] 15 U.S.C. § 80b-7.

204-2(a)(7).[6] On March 6, 2009, Reinhard filed a petition for review of the law judge's decision, and on March 24, 2009, the Division filed its motion for summary affirmance. For the reasons discussed below, we have determined to deny the Division's motion and remand these proceedings to the law judge.

II.

The circumstances under which the district court entered the injunction are relevant to our disposition of the Division's motion and we briefly describe them here.[7] The Division filed an injunctive complaint against Reinhard on December 13, 2007. The Division alleged that he had defrauded investment advisory clients in connection with the margin purchases of collateralized mortgage obligations ("CMOs"), causing substantial losses for those clients. Reinhard requested and received extensions of time within which to answer but, in fact, never answered the complaint. The Division moved to find Reinhard in default on June 9, 2008, and the clerk entered a default against Reinhard on June 12, 2008. After entry of the default, Reinhard interposed several procedural objections, which the district court deemed to be motions to set aside the default. The district court denied Reinhard's motions and, on July 13, 2008, entered a default judgment against him.[8] The district court entered a permanent injunction against Reinhard on October 3, 2008.[9] On December 8, 2008, the district court conducted a bench trial on the issues of disgorgement, prejudgment interest, and monetary penalties; as a result of that trial, the district court entered its Order for Entry of Judgment requiring Reinhard to pay $5,857,241.09 in disgorgement, $2,258,940.58 in prejudgment interest, and a $120,000 civil money penalty.[10] On October 28, 2009, the Eleventh Circuit affirmed the district court decision.[11]

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[6] 15 U.S.C. § 80b-4 and 17 C.F.R. § 275.204-2(a)(7).

[7] *SEC v. Reinhard*, No. 4:07-CV-529-RH/WCS (N.D. Fla.).

[8] *Reinhard*, No. 4:07-CV-529-RH/WCS (N.D. Fla. July 13, 2008).

[9] *Reinhard*, No. 4:07-CV-529-RH/WCS (N.D. Fla. Oct. 3, 2008).

[10] *Reinhard*, No. 4:07-CV-529-RH/WCS (N.D. Fla. Dec. 8, 2008). The district court stated that "[t]he government's proof at trial established that, from January 2002 through July 2003, from the transactions at issue, Mr. Reinhard received commissions of $5,857,241.09." The district court further stated that "[b]ased on the facts as admitted by the default and considering all of the circumstances, I conclude that a [$120,000] penalty is warranted." The district court did not further identify or discuss the circumstances affecting its sanctioning decision.

[11] *SEC v. Reinhard*, No. 09-10213, 2009 U.S. App. LEXIS 23744 (11th Cir. Oct. 28, 2009) (*per curiam*).

III.

On October 27, 2008, we issued an Order Instituting Proceedings ("OIP") alleging that Reinhard had been enjoined based on conduct between January 2002 and August 2003 while he was associated with a registered investment adviser and registered broker-dealer. Advisers Act Sections 203(e) and (f) and Exchange Act Sections 15(b)(4) and (6) allow for imposition of sanctions on a person associated with an investment adviser or broker or dealer, consistent with the public interest, if the person has been permanently enjoined from engaging in any conduct or practice in connection with the purchase or sale of securities.[12]

On December 1, 2008, Reinhard answered the OIP by challenging factual allegations in the injunctive complaint. Among other things, Reinhard asserted that the losses his clients suffered were not the result of his actions but of "illegal liquidation of their investment accounts by Bear Stearns as a result of numerous admitted errors during the period of July 2003."[13] Reinhard also asserted that all of the clients who suffered losses were sophisticated investors who were fully aware of, and accepted, the risks involved in their investments, that he and his wife participated in the same investments as the clients and lost "approximately $1 million," and that allegedly false quarterly statements provided by Magnolia to clients were the fault of "Bear Stearns as custodian of the CMOs" for Magnolia.

On December 18, 2008, the Division moved for summary disposition pursuant to Commission Rule of Practice 250(a).[14] In support, the Division attached three exhibits to its motion: the injunctive complaint, the order of injunction, and the Order to Enter Judgment. Reinhard's opposition to the Division's motion, which asserted that "there are numerous issues of material fact," did not include any exhibits. Reinhard's Answer to the OIP attached eight exhibits consisting primarily of offering documents in connection with the transactions at issue in the injunctive proceeding and correspondence between Reinhard and Commission staff. However, the initial decision admits only the Division's three exhibits and is based solely on those exhibits.

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12 15 U.S.C. §§ 80b-3(e) and (f); 15 U.S.C. §§ 78*o*(b)(4) and (6).

13 Reinhard stated that Bear Stearns & Co., Inc. and Bear Stearns Securities Corp., Inc. (collectively "Bear Stearns") acted as Paragon's clearing agent with respect to the transactions at issue and the custodian of clients' accounts.

14 17 C.F.R. § 201.250(a). Rule of Practice 250(a) provides that a party to the administrative proceeding may move for summary disposition. Such motions may be granted "if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law." 17 C.F.R. § 201.250(b). For purposes of determining if there is a "genuine issue with regard to any material fact," Rule 250(a) provides further that "the facts of the pleadings of the party against whom the motion is made shall be taken as true" subject to certain exceptions. 17 C.F.R. § 201.250(a).

The law judge did not address any of the factual issues raised by Reinhard in his answer to the OIP because, she held, "the Commission does not permit a respondent to relitigate issues that were addressed in a previous civil proceeding against the respondent."[15] The law judge determined that summary disposition was appropriate because

> [t]here is no genuine issue with regard to any fact that is material to this proceeding. All material facts that concern the activities for which Reinhard was enjoined were decided against him in the civil case on which this proceeding is based. Any other facts in his pleadings have been taken as true pursuant to 17 C.F.R. § 201.250(a).

The law judge determined that the statutory requirements for the imposition of sanctions were met. Based on the allegations of the injunctive complaint, the provisions of the injunction, her own characterization of Reinhard's conduct before the district court as "dilatory,"[16] and the district court's findings with respect to disgorgement, pre-judgment interest, and civil money penalties, the law judge concluded that Reinhard should be barred from associating with any broker, dealer, or investment adviser.

IV.

Rule of Practice 411(e)(2) provides that the Commission may summarily affirm an initial decision if the Commission determines that no issue raised in the proceeding warrants further consideration.[17] That rule provides further that the Commission may deny a motion for summary affirmance upon a reasonable showing that, among other reasons, the initial decision embodies "an exercise of discretion . . . that is important and that the Commission should review."[18] In support of its motion, the Division argues that summary affirmance is warranted because Reinhard "does not dispute, nor could he, the material facts relevant to this administrative proceeding," which are, according to the Division, that he defaulted in the Injunctive Proceeding; that the district court entered a permanent injunction against him; and that he was enjoined for conduct while he was associated with a broker-dealer and an investment adviser.

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15 For support, the law judge cited three of our cases involving federal court injunctions entered against respondents following trials or summary judgment. *James E. Franklin*, Securities Exchange Act Rel. No. 56,649 (Oct. 12, 2007), 91 SEC Docket 2708 (injunction entered after jury trial); *John Francis D'Acquisto*, 53 S.E.C. 440 (1998) (injunction entered after summary judgment); *Demitrious Julius Shiva*, 52 S.E.C. 1247 (1997) (injunction entered after trial). None of the authorities cited involved injunctions entered by default.

16 The district court's Order for Entry of Judgment does not include such a finding.

17 17 C.F.R. § 201.411(e)(2).

18 *Id.*

We previously have noted that "[s]ummary affirmance is rare, given that generally we have an interest in articulating our views on important matters of public interest and the parties have a right to full consideration of those matters."[19] Summary affirmance is appropriate when it is clear that "submission of briefs by the parties will not benefit us in reaching a decision."[20] We do not believe that is the case here.

Nor do we believe that the law judge's earlier determination to grant the Division's motion for summary disposition was appropriate. In determining the need for assessment of sanctions in the public interest, we, like the law judge, are guided by the factors identified in *Steadman v. SEC*.[21] These factors include the egregiousness of Reinhard's actions, the isolated or recurrent nature of his conduct, the degree of his scienter, the sincerity of his assurances against future violations, his recognition of the wrongful nature of his conduct, and the likelihood that his occupation will present opportunities for future violations.[22] While the record appears to provide the statutory basis for the imposition of sanctions against Reinhard -- *i.e.*, he was enjoined while associated with an investment adviser and a broker-dealer -- we question whether the record is sufficient to address, in a meaningful manner, the public interest.

The disposition of this proceeding was based on three documents: the injunctive complaint, the injunctive order, and the Order to Enter Judgment. Such evidence can, under certain circumstances, provide an ample basis for the assessment of sanctions, as when the parties have litigated the allegations made in the injunctive complaint, or when the injunction has been entered by consent.[23] We have repeatedly held that a respondent in an administrative proceeding of this type, a so-called "follow-on" proceeding, may not challenge the findings made by the court in the underlying proceeding or, where he has consented to an injunction, the

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19 *Richard E. Cannistraro*, 53 S.E.C. 388, 389 n.3 (1998); *see also Terry T. Steen*, 52 S.E.C. 1337, 1338 (1997) (denying summary affirmance and noting that such action is appropriate only where there are "compelling reasons").

20 *Cannistraro*, 53 S.E.C. at 389 n.3.

21 603 F.2d 1126, 1140 (5th Cir. 1979).

22 *Id.*

23 *See, e.g.*, *Franklin*, 91 SEC Docket at 2708 (bar imposed based on injunction entered after jury trial); *Jeffery L. Gibson*, Exchange Act Rel. No. 57,266 (Feb. 4, 2008), 92 SEC Docket 2104, 2111-12 (bar imposed based on consent injunction), *petition dismissed*, No. 08-3377 (6th Cir. Mar. 11, 2009).

allegations made in that underlying proceeding, and we consider those findings or allegations in determining the appropriate sanction.[24]

Here, however, the injunction was entered by default, and the record before us indicates that the court made limited findings regarding the allegations made in the injunctive complaint.[25] Although the district court stated that, "[b]y his default, Mr. Reinhard in effect admitted the fraud alleged in the complaint," the Supreme Court has held that "[i]n the case of a judgment entered by . . . default, none of the issues is actually litigated. Therefore [issue preclusion, or collateral

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[24] *See, e.g.*, *Franklin*, 91 SEC Docket at 2708 ("It is well established that [respondents are] collaterally estopped from challenging in [follow-on] administrative proceeding the decisions of the district court in the injunctive proceeding."); *Marshall E. Melton*, 56 S.E.C. 695, 712 (2003) (stating that "[d]efendants in Commission injunctive actions must understand that, if the Commission institutes an administrative proceeding against them based on an injunction to which they consented after issuance of this opinion, they may not dispute the factual allegations of the injunctive complaint in the administrative proceeding"); *see also* 17 C.F.R. § 202.5 ("announc[ing Commission] policy not to permit a defendant . . . to consent to a judgment . . . or order that imposes a sanction while denying the allegations in the complaint . . . .").

[25] As discussed, after entry of the default judgment against Reinhard, the district court held a hearing with respect to the amount of disgorgement and penalties to be assessed. The Order to Enter Judgment which followed that hearing did not address issues of liability but merely made findings regarding the amount of commissions received by Reinhard as a result of the transactions at issue. There could be cases, however, in which a district court receives evidence and makes findings following entry of a default judgment with relevance to our sanctions analysis. In such a situation, summary disposition may be appropriate.

estoppel] does not apply with respect to any issue in a subsequent action."[26] Under these circumstances, we believe that our consideration of the public interest would be assisted by the introduction of additional evidence addressing the factors identified in *Steadman*.

Accordingly, it is ORDERED that the motion for summary affirmance by the Division of Enforcement be, and it hereby is, denied; and it is further

ORDERED that this proceeding be, and it hereby is, remanded for further proceedings consistent with this Order.

By the Commission.

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

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[26] *Arizona v. California*, 530 U.S. 392, 414 (2000) (quoting *Restatement (Second) of Judgments*, § 27 cmt. e, p. 257 (1982)); *but see Harold F. Harris*, Exchange Act Rel. No. 53,122A (Jan. 13, 2006), 87 SEC Docket 362, 369 (preclusive effect given to default injunction where district court's accompanying findings took account of "substantive defenses argued by Respondents" in late-filed answer); *Thomas J. Donovan*, Exchange Act Rel. No. 52,883 (Dec. 5, 2005) 86 SEC Docket 2652, 2653 (sanctions based on default injunction, but law judge conducted hearing accepting documents and testimony that related to the misconduct at issue and the public interest); *Lamb Bros., Inc.*, 46 S.E.C. 1053, 1058-59 (1977) (sanctions imposed based on default injunction but "allegations made in the injunctive suit [were] remade" in administrative proceeding and "an evidentiary record with respect to those matters was developed").

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61504 / February 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13779

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

I.

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

II.

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

III.

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

1. Schreiber, is the owner, Chief Executive Officer, and President of Granite Financial Group, LLC ("Granite"), a registered broker-dealer. From 2003 to 2005, Schreiber and Granite provided securities brokerage services to several investment advisers to hedge funds, including JLF Asset Management, LLC ("JLF").

2. On January 19, 2010, a final judgment was entered by consent against Schreiber, permanently enjoining him from future violations of Section 17(a)(2) and (3) of the Securities Act of 1933, in the civil action entitled Securities and Exchange Commission v. Travis, et al., Civil Action Number 09-CV-2288 (PKC), in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that, Schreiber caused Granite to pay for the personal expenses of two JLF employees in exchange for the JLF employees directing a significant amount of the JLF Funds' securities trades through Granite. The personal expenses included rent for a JLF employee's residence and car service. Schreiber personally profited from the commissions Granite generated for executing the JLF Funds' trades. The JLF employees concealed the scheme, and the material conflicts of interest that it created, from the investment adviser's hedge fund clients, which operated as a fraud and deceit on investors.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Schreiber be, and hereby is censured.

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. 61511 / February 8, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13780

In the Matter of J. BENNETT GROCOCK, Esq. Respondent.	CORRECTED ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING SUSPENSION PURSUANT TO RULE 102(e)(3)(i) OF THE COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(3)(i)[1] of the Commission's Rules of Practice against J. Bennett Grocock ("Respondent" or "Grocock").

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 in which the Commission is a party, and without admitting or denying the findings contained in the Order, except with respect to the findings contained in paragraph III.B.3 below, which are admitted, Respondent consents to the entry of this Order.

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

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . attorney . . . who has been by name . . . (A) permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating . . . any provision of the Federal securities laws or of the rules and regulations thereunder.

III.

The Commission finds that:

A. RESPONDENT

1. Grocock is and has been an attorney licensed to practice in the State of Florida.

B. COURT PROCEEDINGS & INJUNCTION

2. On October 29, 2009, the Commission filed a complaint against Grocock in the U.S. District Court for the Middle District of Florida, alleging that Grocock violated Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, 15 U.S.C. 77e(a), 77e(c), and 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. *See SEC v. Grocock*, 09cv1833 (M.D. Fla. 2009).

3. On November 10, 2009, the U.S. District Court for the Middle District of Florida entered its final judgment on consent against Grocock, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933 and Section 10 of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. *See SEC v. Grocock*, 09cv1833 (M.D. Fla. 2009).

IV.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Grocock, an attorney, from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of these findings, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Grocock's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that Grocock be, and hereby is, suspended from appearing or practicing before the Commission.

By the Commission.

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Elizabeth Murphy
Secretary

Commissioner Walter
not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61516 / February 12, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3113 / February 12, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13781

In the Matter of **Michael J. Byrd, CPA** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Michael J. Byrd ("Respondent" or "Byrd") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Byrd, age 49, is and has been a certified public accountant licensed to practice in the State of California, and his license has lapsed. From approximately May 1999 until May 2001, he served as Chief Financial Officer of Brocade Communications Systems, Inc. ("Brocade"), and then became Brocade's Chief Operating Officer from May 2001 until January 2003.

2. Brocade has been, at all relevant times, a Delaware corporation which develops and sells storage networking products, with its principal place of business in San Jose, California. Since May 1999 when it completed its initial public offering of stock, Brocade had common stock registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the NASDAQ National Market.

3. On August 17, 2007, the Commission filed a complaint against Byrd in the United States District Court for the Northern District of California. *SEC v. Byrd*, No. C-07-4223-CRB. On February 3, 2010, the Court entered an order enjoining Byrd, by consent, from future violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"), Sections 13(b)(5) and 16(a) of the Exchange Act, and Rules 13b2-1, 13b2-2, and 16a-3 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. Byrd was also ordered to pay disgorgement of $225,000 plus prejudgment interest thereon in the amount of $24,843, for a total amount of $249,843, and a $175,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Brocade concealed millions of dollars in expenses from investors and overstated its income through a scheme executed by its Chief Executive Officer to backdate employee stock options. The complaint further alleged that at various times during his tenure at Brocade, Byrd was consulted on options grants, and, as a result, should have fully investigated to determine whether Brocade's financial statements accurately reflected the necessary compensation expenses, as required under generally accepted accounting principles.

IV.

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

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

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

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

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

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

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

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

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

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

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

By the Commission.

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. 61518 / February 16, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3114 / February 16, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12326

In the Matter of Nevanna Sacks, CPA	ORDER GRANTING APPLICATION FOR REINSTATEMENT TO APPEAR AND PRACTICE BEFORE THE COMMISSION AS AN ACCOUNTANT RESPONSIBLE FOR THE PREPARATION OR REVIEW OF FINANCIAL STATEMENTS REQUIRED TO BE FILED WITH THE COMMISSION

On June 7, 2006, Nevanna Sacks, CPA ("Sacks") was denied the privilege of appearing or practicing as an accountant before the Commission as a result of settled public administrative proceedings instituted by the Commission against Sacks pursuant to Rule 102(e) of the Commission's Rules of Practice.[1] Sacks consented to the entry of the order without admitting or denying the findings therein. This order is issued in response to Sacks's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

The Commission alleged that Sacks engaged in improper professional conduct with respect to certain audits and reviews of Peregrine Systems, Inc.'s ("Peregrine") financial statements by Arthur Andersen LLP ("Andersen"). Sacks served as audit manager on Andersen's audit of Peregrine's fiscal year 2001 financial statements and review of the company's quarterly financial statements for the third quarter of 2001 and the first, second and third quarters of 2002. Sacks engaged in improper professional conduct by repeatedly engaging in unreasonable conduct, resulting in a violation of applicable professional standards that indicated a lack of competence to practice before the Commission. Sacks (i) failed to adequately audit Peregrine's accounts receivable; (ii) did not obtain sufficient competent evidential matter to conclude that Peregrine had a history of collecting on certain sales; (iii) failed to make adequate inquiries into Peregrine's agreements with customers; (iv) failed to obtain sufficient competent evidential matter to afford a reasonable basis for Andersen to issue a report on the financial

[1] *See* Accounting and Auditing Enforcement Release No. 2441 dated June 7, 2006. Sacks was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.

statements of Peregrine, which consolidated the financial statements of Peregrine Germany, a material subsidiary, after Arthur Andersen Germany refused to provide an audit report on the financial statements of Peregrine Germany; (v) failed to exercise due professional care in connection with Peregrine's false and misleading response to a Commission Comment Letter; and (vi) failed to exercise due professional care in connection with the audit and reviews.

In her capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Sacks attests that she will undertake to have her work reviewed by the independent audit committee of any company for which she works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Sacks is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If she should wish to resume appearing and practicing before the Commission as an independent accountant, she will be required to submit an application to the Commission showing that she has complied and will comply with the terms of the original order, which denied her privilege of appearing and practicing before the Commission as an accountant, in this regard. Therefore, the denial of Sacks's privilege of appearing or practicing before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."[2] This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Sacks, it appears that she has complied with the terms of the June 7, 2006 order denying her the privilege of appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to her character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against her pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Sacks, by undertaking to have her work reviewed by the independent audit committee of any company for which she works, or in some other manner acceptable to the Commission, in her practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

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[2] Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Nevanna Sacks, CPA is hereby reinstated to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61541 / February 18, 2010

Admin. Proc. File No. 3-13648

In the Matter of the Application of EDWARD J. JAKUBIK, JR. c/o De Meo & Feigin, L.L.C. 125 Half Mile Road, Suite 200 Red Bank, NJ 07701 For Review of Disciplinary Action Taken by FINRA	ORDER GRANTING MOTION TO DISMISS APPLICATION FOR REVIEW

On October 13, 2009, Edward J. Jakubik, Jr., formerly a registered representative associated with Grayson Financial LLC ("Grayson Financial" or the "Firm"), a FINRA member firm, filed an application requesting that the Commission set aside a default decision by an NASD Hearing Panel that became final on December 13, 2004 and cancel the bar that had been imposed on Jakubik by that decision.[1] On November 4, 2009, NASD filed a motion to dismiss Jakubik's application for review.[2] NASD asserts that Jakubik failed to exhaust his administrative remedies in not appealing the default decision. Alternatively, NASD contends that Jakubik's application should be denied because it was filed long after the deadline for appeals to the Commission of self-regulatory organization disciplinary action. For the reasons discussed below, we have determined to grant NASD's motion and dismiss Jakubik's application.

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[1] On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Because the disciplinary action here was instituted before that date, we continue to use the designation NASD.

[2] NASD also requested that we stay the issuance of a briefing schedule while its motion remained pending. In light of our order, we do not address this request.

I.

On May 24, 2004, NASD's Department of Enforcement ("Enforcement") issued a complaint against Jakubik alleging that he had violated NASD Conduct Rule 2110 and IM-2310-2[3] by executing unauthorized trades in customer accounts.[4] In its notice accompanying the complaint, issued the same day as the complaint, Jakubik was advised that he was "required . . . by no later than **June 21, 2004**, to answer this Complaint" [emphasis in original].[5] Jakubik does not dispute that he received copies of the complaint and notice and, according to Enforcement's Regional Counsel who was assigned to this matter, Jakubik confirmed that he received these documents in a phone call to the Regional Counsel in which Jakubik expressed his interest in reaching a settlement. Although he contacted Enforcement about a possible settlement on June 11, 2004, Jakubik did not answer the complaint by June 21, 2004 or afterwards.[6]

On June 23, 2004, Enforcement sent a second notice of the complaint to Jakubik.[7] This notice advised Jakubik that, "[Jakubik's] failure to submit an answer to the Complaint . . . on or

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3 NASD Conduct Rule 2210 requires that members and associated persons observe high standards of commercial honor and just and equitable principles of trade and IM-2310-2 imposes a requirement of "fair dealing" with customers.

4 According to the complaint, Jakubik made unauthorized purchases of Loral Space & Communications shares between November 2001 and April 2002 for the accounts of four customers.

5 On May 24, 2004, Enforcement served the complaint and notice by sending copies of both to Jakubik by certified and first class mail. One copy was sent to Jakubik's most current residential address as disclosed in the Central Registration Depository ("CRD"), 315 E. 77th Street, Apt. 3F, New York, NY 10021 (the "CRD Address"). Another copy was sent to 16 Carlisle Terrace, Little Silver, NJ 07739 (the "New Jersey Address"), which Enforcement had reason to believe was actually Jakubik's current residence. The certified mailing to the CRD Address was returned, marked "Returned to Sender, Attempted - Not Known." The first class mailing to the CRD Address was returned, marked "Returned to Sender, Moved, not forwardable." The certified mailing to the New Jersey Address was returned with confirmed delivery of May 28, 2004 and bearing an illegible signature.

6 On June 25, 2004, Enforcement sent Jakubik a proposed offer of settlement but did not receive a response back from him.

7 Enforcement served this notice by sending it to Jakubik's CRD and New Jersey Addresses, again by first class and certified mail. The first class mailing to the CRD Address was not returned. The certified mailing to the CRD Address was returned marked "Returned to Sender, Unclaimed." Neither the first class nor the certified mailing sent to Jakubik's New Jersey Address was returned.

before July 12, 2004, shall allow the [NASD] Hearing Officer, in the exercise of his or her discretion, to: (1) treat as admitted by [Jakubik] the allegations in the complaint; and (2) enter a default decision against [him] . . . ." The notice also told Jakubik that "[t]he case may be decided on that basis and sanctions may be assessed against [him] without further notice." Jakubik did not answer the complaint by July 12, 2004 or afterwards.

Enforcement filed a motion on September 13, 2004 for entry of a default decision and a request for sanctions.[8] On November 16, 2004, the NASD Hearing Officer, acting pursuant to NASD Procedural Rules 9215(f) and 9269,[9] entered a default decision against Jakubik and barred him.[10]

The Hearing Officer's Notice of Default Decision advised Jakubik that the decision would "become the final decision of NASD 25 days after service of the Decision upon [Jakubik] unless either [he] or . . . Enforcement appeals to the [NASD] National Adjudicatory Council ("NAC"),

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[8] Enforcement served this motion by sending it to Jakubik by first class mail at both his CRD and New Jersey Addresses.

[9] NASD Procedural Rule 9215(f) provides, as relevant here, that, if a respondent fails to file an answer or response to an Enforcement complaint "within the time required, the Department of Enforcement . . . shall send a second notice to such Respondent requiring an answer within 14 days after service of the second notice." This second notice is required to advise the respondent that further failure to reply within the period specified "shall allow the Hearing Officer, in the exercise of his or her discretion, pursuant to Rule 9269 to: (1) treat as admitted by the Respondent the allegations in the complaint; and (2) issue a default decision against the Respondent." Procedural Rule 9269 authorizes a hearing officer to issue a default decision in accordance with the notice provisions of Rule 9215(f) and directs that, if the "default decision is not appealed . . . within 25 days after the date the Office of Hearing Officers serves it on the Parties, the default decision shall become the final disciplinary action" of NASD.

[10] In reaching his decision to bar Jakubik, the Hearing Officer concluded that the trades were "quantitatively egregious" and warranted a "severe sanction." He found that there was "strong" evidence that the trades were unauthorized, noting that, not only did Jakubik's four customers declare that they had not given their authorization or consent, but the Firm also "immediately cancelled each of them after finding that they were account-opening transactions that were unauthorized." The Hearing Officer further determined that "there is no evidence that Jakubik misunderstood any communication from these customers, or disputed their claims that the trades were unauthorized," nor were there any mitigating circumstances that would warrant a sanction less than a bar.

or the NAC calls the Decision for Review."[11] The Hearing Officer served the notice and default decision by sending it to Jakubik by both first class and overnight mail. Jakubik did not appeal to the NAC by December 13, 2004 (25 days after service of the Hearing Officer's decision) or afterwards and the NAC did not call the decision for review. The Hearing Officer's decision, accordingly, became NASD's final disciplinary action on December 13, 2004.

II.

Jakubik does not dispute that he failed to seek review within the specified time period, but claims that we should nevertheless consider his appeal, pursuant to our Rule of Practice 420(b),[12] because, he asserts, there exist "extraordinary circumstances" that warrant our granting his request for an extension of time to file the requisite application. These "extraordinary circumstances," Jakubik alleges, consist of "serious issues of alleged prosecutorial misconduct" by Enforcement during the NASD proceeding and "denial of fair process" by the NASD Hearing Officer. According to Jakubik, Enforcement engaged in prosecutorial misconduct by: (1) offering no evidence at the hearing to show that Jakubik engaged in unauthorized trades, "much less 'egregious' unauthorized trades;" and (2) not submitting certain customer questionnaires and declaration into the record but, instead, having its "prosecuting attorney state in his declaration [to the Hearing Officer] that these [customer] documents 'confirm' that Mr. Jakubik engaged in 'egregious' unauthorized trading in four customer accounts."[13]

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11 A case administrator in NASD's Office of Hearing Officers ("OHO") stated in a declaration attached to NASD's brief that it was OHO's business practice to send decisions and notices of decision to the addresses on the service list it maintains for a case, on the same day the documents are dated, and via the means of service identified at the end of the documents. The case administrator noted that both the CRD and New Jersey Addresses were on OHO's service list for the Jakubik proceeding and that two Federal Express shipment detail sheets show that, on November 16, 2004, OHO made two priority overnight shipments to Jakubik. Jakubik does not dispute that he received this notice.

12 Rule of Practice 420(b), 17 C.F.R. § 201.420(b), requires that an applicant file "an application for review with the Commission within 30 days after the notice of the determination is filed with the Commission and received by the aggrieved person applying for review." Further, the rule provides that the Commission will not extend this 30-day period, "absent a showing of extraordinary circumstances," and that this rule is the "exclusive remedy for seeking an extension of the 30-day period."

13 Jakubik requests that we accept into evidence copies of the three customer questionnaires and customer declaration that NASD "withheld below and that are mischaracterized in its prosecuting attorney's declaration below." We note, as an initial matter, that, contrary to Jakubik's claim, these documents appear to support the allegations against Jakubik since the customers stated in these questionnaires and declaration that they had not

(continued...)

Jakubik further maintains that the Hearing Officer denied him fair process by making findings and a sanction determination "based solely on the inadmissible and misleading hearsay statements of the NASD prosecuting attorney, and *not* on any record evidence [emphasis in original]."[14] As a result, Jakubik argues, "the Hearing Officer failed to give Mr. Jakubik, who was *pro se* and had no prior disciplinary record, the fair process that he was due under 15 U.S.C. § 78o-3(b)(8)."[15] Jakubik asserts that, as a *pro se* party, he did not appreciate the "impropriety of the hearsay statements" made by Enforcement and its failure to provide supporting evidence, nor did he appreciate "the legal ramifications of not appealing the default decision within the 30 day time period set forth in Rule 420(b)."[16]

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13 (...continued)
authorized anyone from Grayson Financial to purchase stock for their accounts. One customer stated in his questionnaire response that he had advised Jakubik that he "would buy the stock," but "only after [the customer] read the paperwork on the same" and that he had assumed that the Firm was "not interested" in his business when his phone messages were not returned.

In any event, Jakubik has failed to satisfy the requirement of Rule 452 of our Rules of Practice, 17 C.F.R. §201.452, that his motion for leave to adduce additional evidence "show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." His motion makes neither required showing. The customer questionnaires and declaration relate only to the merits of the underlying proceeding and have no bearing on whether dismissal is warranted because of Jakubik's purported failure to exhaust his administrative remedies and the untimeliness of this appeal.

14 Jakubik further contends that the bar imposed by the Hearing Officer "far exceeds the sanction imposed on . . . Jakubik's former partner and the subject of the investigative proceeding that was the origin of the complaint against Jakubik." Jakubik also maintains that the bar exceeds the $10,000 fine and one-year suspension sought by Enforcement. He notes that the bar imposed by NASD "had already precluded [him] from associating with a member firm for nearly five years now [and that] [u]nless the Commission agrees to review the default decision, it is more than likely [he] will never have the opportunity to associate with a FINRA member firm again." In light of our finding that Jakubik failed to exhaust his administrative remedies and that his appeal is untimely, we do not address these contentions.

15 Exchange Act § 15A(b)(8), 15 U.S.C. § 78o-3(b)(8), requires that a registered securities association "provide a fair procedure for the disciplining of . . . persons associated with members . . . ."

16 Jakubik explains that "[d]uring the entire time the proceedings below were pending," he was "experiencing financial problems . . . [and] could not afford to retain an attorney to represent him before the Office of Hearing Officers or to advise him regarding the
(continued...)

Jakubik argues that the "Commission's interest in determining whether the alleged prosecutorial misconduct occurred and whether Mr. Jakubik received the fair process he was due strongly outweighs FINRA's interest in having the NAC rule on those issues in the first place." He urges that the Commission "exercise its discretion to accept [his] application for review without requiring [him] to first appeal the default decision to the NAC."[17]

NASD maintains that Jakubik's appeal should be denied because he failed to exhaust his administrative remedies in not challenging the Hearing Officer's decision. NASD asserts that, once the Hearing Officer issued his default decision, Jakubik failed to pursue either of the two administrative options available to him under NASD rules to challenge the decision, *i.e.*, (1) filing a motion with NASD's Office of Hearing Officers to set aside the default; or (2) filing a written notice of appeal to the NAC within 25 days after service of the default decision. NASD argues that, consistent with Commission precedent, we should not consider Jakubik's application for review and "should refrain from addressing any of the numerous merit-based arguments that Jakubik advances here."

Alternatively, NASD argues that Jakubik's application for review does not establish his claim of extraordinary circumstances and should, therefore, be dismissed as untimely. According to NASD, "[a] showing of extraordinary circumstances must explain why the appeal was not and could not be filed on time." Noting that Jakubik filed his appeal with the Commission nearly five years after the default decision became NASD's final disciplinary action, NASD contends that Jakubik's arguments purporting to establish the existence of extraordinary circumstances "lack merit," and that "nearly all of the arguments that Jakubik has advanced in his extension request . . . go to the merits of an appeal," which is irrelevant in determining whether extraordinary circumstances exist. To permit Jakubik to have his appeal heard at this late date, NASD argues, "would open the floodgates of late appeals from barred respondents who previously opted not to pursue all their appeal options . . . [and] would also severely frustrate the interests of finality served by the appeal deadline." Accordingly, NASD argues, Jakubik's appeal should be dismissed as untimely.

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16 (...continued)
legal ramifications of not appealing the Default Decision within 30 days of the decision becoming final.

17 Jakubik asks that, if we dismiss his appeal, we do so without prejudice. In support, he cites to *Standard Inv. Chartered, Inc. v. NASD*, 560 F.3d 118 (2d Cir. 2009), for the proposition that a "dismissal for failure to exhaust available administrative remedies should be without prejudice." *Id.* at 124. He cites, however, to no provision in our Rules of Practice or relevant Commission precedent to support his request, and we are aware of none. In any event, as discussed below, our order dismissing Jakubik's application is based not only on his failure to exhaust his administrative remedies but also on his failure to meet the filing deadline for submitting his appeal to us, and we therefore deny his request.

III.

We agree with NASD and conclude that we should dismiss Jakubik's appeal. Jakubik failed to exhaust his administrative remedies by appealing to the NAC, as required by NASD's rules. We have repeatedly held that "the Commission will not consider an application for review if the applicant failed to follow NASD procedures."[18] These procedures serve an important regulatory purpose. As we recently explained, "NASD's rules are designed to provide for a timely reexamination by the NAC of decisions of various hearing panels before NASD's action can be brought before us for review . . . [and that [t]]o allow the bypassing of the NAC . . . would tend to destroy the effectiveness of these procedures."[19] The United States Court of Appeals for the Second Circuit expanded on this in *MFS Securities Corp. v. SEC*:

> Were SRO members, or former SRO members, free to bring their SRO-related grievances before the SEC without first exhausting SRO remedies, the self-regulatory function of SROs could be compromised. Moreover, like other administrative exhaustion requirements, the SEC's promotes the development of a record in a forum particularly suited to create it, upon which the Commission and, subsequently, the courts can more effectively conduct their review. It also provides SROs with the opportunity to correct their own errors prior to review by the Commission. The SEC's exhaustion requirement thus promotes the efficient resolution of disciplinary disputes between SROs and their members and is in harmony with Congress's delegation of authority to SROs to settle, in the first instance, disputes relating to their operations.[20]

Here, Jakubik did not follow the clear steps provided under NASD's rules to appeal the Hearing Officer's decision and bar. Jakubik was specifically advised in the Hearing Officer's opinion that, pursuant to those rules, the decision would become the final decision of NASD twenty-five days after service of the decision upon Jakubik unless he appealed to the NAC. It is undisputed that Jakubik was properly served once the default decision was entered and that he did not seek to set aside the default or appeal to the NAC by this deadline or, in fact, at any time afterwards. We conclude, therefore, that the regulatory purposes underlying the exhaustion doctrine would not be

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18 *Jeffrey A. King*, Securities Exchange Act Rel. No. 52571 (Oct. 7, 2005), 86 SEC Docket 1439, 1443; *Lee Gura*, 57 S.E.C. 972, 976 (2004) (same); *David I. Cassuto*, 56 S.E.C. 565, 570 (2003) (same). *See also Calvin David Fox*, Exchange Act Rel. No. 54840 (Nov. 30, 2006), 89 SEC Docket 1282, 1284 (holding that applicant's "failure to exhaust his remedies at the NYSE precludes our consideration of his application for review").

19 *Florence Sarah Pollard*, Exchange Act Rel. No. 55978 (June 28, 2007), 90 SEC Docket 2909, 2910 (internal quotation omitted).

20 380 F.3d 611, 621-22 (2d Cir. 2004).

served if we were to consider Jakubik's application for review without his having first allowed the NAC to consider the issues raised in this appeal.

We have stated that "parties to administrative proceedings have an interest in knowing when decisions are final and on which decisions their reliance can be placed."[21] We thus agree with NASD that Jakubik's appeal is untimely. Nowhere does he explain why he waited nearly five years to file his application despite the fact that he received timely notice of the NASD action. Moreover, in our view, Jakubik's arguments that "extraordinary circumstances" exist to justify our hearing this appeal are misplaced. Jakubik offers various challenges to Enforcement's and the Hearing Officer's actions and decision in the prior proceeding, but fails to present the kind of circumstances required to justify an extension of the appeal filing deadline, particularly given the extreme delay in the filing of his appeal.[22]

Accordingly, it is hereby ORDERED that NASD's motion to dismiss the application for review filed by Edward J. Jakubik, Jr. be, and it hereby is, GRANTED.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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21 *Robert M. Ryerson*, Exchange Act Rel. No. 57839 (May 20, 2008), 93 SEC Docket 6058, 6061 (quoting *Lance E. Van Alstyne*, 53 S.E.C. 1093, 1098 n.10 (1998)).

22 *Cf. Ryerson*, 93 SEC Docket at 6064 (holding that extraordinary circumstances did not exist where, among other things, NASD "did not cause the fourteen-month delay between the issuance of the NAC decision and the filing of the petition before [the Commission]" but rather the delay "resulted from [Ryerson's] deliberate choice not to appeal . . . .").

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61532 / February 18, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13783

In the Matter of **Platinum & Gold, Inc.,** **PNI Technologies, Inc.,** **Pride Business Development Holdings, Inc.,** **Probex Corp.,** **Property Capital Trust, Inc.** **Protech, Inc.,** **Provell, Inc.,** **PSINet, Inc.,** **PT. Inti Indorayon Utama (n/k/a P.T. Toba Pulp Lestari Tbk), and** **PT. Riau Andalan Pulp & Paper,** **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 Platinum & Gold, Inc., PNI Technologies, Inc., Pride Business Development Holdings, Inc., Probex Corp., Property Capital Trust, Inc., Protech, Inc., Provell, Inc., PSINet, Inc., PT. Inti Indorayon Utama (n/k/a P.T. Toba Pulp Lestari Tbk), and PT. Riau Andalan Pulp & Paper.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Platinum & Gold, Inc. (CIK No. 1081084) is a permanently revoked Nevada corporation located in Sunrise, Florida with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Platinum & Gold 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 $101,817 for the prior nine months.

2. PNI Technologies, Inc. (CIK No. 893335) is a revoked Georgia corporation located in Norcross, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PNI 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, 2001, which reported a net loss of over $26 million for the prior six months. As of February 16, 2010, the company's stock (symbol "PNLG") was traded on the over-the-counter markets.

3. Pride Business Development Holdings, Inc. (CIK No. 1137667) is a defaulted Nevada corporation located in Metairie, Louisiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pride is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended September 30, 2006, which reported a net loss of over $17 million for the prior nine months. As of February 16, 2010, the company's stock (symbol "PDVG") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc.

4. Probex Corp. (CIK No. 845880) is a void Delaware corporation located in Addison, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Probex 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, 2002, which reported a net loss of over $10.8 million for the prior three months. On May 13, 2003, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of Texas, which was still pending as of March 23, 2009. As of February 16, 2010, the company's stock (symbol "PRBX") was traded on the over-the-counter markets.

5. Property Capital Trust, Inc. (CIK No. 80718) is a Massachusetts corporation located in Boston, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Property Capital 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.

6. Protech, Inc. (CIK No. 802142) is a permanently revoked Nevada corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Protech 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, 1993, which reported a net loss of over $1.28 million for the prior nine months.

7. Provell, Inc. (CIK No. 883324) is an inactive Minnesota corporation located in Minneapolis, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Provell is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the

period ended December 31, 2001, which reported a net loss of over $79 million for the prior twelve months.

8. PSINet, Inc. (CIK No. 940716) is a dissolved New York corporation located in Ashburn, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PSINet is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2000, which reported a net loss of over $4.96 billion for the prior twelve months.

9. PT. Inti Indorayon Utama (n/k/a P.T. Toba Pulp Lestari Tbk) (CIK No. 865501) is an Indonesian corporation located in Jakarta, Indonesia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PT. Inti 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, 1998, which reported a net loss of over $42.2 million for the prior twelve months.

10. PT. Riau Andalan Pulp & Paper (CIK No. 935804) is an Indonesian corporation located in Jakarta, Indonesia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PT. Riau 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, 1996, which reported a net loss of $26,526 for the prior twelve months.

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 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.

13. 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 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
Platinum & Gold, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Platinum & Gold, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	106
	10-QSB	03/31/01	05/15/01	Not filed	105
	10-QSB	06/30/01	08/14/01	Not filed	102
	10-QSB	09/30/01	11/14/01	Not filed	99
	10-KSB	12/31/01	04/01/02	Not filed	94
	10-QSB	03/31/02	05/15/02	Not filed	93
	10-QSB	06/30/02	08/14/02	Not filed	90
	10-QSB	09/30/02	11/14/02	Not filed	87
	10-KSB	12/31/02	03/31/03	Not filed	83
	10-QSB	03/31/03	05/15/03	Not filed	81
	10-QSB	06/30/03	08/14/03	Not filed	78
	10-QSB	09/30/03	11/14/03	Not filed	75
	10-KSB	12/31/03	03/30/04	Not filed	71
	10-QSB	03/31/04	05/17/04	Not filed	69
	10-QSB	06/30/04	08/16/04	Not filed	66
	10-QSB	09/30/04	11/15/04	Not filed	63
	10-KSB	12/31/04	03/31/05	Not filed	59
	10-QSB	03/31/05	05/16/05	Not filed	57
	10-QSB	06/30/05	08/15/05	Not filed	54
	10-QSB	09/30/05	11/14/05	Not filed	51
	10-KSB	12/31/05	03/31/06	Not filed	47
	10-QSB	03/31/06	05/15/06	Not filed	45
	10-QSB	06/30/06	08/14/06	Not filed	42
	10-QSB	09/30/06	11/14/06	Not filed	39
	10-KSB	12/31/06	04/02/07	Not filed	34
	10-QSB	03/31/07	05/15/07	Not filed	33
	10-QSB	06/30/07	08/14/07	Not filed	30
	10-QSB	09/30/07	11/14/07	Not filed	27
	10-KSB	12/31/07	03/31/08	Not filed	23
	*10-Q**	03/31/08	05/15/08	Not filed	21
	*10-Q**	06/30/08	08/14/08	Not filed	18
	*10-Q**	09/30/08	11/14/08	Not filed	15
	*10-K**	12/31/08	04/01/09	Not filed	10
	*10-Q**	03/31/09	05/15/09	Not filed	9

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	*10-Q**	06/30/09	08/14/09	Not filed	6
	*10-Q**	09/30/09	11/16/09	Not filed	3
Total Filings Delinquent	**36**				
PNI Technologies, Inc.					
	10-Q	09/30/01	11/14/01	Not filed	99
	10-K	12/31/01	04/01/02	Not filed	94
	10-Q	03/31/02	05/15/02	Not filed	93
	10-Q	06/30/02	08/14/02	Not filed	90
	10-Q	09/30/02	11/14/02	Not filed	87
	10-K	12/31/02	03/31/03	Not filed	83
	10-Q	03/31/03	05/15/03	Not filed	81
	10-Q	06/30/03	08/14/03	Not filed	78
	10-Q	09/30/03	11/14/03	Not filed	75
	10-K	12/31/03	03/30/04	Not filed	71
	10-Q	03/31/04	05/17/04	Not filed	69
	10-Q	06/30/04	08/16/04	Not filed	66
	10-Q	09/30/04	11/15/04	Not filed	63
	10-K	12/31/04	03/31/05	Not filed	59
	10-Q	03/31/05	05/16/05	Not filed	57
	10-Q	06/30/05	08/15/05	Not filed	54
	10-Q	09/30/05	11/14/05	Not filed	51
	10-K	12/31/05	03/31/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	45
	10-Q	06/30/06	08/14/06	Not filed	42
	10-Q	09/30/06	11/14/06	Not filed	39
	10-K	12/31/06	04/02/07	Not filed	34
	10-Q	03/31/07	05/15/07	Not filed	33
	10-Q	06/30/07	08/14/07	Not filed	30
	10-Q	09/30/07	11/14/07	Not filed	27
	10-K	12/31/07	03/31/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	21
	10-Q	06/30/08	08/14/08	Not filed	18
	10-Q	09/30/08	11/14/08	Not filed	15
	10-K	12/31/08	04/01/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	9
	10-Q	06/30/09	08/14/09	Not filed	6
	10-Q	09/30/09	11/16/09	Not filed	3

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Total Filings Delinquent	33				
Pride Business Development Holdings, Inc.					
	10-KSB	12/31/06	04/02/07	Not filed	34
	10-QSB	03/31/07	05/15/07	Not filed	33
	10-QSB	06/30/07	08/14/07	Not filed	30
	10-QSB	09/30/07	11/14/07	Not filed	27
	10-KSB	12/31/07	03/31/08	Not filed	23
	*10-Q**	03/31/08	05/15/08	Not filed	21
	*10-Q**	06/30/08	08/14/08	Not filed	18
	*10-Q**	09/30/08	11/14/08	Not filed	15
	*10-K**	12/31/08	04/01/09	Not filed	10
	*10-Q**	03/31/09	05/15/09	Not filed	9
	*10-Q**	06/30/09	08/14/09	Not filed	6
	*10-Q**	09/30/09	11/16/09	Not filed	3
Total Filings Delinquent	12				
Probex Corp.					
	10-QSB	03/31/03	05/15/03	Not filed	81
	10-QSB	06/30/03	08/14/03	Not filed	78
	10-KSB	09/30/03	12/29/03	Not filed	74
	10-QSB	12/31/03	02/17/04	Not filed	72
	10-QSB	03/31/04	05/17/04	Not filed	69
	10-QSB	06/30/04	08/16/04	Not filed	66
	10-KSB	09/30/04	12/29/04	Not filed	62
	10-QSB	12/31/04	02/14/05	Not filed	60
	10-QSB	03/31/05	05/16/05	Not filed	57
	10-QSB	06/30/05	08/15/05	Not filed	54
	10-KSB	09/30/05	12/29/05	Not filed	50
	10-QSB	12/31/05	02/14/06	Not filed	48
	10-QSB	03/31/06	05/15/06	Not filed	45
	10-QSB	06/30/06	08/14/06	Not filed	42
	10-KSB	09/30/06	12/29/06	Not filed	38
	10-QSB	12/31/06	02/14/07	Not filed	36
	10-QSB	03/31/07	05/15/07	Not filed	33

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	06/30/07	08/14/07	Not filed	30
	10-KSB	09/30/07	12/31/07	Not filed	26
	10-QSB	12/31/07	02/14/08	Not filed	24
	10-QSB	03/31/08	05/15/08	Not filed	21
	10-QSB	06/30/08	08/14/08	Not filed	18
	10-KSB	09/30/08	12/29/08	Not filed	14
	*10-Q**	12/31/08	02/17/09	Not filed	12
	*10-Q**	03/31/09	05/15/09	Not filed	9
	*10-Q**	06/30/09	08/14/09	Not filed	6
	*10-K**	09/30/09	12/29/09	Not filed	2
Total Filings Delinquent	**27**				
Property Capital Trust, Inc.					
	10-Q	06/30/99	08/16/99	Not filed	126
	10-Q	09/30/99	11/15/99	Not filed	123
	10-K	12/31/99	03/30/00	Not filed	119
	10-Q	03/31/00	05/15/00	Not filed	117
	10-Q	06/30/00	08/14/00	Not filed	114
	10-Q	09/30/00	11/14/00	Not filed	111
	10-K	12/31/00	04/02/01	Not filed	106
	10-Q	03/31/01	05/15/01	Not filed	105
	10-Q	06/30/01	08/14/01	Not filed	102
	10-Q	09/30/01	11/14/01	Not filed	99
	10-K	12/31/01	04/01/02	Not filed	94
	10-Q	03/31/02	05/15/02	Not filed	93
	10-Q	06/30/02	08/14/02	Not filed	90
	10-Q	09/30/02	11/14/02	Not filed	87
	10-K	12/31/02	03/31/03	Not filed	83
	10-Q	03/31/03	05/15/03	Not filed	81
	10-Q	06/30/03	08/14/03	Not filed	78
	10-Q	09/30/03	11/14/03	Not filed	75
	10-K	12/31/03	03/30/04	Not filed	71
	10-Q	03/31/04	05/17/04	Not filed	69
	10-Q	06/30/04	08/16/04	Not filed	66
	10-Q	09/30/04	11/15/04	Not filed	63
	10-K	12/31/04	03/31/05	Not filed	59
	10-Q	03/31/05	05/16/05	Not filed	57

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	06/30/05	08/15/05	Not filed	54
	10-Q	09/30/05	11/14/05	Not filed	51
	10-K	12/31/05	03/31/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	45
	10-Q	06/30/06	08/14/06	Not filed	42
	10-Q	09/30/06	11/14/06	Not filed	39
	10-K	12/31/06	04/02/07	Not filed	34
	10-Q	03/31/07	05/15/07	Not filed	33
	10-Q	06/30/07	08/14/07	Not filed	30
	10-Q	09/30/07	11/14/07	Not filed	27
	10-K	12/31/07	03/31/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	21
	10-Q	06/30/08	08/14/08	Not filed	18
	10-Q	09/30/08	11/14/08	Not filed	15
	10-K	12/31/08	04/01/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	9
	10-Q	06/30/09	08/14/09	Not filed	6
	10-Q	09/30/09	11/16/09	Not filed	3
Total Filings Delinquent	**42**				
Protech, Inc.					
	10-K	06/30/93	09/28/93	Not filed	197
	10-Q	09/30/93	11/15/93	Not filed	195
	10-Q	12/31/93	02/14/94	Not filed	192
	10-Q	03/31/94	05/16/94	Not filed	189
	10-K	06/30/94	09/28/94	Not filed	185
	10-Q	09/30/94	11/14/94	Not filed	183
	10-Q	12/31/94	02/14/95	Not filed	180
	10-Q	03/31/95	05/15/95	Not filed	177
	10-K	06/30/95	09/28/95	Not filed	173
	10-Q	09/30/95	11/14/95	Not filed	171
	10-Q	12/31/95	02/14/96	Not filed	168
	10-Q	03/31/96	05/15/96	Not filed	165
	10-K	06/30/96	09/30/96	Not filed	161
	10-Q	09/30/96	11/14/96	Not filed	159
	10-Q	12/31/96	02/14/97	Not filed	156
	10-Q	03/31/97	05/15/97	Not filed	153
	10-K	06/30/97	09/29/97	Not filed	149

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/97	11/14/97	Not filed	147
	10-Q	12/31/97	02/17/98	Not filed	144
	10-Q	03/31/98	05/15/98	Not filed	141
	10-K	06/30/98	09/28/98	Not filed	137
	10-Q	09/30/98	11/16/98	Not filed	135
	10-Q	12/31/98	02/16/99	Not filed	132
	10-Q	03/31/99	05/17/99	Not filed	129
	10-K	06/30/99	09/28/99	Not filed	125
	10-Q	09/30/99	11/15/99	Not filed	123
	10-Q	12/31/99	02/14/00	Not filed	120
	10-Q	03/31/00	05/15/00	Not filed	117
	10-K	06/30/00	09/28/00	Not filed	113
	10-Q	09/30/00	11/14/00	Not filed	111
	10-Q	12/31/00	02/14/01	Not filed	108
	10-Q	03/31/01	05/15/01	Not filed	105
	10-K	06/30/01	09/28/01	Not filed	101
	10-Q	09/30/01	11/14/01	Not filed	99
	10-Q	12/31/01	02/14/02	Not filed	96
	10-Q	03/31/02	05/15/02	Not filed	93
	10-K	06/30/02	09/30/02	Not filed	89
	10-Q	09/30/02	11/14/02	Not filed	87
	10-Q	12/31/02	02/14/03	Not filed	84
	10-Q	03/31/03	05/15/03	Not filed	81
	10-K	06/30/03	09/29/03	Not filed	77
	10-Q	09/30/03	11/14/03	Not filed	75
	10-Q	12/31/03	02/17/04	Not filed	72
	10-Q	03/31/04	05/17/04	Not filed	69
	10-K	06/30/04	09/28/04	Not filed	65
	10-Q	09/30/04	11/15/04	Not filed	63
	10-Q	12/31/04	02/14/05	Not filed	60
	10-Q	03/31/05	05/16/05	Not filed	57
	10-K	06/30/05	09/28/05	Not filed	53
	10-Q	09/30/05	11/14/05	Not filed	51
	10-Q	12/31/05	02/14/06	Not filed	48
	10-Q	03/31/06	05/15/06	Not filed	45
	10-K	06/30/06	09/28/06	Not filed	41
	10-Q	09/30/06	11/14/06	Not filed	39
	10-Q	12/31/06	02/14/07	Not filed	36
	10-Q	03/31/07	05/15/07	Not filed	33
	10-K	06/30/07	09/28/07	Not filed	29

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/07	11/14/07	Not filed	27
	10-Q	12/31/07	02/14/08	Not filed	24
	10-Q	03/31/08	05/15/08	Not filed	21
	10-K	06/30/08	09/29/08	Not filed	17
	10-Q	09/30/08	11/14/08	Not filed	15
	10-Q	12/31/08	02/17/09	Not filed	12
	10-Q	03/31/09	05/15/09	Not filed	9
	10-K	06/30/09	09/28/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	3
Total Filings Delinquent	**65**				
Provell, Inc.					
	10-Q	03/31/02	05/15/02	Not filed	93
	10-Q	06/30/02	08/14/02	Not filed	90
	10-Q	09/30/02	11/14/02	Not filed	87
	10-K	12/31/02	03/31/03	Not filed	83
	10-Q	03/31/03	05/15/03	Not filed	81
	10-Q	06/30/03	08/14/03	Not filed	78
	10-Q	09/30/03	11/14/03	Not filed	75
	10-K	12/31/03	03/30/04	Not filed	71
	10-Q	03/31/04	05/17/04	Not filed	69
	10-Q	06/30/04	08/16/04	Not filed	66
	10-Q	09/30/04	11/15/04	Not filed	63
	10-K	12/31/04	03/31/05	Not filed	59
	10-Q	03/31/05	05/16/05	Not filed	57
	10-Q	06/30/05	08/15/05	Not filed	54
	10-Q	09/30/05	11/14/05	Not filed	51
	10-K	12/31/05	03/31/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	45
	10-Q	06/30/06	08/14/06	Not filed	42
	10-Q	09/30/06	11/14/06	Not filed	39
	10-K	12/31/06	04/02/07	Not filed	34
	10-Q	03/31/07	05/15/07	Not filed	33
	10-Q	06/30/07	08/14/07	Not filed	30
	10-Q	09/30/07	11/14/07	Not filed	27
	10-K	12/31/07	03/31/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	21
	10-Q	06/30/08	08/14/08	Not filed	18

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/08	11/14/08	Not filed	15
	10-K	12/31/08	04/01/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	9
	10-Q	06/30/09	08/14/09	Not filed	6
	10-Q	09/30/09	11/16/09	Not filed	3
Total Filings Delinquent	**31**				
PSINet, Inc.					
	10-Q	03/31/01	05/15/01	Not filed	105
	10-Q	06/30/01	08/14/01	Not filed	102
	10-Q	09/30/01	11/14/01	Not filed	99
	10-K	12/31/01	04/01/02	Not filed	94
	10-Q	03/31/02	05/15/02	Not filed	93
	10-Q	06/30/02	08/14/02	Not filed	90
	10-Q	09/30/02	11/14/02	Not filed	87
	10-K	12/31/02	03/31/03	Not filed	83
	10-Q	03/31/03	05/15/03	Not filed	81
	10-Q	06/30/03	08/14/03	Not filed	78
	10-Q	09/30/03	11/14/03	Not filed	75
	10-K	12/31/03	03/30/04	Not filed	71
	10-Q	03/31/04	05/17/04	Not filed	69
	10-Q	06/30/04	08/16/04	Not filed	66
	10-Q	09/30/04	11/15/04	Not filed	63
	10-K	12/31/04	03/31/05	Not filed	59
	10-Q	03/31/05	05/16/05	Not filed	57
	10-Q	06/30/05	08/15/05	Not filed	54
	10-Q	09/30/05	11/14/05	Not filed	51
	10-K	12/31/05	03/31/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	45
	10-Q	06/30/06	08/14/06	Not filed	42
	10-Q	09/30/06	11/14/06	Not filed	39
	10-K	12/31/06	04/02/07	Not filed	34
	10-Q	03/31/07	05/15/07	Not filed	33
	10-Q	06/30/07	08/14/07	Not filed	30
	10-Q	09/30/07	11/14/07	Not filed	27
	10-K	12/31/07	03/31/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	21
	10-Q	06/30/08	08/14/08	Not filed	18
	10-Q	09/30/08	11/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-K	12/31/08	04/01/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	9
	10-Q	06/30/09	08/14/09	Not filed	6
	10-Q	09/30/09	11/16/09	Not filed	3
Total Filings Delinquent	**35**				
PT. Inti Indorayon Utama (n/k/a P.T. Toba Pulp Lestari Tbk)					
	20-F	12/31/99	06/30/00	Not filed	116
	20-F	12/31/00	07/02/01	Not filed	103
	20-F	12/31/01	07/01/02	Not filed	91
	20-F	12/31/02	06/30/03	Not filed	80
	20-F	12/31/03	06/30/04	Not filed	68
	20-F	12/31/04	06/30/05	Not filed	56
	20-F	12/31/05	06/30/06	Not filed	44
	20-F	12/31/06	07/02/07	Not filed	31
	20-F	12/31/07	06/30/08	Not filed	20
	20-F	12/31/08	06/30/09	Not filed	8
Total Filings Delinquent	**10**				
PT. Riau Andalan Pulp & Paper					
	20-F	12/31/97	06/30/98	Not filed	140
	20-F	12/31/98	06/30/99	Not filed	128
	20-F	12/31/99	06/30/00	Not filed	116
	20-F	12/31/00	07/02/01	Not filed	103
	20-F	12/31/01	07/01/02	Not filed	91
	20-F	12/31/02	06/30/03	Not filed	80
	20-F	12/31/03	06/30/04	Not filed	68
	20-F	12/31/04	06/30/05	Not filed	56
	20-F	12/31/05	06/30/06	Not filed	44
	20-F	12/31/06	07/02/07	Not filed	31
	20-F	12/31/07	06/30/08	Not filed	20
	20-F	12/31/08	06/30/09	Not filed	8
Total Filings Delinquent	**12**				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)

* 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. 61547 / February 19, 2010

In the Matter of: NASDAQ OMX PHLX, Inc. File Nos. SR-Phlx-2009-104, SR-Phlx-2009-116, & SR-Phlx-2010-14	)	ORDER OF SUMMARY ABROGATION

Notice is hereby given that the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(3)(C) of the Securities Exchange Act of 1934 ("Act"),[1] is summarily abrogating three proposed rule changes of NASDAQ OMX PHLX, Inc. ("Phlx" or "Exchange").

On December 22, 2009, on December 31, 2009, and on January 26, 2010, Phlx filed proposed rule changes to amend its fee schedule. In SR-Phlx-2009-104, Phlx proposed to amend its fee schedule, to among other things, assess a transaction fee of $0.05 per contract on Phlx specialists, Streaming Quote Traders ("SQTs") and Remote Streaming Quote Traders ("RSQTs")[2] for equity option orders directed to them by an

1 15 U.S.C. 78s(b)(3)(C).

2 Streaming Quote Traders, or "SQTs," and Remote Streaming Quote Traders, or "RSQTs," are Phlx market makers who may generate and submit option

order flow provider and executed electronically. A Phlx specialist, SQT, or RSQT would be assessed a transaction fee of $0.21 per contract when it trades with an order not directed to it. In SR-Phlx-2009-116, Phlx proposed to amend its fee schedule to adopt, for a two-month pilot period expiring March 2, 2010, a per contract transaction fee on market participants who remove liquidity from the Exchange in options on Standard & Poor's Depositary Receipts/SPDRs ("SPY") and a per contract rebate or transaction fee for market participants who add liquidity in SPY options.[3] The amount of such transaction fees and rebates vary depending on the type of market participant. In SR-Phlx-2010-14, Phlx proposed to amend its fee schedule to apply, for a pilot period expiring March 2, 2010, the same per contract transaction fees and rebates Phlx adopted in SR-Phlx-2009-116 for transactions in options on SPY to transactions in options overlying the PowerShares QQQ Trust ("QQQQ")®; Ishares Russell 2000 ("IWM"), and Citigroup Inc. ("C").

The proposed rule changes were immediately effective upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act.[4] Pursuant to Section 19(b)(3)(C) of the Act,[5] at any time within 60 days of the date of filing a proposed rule change pursuant to Section 19(b)(1) of the Act,[6] the Commission may summarily abrogate the change in the rules of the self-regulatory organization and require that the

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quotations electronically on the Phlx. RSQTs may only submit quotations from off the floor.

3 Phlx filed Amendment No. 1 to SR-Phlx-2009-116 on January 5, 2010 to correct a typographical error in the purpose section to make it consistent with the fee schedule provided in Exhibit 5 thereto.

4 15 U.S.C. 78s(b)(3)(A).

5 15 U.S.C. 78s(b)(3)(C).

6 15 U.S.C. 78s(b)(1).

proposed rule change be re-filed in accordance with the provisions of Section 19(b)(1) of the Act[7] and reviewed in accordance with Section 19(b)(2) of the Act,[8] 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.

The Commission is concerned about whether the proposals are consistent with the statutory requirements applicable to a national securities exchange under the Act, including, among other provisions, Section 6(b)(4) of the Act,[9] which requires that the rules of a national securities exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other parties using its facilities; Section 6(b)(5) of the Act,[10] which requires, among other things, that the rules of a national securities exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers; and Section 6(b)(8) of the Act,[11] which requires that the rules of a national securities exchange do not impose any burden on competition not necessary or appropriate in furtherance of the Act.

Accordingly, the Commission believes that the procedures provided by Section 19(b)(2) of the Act[12] will provide a more appropriate mechanism for determining whether the proposed rule changes are consistent with the Act. Therefore, the Commission finds that it is appropriate in the public interest, for the protection of investors, and otherwise in furtherance of the purposes of the Act, to abrogate the proposed rule changes.

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7 Id.

8 15 U.S.C. 78s(b)(2).

9 15 U.S.C. 78f(b)(4).

10 15 U.S.C. 78f(b)(5).

11 15 U.S.C. 78f(b)(8).

12 15 U.S.C. 78s(b)(2).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(3)(C) of the Act,[13] that File Nos. SR-Phlx-2009-104, SR-Phlx-2009-116, as modified by Amendment No. 1, and SR-Phlx-2010-14, be and hereby are, summarily abrogated. If Phlx chooses to re-file the proposed rule changes, it must do so pursuant to Sections 19(b)(1)[14] and 19(b)(2) of the Act.[15]

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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13 15 U.S.C. 78s(b)(3)(C).

14 15 U.S.C. 78s(b)(1).

15 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61561 / February 22, 2010

Admin. Proc. File No. 3-13628

In the Matter of

CONSUMERS FINANCIAL CORPORATION

ORDER GRANTING DIVISION OF ENFORCEMENT'S
MOTION TO AMEND ORDER INSTITUTING PROCEEDINGS

On September 29, 2009, the Commission issued an Order Instituting Proceedings ("OIP") in the matter of Consumers Financial Corporation, a dually-registered Nevada and Pennsylvania corporation ("CFC"). CFC's common stock had been registered pursuant to Section 12(g) of the Securities Exchange Act of 1934.[1] The OIP was issued pursuant to Section 12(j) of the Exchange Act[2] and sought the suspension or revocation of the registration of CFC's securities. The OIP alleged that CFC had failed to file timely reports with the Commission in violation of Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 13a-13.[3] The OIP stated that CFC had failed to file any periodic or other required reports with the Commission since it filed, on March 23, 2007, a Form 10-KSB for the year ended December 31, 2005.

Under Exchange Act Section 12(g)(4), "Registration of any class of security . . . shall be terminated ninety days, or such shorter period as the Commission may determine, after the issuer files a certification with the Commission that the number of holders of record of such security is reduced to less than three hundred persons." On April 13, 2009, CFC filed a Form 15

[1] 15 U.S.C. § 78*l*(g).

[2] 15 U.S.C. § 78*l*(j). Section 12(j) authorizes the Commission "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 has failed to comply with any provision of [the Exchange Act] or the rules and regulations thereunder."

[3] 15 U.S.C. § 78m(a), 17 C.F.R. §§ 240.13a-1 and 13a-13, respectively.

Certification and Notice of Termination of Registration under Section 12(g) or Suspension of Duty to File Reports under Sections 13 and 15(d) (the "Form 15"), asserting that the number of holders of record of its shares was 200.

On October 13, 2009, the administrative law judge issued an Order to Show Cause, which noted that CFC had filed the Form 15 and ordered the Division of Enforcement to show cause why the proceeding instituted by the OIP should not be dismissed. The law judge noted that the OIP sought suspension or revocation of the registration of CFC's shares under Exchange Act Section 12(j), but that pursuant to Exchange Act Section 12(g), the Form 15 appeared to have terminated that registration as of July 13, 2009, ninety days after CFC filed the Form 15.

In response to the Order to Show Cause, the Division produced evidence suggesting that CFC's declaration in the Form 15 that there were only 200 holders of record of its shares on April 13, 2009 was untrue. The Division introduced a Declaration by the President of Integrity Stock Transfer, the transfer agent for CFC's common stock, which was responsible for maintaining the master security holder file for CFC's stock, stating that there were, in fact, 3,092 holders of record of CFC's stock on April 13, 2009. The Division took the position that because the Form 15 was untrue, it "did not effectively deregister [CFC's] securities."

The law judge rejected the Division's argument and found that "[w]hile the Division has raised a question as to the truthfulness of CFC's certification, the termination of registration of its securities did become effective through operation of law by July 13, 2009. Therefore, at the time of the OIP, CFC did not have any registered securities subject to revocation pursuant to Exchange Act Section 12(j)."

The law judge noted, however, that the termination of registration of CFC's securities pursuant to the Form 15 "can be challenged through a proceeding under Exchange Act Section 12(g)(4)." Exchange Act Section 12(g)(4) states, "The Commission shall after notice and opportunity for hearing deny termination of registration if it finds that the [Form 15] certification is untrue."

Because the OIP was instituted only pursuant to Exchange Act Section 12(j), the law judge found that a proceeding under Section 12(g)(4) was "outside the scope of the [OIP]." The Division requests that the Commission amend the OIP to include proceedings under Section 12(g)(4), seeking to deny CFC's termination of registration based on the Division's contention that CFC filed an untrue Form 15.[4] If, after the requisite notice and opportunity for hearing, the Commission determines to deny the termination of registration of CFC's securities, the Division could properly pursue the proceeding under Exchange Act Section 12(j), as CFC's securities

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[4] Commission Rule of Practice 200(d)(1), 17 C.F.R. § 201.200(d)(1), provides: "Upon motion by a party, the Commission may, at any time, amend an order instituting proceedings to include new matters of fact and law."

would then be registered and subject to suspension or revocation. CFC has not opposed the Division's request to amend the OIP.

Accordingly, IT IS ORDERED that the Order Instituting Proceedings, issued in the matter of Consumers Financial Corporation on September 29, 2009, be, and it hereby is, amended to authorize proceedings pursuant to Section 12(g)(4) of the Securities Exchange Act of 1934.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro and Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61562 / February 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12596

In the Matter of SALVATORE F. SODANO, Respondent.	ORDER MAKING FINDINGS PURSUANT TO SECTION 19(h) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

On March 22, 2007, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 19(h)(4) of the Securities Exchange Act of 1934 ("Exchange Act") against Salvatore F. Sodano ("Sodano" or "Respondent"), the former Chairman and Chief Executive Officer of the American Stock Exchange LLC ("Amex").

II.

Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Sodano and the subject matter of these proceedings, which are admitted, Sodano consents to the entry of this Order Making Findings Pursuant to Sections 19(h) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

A. SUMMARY

This matter arises out of the failure by the Amex adequately to enforce certain order handling rules and to comply with its record keeping obligations. As the Amex's Chairman and Chief Executive Officer ("CEO"), Sodano was one of the individuals who had an obligation to enforce compliance during the relevant period by the Amex's members and associated persons with the Exchange Act, the Exchange Act rules and regulations, and the Amex's own rules. From at least 1999 through June 2004, the Amex had critical deficiencies in its surveillance, investigative, and enforcement programs for assuring compliance with its rules as well as the federal securities laws. These regulatory deficiencies resulted in part from Sodano's failure to take adequate steps to ensure that he and the Amex were meeting their regulatory obligations. As a result of the Amex's failure adequately to surveil for and investigate violations of, and to enforce, certain options order handling rules, the Amex violated Section 19(g) of the Exchange Act. In addition, the Amex failed to furnish accurate records and, as a result, violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1. As CEO, Sodano, without reasonable justification or excuse, failed to enforce compliance by Amex's members and associated persons with the Exchange Act, the Exchange Act rules and regulations, and the Amex's own rules, within the meaning of Section 19(h)(4) of the Exchange Act.

B. RESPONDENT

Salvatore F. Sodano, age 54, resides in Nissequogue, New York. In March 1999, Sodano, while serving as the Chief Financial Officer and Chief Operating Officer of NASD, Inc. ("NASD"), began serving as the Amex's acting President. In September 1999, Sodano was appointed Chairman and CEO of the Amex. Sodano resigned as Amex's CEO in January 2005 and as Chairman in April 2005.

C. RELEVANT ENTITY

American Stock Exchange LLC (previously known as American Stock Exchange, Inc. and now known as NYSE Amex LLC), located in New York, New York, was and is a national securities exchange registered with the Commission pursuant to Section 6 of the Exchange Act. From 1998 until December 2004, the Amex was a subsidiary of NASD, Inc. ("NASD"). At all relevant times, the Amex was its own self-regulatory organization ("SRO") with all of an SRO's attendant obligations under the Exchange Act. The Amex's Member Firm Regulation department

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

("MFR") was the business unit primarily responsible for executing the Amex's regulatory responsibilities. On March 22, 2007, the Commission filed a settled Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934 ("Order") against the Amex for violations of Sections 17(a)(1) and 19(g)(1) of the Exchange Act and Exchange Act Rule 17a-1. On October 1, 2008, the Amex was acquired by NYSE Euronext and initially renamed NYSE Alternext US LLC.

D. FACTS

In November 1998, the NASD purchased the Amex and began to integrate certain Amex operations. In 1999, the NASD sought to sell the Amex. As part of the sale process, the Amex was required to dis-integrate itself from the NASD's operations and to rebuild the departments and functions that had been impacted by the acquisition and consolidation, including MFR. Notwithstanding the NASD's ownership of the Amex, the Amex and Sodano retained their own independent obligations to enforce compliance by the Amex's members and associated persons with the securities laws and the Amex's rules.

From at least 1999, Sodano, as the Amex's CEO and Chairman, was on notice that Amex's surveillance, investigatory, and enforcement programs were not adequate to meet its regulatory obligations. In July 1999, the Commission's Office of Compliance Inspections and Examinations ("OCIE") issued an inspection report in which the staff concluded that the Amex had failed to fulfill its regulatory responsibility effectively to enforce compliance by its members with Exchange rules and federal securities laws relating to order handling practices. Then, in November 1999, the OCIE issued an additional inspection report finding additional problems with the Amex's derivatives and equities surveillance programs.

On September 11, 2000, the Commission issued a settled Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions ("September 2000 Order") finding, in relevant part, that the Amex had failed effectively to enforce compliance by its members with exchange rules, policies, or procedures relating to options order handling.[2] Specifically, the Commission found that the Amex had failed to surveil for, or to take appropriate action with respect to evidence of, violations of firm quote,[3] customer priority,[4] limit order display,[5] and

2 See In the Matter of Certain Activities of Options Exchanges, Exchange Act Rel. No. 43268 (Sept. 11, 2000). The Commission issued its order against the Amex and three other options exchanges. The violative conduct charged in the September 2000 Order largely predated Sodano's tenure at the Amex.

3 The firm quote rule generally requires options specialists to trade options at the prices and in the amounts that they quote. During most of the period relevant to this Order, the firm quote rule for options was set forth in Exchange Act Rule 11Ac1-1, which had a compliance date of April 2001, and Amex Rule 958A. With the Commission's adoption of Regulation NMS in August 2005, the Commission's firm quote rule was redesignated as Exchange Act Rule 602. During the period relevant to this Order, under Exchange Act Rule 602, its predecessor Exchange Act Rule 11Ac1-1, and Amex Rule 958A, responsible brokers or dealers were required, with a few

trade reporting rules[6]. These rules were designed to protect investors and provide some of the primary safeguards against execution abuses by specialists.

In the September 2000 Order, the Commission ordered the Amex to enhance and improve its regulatory programs for surveillance, investigation, and enforcement of the options order handling rules, including compliance with the limit order display, priority, trade reporting, and firm quote rules. The Commission further required the Amex to provide Commission staff with annual affirmations detailing its progress in complying with the September 2000 Order. The Amex failed to fully comply with these obligations. As late as 2003, there remained significant deficiencies in the Amex's surveillance, investigatory, and disciplinary programs regarding the firm quote, customer priority, trade reporting, limit order display, as well as other options order handling rules. In addition, the Amex failed adequately to surveil for compliance with certain equity trading rules by its specialists and trading by its floor brokers.

In June 2003, the OCIE issued another inspection report to the Amex. In that report, the OCIE detailed serious deficiencies in the enforcement and surveillance programs related to the firm quote rule, trade reporting, trading ahead, limit order display, and best execution. The report also detailed deficiencies with respect to the documentation maintained in the Amex's surveillance and investigative files.

As an SRO, the Amex was responsible for enforcing compliance with the Exchange Act, Exchange Act rules and regulations, and the Amex's rules by the Amex's members and associated persons. The NASD, as owner of the Amex during the relevant time, also had responsibilities for enforcing compliance with these provisions. Those responsibilities, however, in no way lessened the Amex's independent obligation to enforce compliance.

Sodano, as CEO of the Amex, shared the Amex's obligation to enforce compliance with the Exchange Act, Exchange Act rules and regulations, and Amex rules by the Amex's members and

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exceptions, to execute options transactions with customers at prices at least as favorable as their published bids or offers at the time the orders were presented and in any amount of contracts up to their published sizes.

4 With certain exceptions, the priority rules generally require that a customer limit order be executed prior to the execution of any other order if it has the best price, i.e., the highest bid or lowest offer. During the period relevant to this Order, the Amex's priority rules were set forth in Amex Rules 126 and 950(d). If there was more than one customer order at the best price, the customer order that arrived first had priority.

5 The obligation to display limit orders generally requires that a customer limit order that is priced better than the highest bid or the lowest ask price currently quoted on the exchange immediately be displayed in the quotations. At the time of the September 2000 Order, specialists were required to display such limit orders as part of their due diligence obligations. In January 2005, the Commission approved, and the Amex thereafter implemented, a limit order display rule specifically applicable to options.

6 The trade reporting rule generally requires that transactions be reported within a specified time after execution. During the period relevant to this Order, the Amex's trade reporting rule, Amex Rule 992, adopted in August 2000, required that options transactions be reported to the Amex Options Market Data System within 90 seconds of execution and that transactions not reported within that time were to be designated as late.

associated persons. Enforcing compliance, in fact, was one of Sodano's primary responsibilities. While serving as CEO, Sodano received the July and November 1999 OCIE inspection reports, the September 2000 Order, and the June 2003 OCIE inspection report. The OCIE reports, the September 2000 Order, and internal information at the Amex provided Sodano with multiple red flags of ongoing deficiencies in the surveillance, investigative, and enforcement programs of the Amex. Although these deficiencies began at the Amex before Sodano became CEO, Sodano had an affirmative obligation to take steps to correct these deficiencies. Sodano failed to establish procedures or a structure sufficient to monitor for, and to enforce, compliance with the applicable statute, rules, and regulations by the Amex's members and associated persons.

Sodano received information that suggested that the Amex would be addressing certain regulatory issues identified in the September 2000 Order, the OCIE reports, and otherwise. Sodano, however, received other information that showed that the Amex was continuing to fall short of meeting its regulatory obligations. Notwithstanding this conflicting information, he did not take affirmative steps to ensure that the Amex met those obligations. Instead Sodano, who lacked a regulatory background, unreasonably relied on MFR and others to correct the Amex's deficiencies without sufficiently following up on their efforts. For example, Sodano did not request or receive regular detailed reports regarding certain of the Amex's significant regulatory activities. Without this type of information, Sodano had no meaningful way personally to determine whether he and the Amex were correcting the deficiencies specified in the September 2000 Order and the OCIE reports or otherwise were fulfilling their regulatory responsibilities.

The deficiencies in carrying out these regulatory responsibilities were exacerbated by hiring freezes and budget restrictions. Sodano was responsible for approving personnel budgets and, during the relevant time, ordered and/or approved hiring freezes and other budgetary restrictions that impacted the Amex's regulatory function. Notwithstanding the September 2000 Order and the OCIE reports, as well as normal regulatory responsibilities of an SRO, Sodano did not exempt the Amex department primarily responsible for the Amex's regulatory program, MFR, from budget and hiring restrictions. These restrictions were a disincentive to managers in MFR to seek additional personnel. Although they could seek to hire individuals, MFR managers had to demonstrate how hiring an individual would save the Amex costs or generate revenues. As a consequence, MFR remained understaffed throughout the relevant time. This lack of staff contributed to the MFR's failure adequately to perform its regulatory responsibilities.

E. LEGAL ANALYSIS

Section 19(h)(4) of the Exchange Act authorizes the Commission, among other things, to issue an order as to any officer or director of an SRO who, without reasonable justification or excuse, has failed to enforce compliance with any provision of the Exchange Act, the rules or regulations of the Exchange Act, or the rules of the SRO by a member of the self-regulatory organization or a person associated with a member. As a result of the conduct described above, Sodano failed, without reasonable justification or excuse, to enforce compliance with the Exchange Act, the Exchange Act rules and regulations, and the Amex's rules.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest and for the protection of investors to issue this Order agreed to in Respondent Sodano's Offer.

Accordingly, the Commission hereby finds that Respondent Sodano, without reasonable justification or excuse, failed to enforce compliance with the Exchange Act, Exchange Act rules and regulations, and Amex rules by Amex members and associated persons within the meaning of Section 19(h)(4) of the Exchange Act.

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. 2986 / February 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13788

In the Matter of MARK J. HARRINGTON, 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 Mark J. Harrington ("Harrington" 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. From at least August 2000 to January 2009, Harrington served as a vice president and controller of Anchor Capital Advisors, LLC ("Anchor"), an investment adviser registered with the Commission.

2. On April 14, 2009, Harrington pled guilty to ERISA Theft and Embezzlement in violation of Title 18 of the United States Code, Section 664, before the United States District Court for the District of Massachusetts, in United States v. Mark J. Harrington, Criminal No. 09-10086-PBS. On July 23, 2009, a judgment in a criminal case was entered against Harrington. He was sentenced to 24 months imprisonment followed by 24 months of supervised release and ordered to make restitution in the amount of $349,887.04.

3. The count of the criminal information to which Harrington pled guilty alleged, inter alia, that Harrington embezzled, stole, and unlawfully and willfully converted approximately $368,711.70, which belonged to Anchor's 401(k) Profit Sharing and Retirement Plan, an employee pension benefit plan and a fund connected with an employee pension benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Harrington 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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 240

[Release Nos. 33-9108; 34-61560; IC-29131; File No. S7-22-09]

RIN 3235-AK25

AMENDMENTS TO RULES REQUIRING INTERNET AVAILABILITY OF PROXY MATERIALS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are amending rules under the Securities Exchange Act of 1934 and the Securities Act of 1933 to clarify and provide additional flexibility regarding the format of the Notice of Internet Availability of Proxy Materials that is sent to shareholders and to permit issuers and other soliciting persons to better communicate with shareholders by including explanatory materials regarding the reasons for the use of the notice and access proxy rules and the process of receiving and reviewing proxy materials and voting pursuant to the notice and access proxy rules. The amendments also revise the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice and access proxy rules and permit mutual funds to accompany the Notice with a summary prospectus.

EFFECTIVE DATE: [Insert date 30 days after publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Steven G. Hearne, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, or with respect to registered investment companies, Sanjay Lamba, Senior Counsel, in the Office of Disclosure Regulation, Division of Investment Management, at (202) 551-6784, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is amending Rule 14a-16[1] under the Securities Exchange Act of 1934[2] and Rule 498[3] under the Securities Act of 1933.[4]

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1 17 CFR 240.14a-16.

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

3 17 CFR 230.498.

4 15 U.S.C. 77a et seq.

I. BACKGROUND AND OVERVIEW OF THE AMENDMENTS

On October 14, 2009, we proposed amendments to the notice and access proxy rules to remove regulatory impediments that may be reducing shareholder response rates to proxy solicitations by permitting issuers and other soliciting persons to more effectively use the notice and access model.[5] These amendments were proposed based on our continuing review of the disclosures shareholders receive when they are asked to make a voting decision and the process followed when those votes are solicited.[6] As discussed in detail below, we are adopting the proposed amendments with certain modifications based on the comments received on the proposal.

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5 Amendments to Rules Requiring Internet Availability of Proxy Materials, Release No. 33-9073 (Oct. 14, 2009) [74 FR 53954] (the "Proposing Release").

6 See, e.g., Facilitating Shareholder Director Nominations, Release No. 33-9046 (June 10, 2009) [74 FR 29024], Proxy Disclosure Enhancements, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68443], and Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, Release No. 34-60215 (July 1, 2009) [74 FR 33293].

We received 25 comment letters in response to the proposed amendments.[7] These letters came from corporations, professional associations, institutional investors, law firms, transfer agents, proxy service providers and other interested parties. We have reviewed and considered all of the comments that we received on the proposed amendments. Most commenters supported the use of the notice and access model and the Commission's proposed modifications to improve its implementation.[8] The adopted rules reflect changes made in response to some of these comments. We explain our revisions with respect to each proposed rule amendment in more detail throughout this release.

In 2007, the Commission established procedures that promote the use of the Internet as a reliable and cost-efficient means of making proxy materials available to shareholders.[9] The notice and access proxy rules require all issuers and other soliciting persons to post their proxy materials on an Internet Web site and provide a Notice of Internet Availability of Proxy Materials ("Notice") to shareholders. These rules also provide issuers and other soliciting persons an option as to whether to send a full set of

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7 See letters from American Bar Association ("ABA"), American Business Conference ("ABC"), Ameriprise Financial, Inc. ("Ameriprise"), Association of Corporate Counsel ("ACC"), The Altman Group ("Altman"), BNY Mellon Shareowner Services ("BNY"), Broadridge Financial Solutions, Inc. ("Broadridge"), Independent Steering Committee of Broadridge Investor Communications Solutions ("Broadridge Steering Committee"), California State Teachers Retirement System ("CalSTRS"), Calvert Group Limited ("Calvert"), U.S. Chamber of Commerce ("Chamber"), Computershare Limited ("Computershare"), Corporate Governance, Diversified Global Graphics Group ("DG3"), Edison International ("Edison"), Investment Company Institute ("ICI"), Intel Corporation ("Intel"), IR WebReport.com, Moxy Vote ("Moxy"), National Investor Relations Institute ("NIRI"), Otter Tail Corporation ("Otter Tail"), Registrar and Transfer Company ("R&T"), Sullivan & Cromwell ("S&C"), Society of Corporate Secretaries and Governance Professionals ("SCSGP"), and Securities Transfer Association, Inc. ("STA").

8 See, e.g., letters from ABA, ABC, ACC, Altman, BNY, Broadridge, Broadridge Steering Committee, CalSTRS, Calvert, Chamber, Computershare, Edison, ICI, Intel, NIRI, Otter Tail, R&T, S&C, SCSGP, and STA.

9 See Internet Availability of Proxy Material, Release No. 34-55146 (Jan. 22, 2007) [72 FR 4148] ("Internet Availability of Proxy Material Adopting Release") and Shareholder Choice Regarding Proxy Materials, Release No. 34-56135 (July 26, 2007) [72 FR 42221].

proxy materials to all shareholders or to send shareholders only the Notice. According to Broadridge Financial Solutions, Inc. ("Broadridge"), over 1,300 corporate issuers used the notice-only option for distribution of the Notice to some portion of their beneficial owners under the notice and access model in the 2009 proxy season.[10] Commenters, including Broadridge and transfer agents who conduct the distribution to registered owners, indicated that issuers have experienced significant cost savings in printing, postage and processing fees.[11]

As we noted in the Proposing Release, while many issuers have experienced significant cost savings using the notice-only option, statistics indicate lower shareholder response rates to proxy solicitations when the notice-only option is used.[12] We are concerned that some investors may be confused when issuers and other soliciting persons distribute proxy materials using the notice-only option and we believe our rules should be amended to provide additional flexibility for issuers and other soliciting persons to better communicate with shareholders to reduce that confusion.

We are adopting amendments today to provide issuers and other soliciting persons with additional flexibility to provide to shareholders a more effective explanation of the

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10 See Broadridge Notice & Access, Statistical Overview of Use with Beneficial Shareholders (as of June 30, 2009) attached to the letter from Broadridge ("Broadridge Statistical Overview"). Broadridge is the largest provider of brokerage processing services with respect to beneficial owners holding through a broker or similar intermediary and has provided detailed statistical information on the use of the notice and access model. The Broadridge Statistical Overview is generally limited to comparisons between issuers that have used the notice-only option for distribution to some portion of their beneficial owners and issuers that exclusively used the full set delivery option and comparisons between the first and second years of use of the notice-only option. The data does not provide a comparison to an issuer's experience in the year prior to using the notice-only option for distribution.

11 See, e.g., letters from Broadridge, BNY, and R&T. Some commenters noted that processing fees were reduced on distributions to registered owners, but expressed concern about the processing fees charged by service providers for distributions to beneficial owners. See, e.g., letters from Altman, BNY, ICI, NIRI, Otter Tail, R&T, and STA.

12 See notes 18 – 20 of the Proposing Release.

importance and effect of the Notice and the reasons for its use, which should better facilitate use of our rules and improve investor understanding. Specifically, the amendments provide additional flexibility regarding the format and content of the Notice, permit issuers and other soliciting persons to better communicate with shareholders by including explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and reviewing proxy materials and voting, and revise the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option.

II. DISCUSSION OF THE AMENDMENTS

A. Revisions to the Notice Requirements and Inclusion of Explanatory Materials

We proposed amendments to Exchange Act Rule 14a-16 to provide issuers and other soliciting persons with additional flexibility to develop a more effective Notice and to provide shareholders with guidance as to how to access the proxy materials online, request a paper copy of the proxy materials, and vote their shares. We are adopting the amendments generally as proposed with some changes as recommended by commenters.

1. Proposed Amendments

Under the amendments we proposed, issuers and other soliciting persons would have additional flexibility in formatting and selecting the language to be used in the Notice. Rather than requiring the soliciting person to include a detailed legend that may seem like boilerplate language to shareholders, we proposed to require that the information appearing on the Notice address certain topics, without specifying the exact language to be used.[13] Further, in order to mitigate confusion about the Notice and to allow issuers and other soliciting persons to better engage shareholders, we proposed to revise Exchange Act Rule 14a-16(f)(2)[14] to permit issuers and other soliciting persons to accompany the Notice with an explanation of the notice and access model, which would be limited to an explanation of the process of receiving and reviewing the proxy materials and voting. Materials designed to persuade shareholders to vote in a particular manner, change the method of delivery of proxy materials, or explain why the person was sending only a Notice to shareholders would not be permitted under the proposed amendments.

2. Comments on the Proposed Amendments

Most commenters supported the additional flexibility provided by the proposed amendments to design and prepare the Notice and provide explanatory materials, and many of these commenters offered additional suggestions for improving the proposals.[15] Several commenters recommended that the design and wording of the Notice should be required to clearly indicate that the Notice is not a proxy card and may not be voted.[16] Other commenters supported a uniform and easily recognizable design for the Notice,[17]

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13 As proposed, Exchange Act Rule 14a-16(d) would limit the required legend to the line "Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting To Be Held on [insert meeting date]" and would require the other information currently required in the legend to be included in the Notice, but not as part of a specified legend.

14 17 CFR 240.14a-16(f)(2).

15 See, e.g., letters from ABA, ACC, BNY, Broadridge, Broadridge Steering Committee, Calvert, Chamber, Computershare, Edison, ICI, Intel, Otter Tail, R&T, S&C, SCSGP, and STA.

16 See, e.g., letters from ABA, Altman, Otter Tail, and Intel. Letters from ABA, Altman and Intel suggested the inclusion of a mandatory legend indicating that a separate proxy card should be used for voting.

17 See letter from Otter Tail.

requiring intermediaries to forward the Notice in issuer provided envelopes,[18] or requiring that the Notice identify proxy items by topic rather than specific proposals.[19]

Several commenters supported more flexibility than we had proposed for the explanatory materials, such as permitting an issuer to explain the reasons for its use of the notice-only option.[20] Commenters suggested that an issuer's rationale for using the notice-only option would enhance shareholders' understanding of the reasons for receiving the Notice, inform investors of the benefits of using the notice-only option and help to distinguish the Notice from the proxy card, without influencing a shareholder's voting decision.[21] One commenter supported additionally requiring that intermediaries be required to pass explanatory materials on to beneficial owners.[22]

Finally, one commenter noted that if the Commission approved the proposed amendments to the Notice requirements, a technical change is necessary to Exchange Act Rule 14a-16(n).[23] Rule 14a-16(n) addresses the notice and access requirements when an issuer or other soliciting person sends a full set of proxy materials to security holders. The suggested technical change related to references in Rule 14a-16(n)(4) to the disclosure requirements of the Notice in Exchange Act Rule 14a-16(d). Since the proposed amendments revise the disclosure requirements of Rule 14a-16(d), conforming changes should also be made to 14a-16(n)(4).

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18 See letter from Edison.

19 See letter from Intel suggesting that the mandated format of the Notice be changed so that matters to be addressed at the annual meeting be identified by topic rather than identifying the specific proposals in order to avoid confusion between the Notice and the proxy card.

20 See, e.g., letters from ABA, ACC, S&C, and STA.

21 See, e.g., letters from ABA and ACC.

22 See letter from ABA.

23 See letter from S&C.

3. Final Rule

After considering the comments, we are adopting the amendments to our requirements regarding the Notice and the rules about what materials may accompany the initial distribution of the Notice as proposed with some changes as recommended by commenters. The final rule provides issuers and other soliciting persons with additional flexibility in formatting and selecting the language to be used in the Notice, as proposed. The information appearing on the Notice is required to address certain topics, without specifying the exact language to be used. In response to comments requesting that the rules specifically state that the Notice is not a form of proxy and may not be voted, we are adopting final rules that require an issuer or other soliciting person to indicate that the Notice is not a form for voting. We are not, however, adopting suggested changes to the Notice requirements that would require a prescribed legend that the Notice is not a proxy card. We are also not adopting changes to the Notice that would require a uniform design for the Notice or would require that the Notice identify proxy items by topic rather than specific identification. We believe that the requirement that the Notice indicate that it is not a form for voting and the additional flexibility provided by the revised rules, as well as the guidance regarding the requirements of redesignated Exchange Act Rule 14a-16(d)(6),[24] address the concerns raised by commenters. These changes also provide issuers and other soliciting persons the flexibility to draft the Notice more effectively. We believe that the flexibility should discourage the development of boilerplate disclosure, which is one of the problems our amendments are designed to address.

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[24] We are redesignating 17 CFR 240.14a-16(d)(2) through 17 CFR 240.14a-16(d)(8) as 17 CFR 240.14a-16(d)(5) through 17 CFR 240.14a-16(d)(11). Prior to this redesignation, the referenced paragraph was 17 CFR 240.14a-16(d)(3) as indicated in the Proposing Release. After adoption, as noted here, the referenced paragraph is 17 CFR 240.14a-16(d)(6).

As noted above, several commenters supported additional flexibility to allow the materials to address the reasons for the use of the notice-only option.[25] Consistent with the proposal, the final rule permits issuers and other soliciting persons to accompany the Notice with an explanation of the notice and access model.[26] As proposed, new Exchange Act Rule 14a-16(f)(2)(iv)[27] allows issuers and other soliciting persons to provide an explanation of the process of receiving and reviewing the proxy materials and voting under the notice and access proxy rules. In a change from the proposal, new Exchange Act Rule 14a-16(f)(2)(iv) also permits an explanation of the reasons for the use of the notice and access rules, as some commenters suggested.

We concur that additional flexibility to explain the reasons for the use of the notice and access rules and the notice-only option may enhance shareholders' understanding of the notice and access model and, therefore, we have expanded the exception to include those topics. Materials designed to persuade shareholders to vote in a particular manner or change the method of the delivery of proxy materials are still not permitted under the revised exception.[28] As also noted above, one commenter suggested that we specifically require that intermediaries and their agents be required to distribute explanatory materials prepared in reliance on the amended rules. Since issuers and other soliciting persons are generally required to reimburse intermediaries for the reasonable

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25 See note 20 above.

26 We emphasize that under revised Rule 14a-16(f)(2) only registrants and other soliciting persons, and not other parties, may accompany a Notice with explanatory materials.

27 This new provision is an additional exception to the general rule in Exchange Act Rule 14a-16(f) that the Notice be sent separately from other types of security holder communications.

28 While the Notice continues to permit the soliciting person to include their recommendations as provided in redesignated Exchange Act Rule 14a-16(d)(6), as we explained in the Internet Availability of Proxy Material Adopting Release, "The Notice is intended merely to make shareholders aware that these proxy materials are available on an Internet Web site; it is not intended to serve as a stand-alone basis for making a voting decision."

expenses incurred in connection with forwarding materials to shareholders, we are not at this time specifically requiring intermediaries and their agents to forward explanatory materials. Of course, to the extent that materials that accompany the Notice are "other soliciting materials" then our current rules[29] would specifically require distribution of the materials.

In response to comments, we are also making a technical change to Exchange Act Rule 14a-16(n). Rule 14a-16(n)(4) details the notice and access disclosures that registrants and other soliciting persons are not required to include in proxy materials when they choose to send a full set of proxy materials to security holders. Since we are amending the notice and access disclosure requirements in Rule 14a-16(d), we are making conforming changes to Rule 14a-16(n)(4). Specifically, we are revising Rule 14a-16(n)(4)(i) to delete the reference to legend requirements that are no longer part of Rule 14a-16(d)(1) and to make reference to new paragraph 14a-16(d)(2) and changing the reference to "(d)(7)" in Rule 14a-16(n)(4)(iii) to "(d)(10)" to track the new numbering in Rule 14a-16(d).

Finally, we are confirming the guidance provided in the Proposing Release that it is not necessary that the Notice directly mirror the proxy card. Rather, Exchange Act Rule 14a-16(d)(6) provides that the Notice must clearly and impartially identify each separate matter intended to be acted on that will be considered at the meeting. We do not believe the Notice has to conform to the specific Exchange Act Rule 14a-4[30] formatting and content requirements for disclosure of matters on the proxy card.

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[29] See 17 CFR 240.14b-1(b)(2) and 17 CFR 240.14b-2(b)(3).

[30] 17 CFR 240.14a-4.

B. Amendment to Notice Deadlines for Soliciting Persons Other Than the Issuer

We proposed to amend Exchange Act Rule 14a-16(l)(2)(ii)[31] to improve the workability of the notice and access rules that apply to soliciting persons, other than the issuer, that choose to use the notice-only option.

1. Proposed Amendment

As we noted in the Proposing Release, the current requirement in Exchange Act Rule 14a-16(l)(2) that requires soliciting persons to send the Notice to shareholders 10 calendar days after the date that the issuer first sends its proxy materials to shareholders can create potential compliance issues for soliciting persons. The staff review of filings may result in outstanding comments on a soliciting person's preliminary proxy statement more than 10 calendar days after the soliciting person has initially filed. The practical effect of this requirement was to limit that soliciting person's ability to use the notice-only option if the soliciting person was unable to file its definitive proxy statement with the Commission by that time. To improve implementation of the notice and access model, we proposed to amend Exchange Act Rule 14a-16(l)(2)(ii) to require soliciting persons relying on this alternative[32] to file a preliminary proxy statement within 10 calendar days after the issuer files its definitive proxy statement and to send its Notice to shareholders no later than the date on which it files its definitive proxy statement with the Commission.

31 17 CFR 240.14a-16(l)(2)(ii).

32 Alternatively, a soliciting person may also send the Notice 40 calendar days before the shareholder meeting to which the proxy materials relate. 17 CFR 14a-16(l)(2)(i).

2. Comments on the Proposed Amendment

Comments on the proposal were limited and mixed. One commenter supported the Commission's proposal for a soliciting person to file a preliminary proxy statement within 10 calendar days after the issuer files its definitive proxy statement and send its Notice no later than the date on which it files its definitive proxy statement.[33] Other commenters expressed concern that without a specific time requirement for sending the Notice prior to the shareholder meeting, shareholders may not have sufficient time to access and consider the materials provided or obtain paper copies prior to casting their vote.[34]

3. Final Rule

After considering the comments, we are adopting the revisions as proposed to amend Exchange Act Rule 14a-16(l)(2)(ii) to require soliciting persons other than the issuer to file a preliminary proxy statement within 10 calendar days after the issuer files its definitive proxy statement and to send its Notice to shareholders no later than the date on which it files its definitive proxy statement with the Commission. We continue to believe that the time period provides sufficient time for a soliciting person to prepare its proxy statement and respond to any staff comments, while still permitting the soliciting person to use the notice and access model. While the rule does not provide for a specific period of time before the meeting by which a soliciting person is required to mail the Notice, the soliciting person should, and generally it would be in their best interest to, make the Notice and proxy materials available to shareholders with sufficient time for

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33 See letter from ABA.

34 See, e.g., letters from Ameriprise, SCSGP, and S&C.

shareholders to review the materials and make an informed voting decision.

C. Additional Comments on the Proposed Amendments and Actions Taken by the Commission

Some commenters indicated their belief that the proposed amendments would result in only modest improvements.[35] A number of commenters recommended revising the notice and access model to permit issuers to send a proxy card and business reply envelope, either with or without a short summary proxy statement accompanying the Notice in order to increase voting rates and facilitate shareholder participation.[36] Other commenters expressed support for reducing the amount of time required for sending the Notice prior to the meeting from 40 days to 30 days.[37] Still other commenters expressed concern regarding the notice and access processing fee structure, the lack of competition for proxy service providers and issuers' inability to negotiate the fees which results in limitations on the amount of the cost savings from switching to the notice and access model.[38] We are not addressing these issues at this time, as the Commission is still considering these and other ways to further encourage informed shareholder participation.

Many commenters suggested that the Commission should do more to improve not only the notice and access model, but also the proxy process generally.[39] While supporting the proposal, a number of commenters suggested that the Notice and lack of

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35 See, e.g., letters from ABC and R&T.

36 See, e.g., letters from Altman, Chamber, Computershare, Edison, ICI, Intel, R&T, SCSGP, and STA.

37 See, e.g., letters from ABA, ACC, Altman, Broadridge Steering Committee, Calvert, Chamber, Computershare, ICI, Intel, NIRI, Otter Tail, R&T, and SCSGP.

38 See, e.g., letters from Altman, DG3, Otter Tail, NIRI, R&T, SCSGP, and STA.

39 See, e.g., letters from ABA, ABC, Altman, BNY, Broadridge, Broadridge Steering Committee, Chamber, Computershare, Edison, ICI, Intel, NIRI, Otter Tail, R&T, S&C, and SCSGP.

explanatory materials accompanying the Notice were not the primary reasons for reduced retail voting and advocated for more sweeping changes.[40] A few commenters did not directly address the proposed amendments, but made broader appeals regarding the proxy process or provided alternative insights,[41] and one commenter suggested that use of the notice and access model undermines investor protection and should be repealed.[42]

While we are not in this release addressing the broader concerns with the proxy system or the notice and access model raised by commenters that went beyond the scope of the proposals, we are continuing to consider these and other concerns relating to the proxy process that have been raised. At the direction of the Chairman, the Commission's staff is conducting a comprehensive review of the mechanics by which proxies are voted and the way in which information is conveyed to shareholders and is preparing a concept release to seek public comment on these issues.[43] In that review, the Commission's staff will continue to monitor shareholder activity under, and the effects of, the notice and access model. In addition, the Commission's staff is undertaking educational efforts to increase understanding of proxy mechanics generally and the notice and access model of delivery of proxy materials.[44]

D. Technical Amendments Relating to Registered Investment Companies

We are also adopting, as proposed, technical amendments to our rules for registered investment companies. Exchange Act Rule 14a-16(f)(2)(iii) currently permits

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40 See, e.g., letters from ABC, Altman, ICI, NIRI, R&T, and STA.

41 See, e.g., letters from Corporate Governance, DG3, and Moxy.

42 See letter from IRWebReport.com.

43 See Speech by Chairman Mary Schapiro to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009) at http://sec.gov/news/speech/2009/spch110409mls.htm.

44 Information about the Commission's educational efforts can be found at: http://www.sec.gov/spotlight/proxymatters.shtml.

a registered investment company to accompany the Notice with a prospectus or report to shareholders.[45] The Commission recently adopted rule amendments that permit mutual funds[46] to satisfy their prospectus delivery obligations by sending or giving investors key information in the form of a summary prospectus.[47] Consistent with permitting mutual funds to use a summary prospectus to satisfy their delivery obligations, we are revising our rules to permit mutual funds to accompany the Notice with a summary prospectus.[48] Commenters that addressed this issue supported the technical amendments.[49]

III. PAPERWORK REDUCTION ACT

A. Background

Certain provisions of the amendments contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995.[50] The Commission published a notice requesting comment on the collection of information requirements in the Proposing Release for the amendments, and we are submitting these requirements to

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45 17 CFR 240.14a-16(f)(2)(iii). Unless otherwise specified or the context otherwise requires, the term "prospectus" means a prospectus meeting the requirements of Section 10(a) of the Securities Act [15 U.S.C. 77j(a)]. See 17 CFR 240.0-1(d).

46 We use the term "mutual fund" to mean a registered investment company that is an open-end management company as defined in Section 5(a)(1) of the Investment Company Act of 1940 [15 U.S.C. 80a-5(a)(1)].

47 See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Release No. 33-8998 (Jan. 13, 2009) [74 FR 4546]. Although the summary prospectus is not a Section 10(a) prospectus, it may be used to satisfy any prospectus delivery obligations under Section 5(b)(2) of the Securities Act [15 U.S.C. 77e(b)(2)]. 17 CFR 230.498(c).

48 See amendment to Exchange Act Rule 14a-16(f)(2)(iii). We are also adopting a conforming amendment to Rule 498 under the Securities Act [17 CFR 230.498], which permits mutual funds to use a summary prospectus to satisfy their prospectus delivery obligations. Rule 498(f)(2) provides that a mutual fund's summary prospectus shall be given greater prominence than any accompanying materials. We are amending Rule 498(f)(2) to provide that a summary prospectus need not be given greater prominence than an accompanying Notice.

49 See, e.g., letters from ABA, Calvert, and ICI.

50 44 U.S.C. 3501 et seq.; 5 CFR 1320.11.

the Office of Management and Budget for review in accordance with the PRA.[51] 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. Compliance with the rules as they are amended is mandatory; however, certain information collections under these rules are required and some are voluntary. Responses to the information collections will not be kept confidential and there is no mandatory retention period for the information disclosed.

B. Summary of the Final Rules

As discussed in more detail below, the amendments that we are adopting provide additional flexibility regarding the format of the Notice that is sent to shareholders, permit issuers and other soliciting persons to better communicate with shareholders by including explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and reviewing proxy materials and voting, and revise the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option.

In the Proposing Release, we requested comment on the PRA analysis. We received no comments that addressed our burden estimates for the proposed amendments.

1. Regulation 14A and 14C

The titles for the collections of information for operating companies are:

- Regulation 14A (OMB Control No. 3235-0059); and
- Regulation 14C (OMB Control No. 3235-0057).

[51] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

We previously revised these collections of information in the release that proposed the notice and access model as a voluntary model for disseminating proxy materials[52] and the release in which we adopted amendments requiring issuers and other soliciting persons to follow the model.[53] We submitted the revisions in those releases and are submitting the amendments to OMB for review in accordance with the PRA.

We have made some additional changes to the amendments, but we do not expect those changes to affect our estimates.[54] The following table summarizes for purposes of the PRA the burden estimates for Schedules 14A and 14C reflecting amendments that permit, but do not require, an issuer or other soliciting person to include explanatory materials with the Notice, which are the only amendments in the release affecting our burden estimates:

Table 1: Calculation of Incremental Paperwork Reduction Act Burden Estimates for Proxy and Information Statements

Form	Annual Responses	Incremental Hours/Form	Incremental Burden	75% Issuer	25% Professional	$400 Professional Cost
	(A)	(B)	(C)=(A)*(B)	(D)=(C)*0.75	(E)=(C)*0.25	(F)=(E)*$400
Schedule 14A	7300	0.5	3650	2737.5	912.5	$365,000
Schedule 14C	680	0.5	340	255	85	$34,000
Total	7980		3990	2992.5	997.5	$399,000

2. Rule 20a-1

Certain provisions of the current notice and access model contain ''collection of information'' requirements within the meaning of the PRA, including preparation of Notices, maintaining Web sites, maintaining records of shareholder preferences, and

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52 See Internet Availability of Proxy Materials, Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597].

53 See the Internet Availability of Proxy Material Adopting Release at note 9 above.

54 While the revised amendments additionally permit an explanation of the reasons for an issuer's use of the notice and access rules, we expect the additional explanation to be part of the same drafting process and to be limited to a few lines of text. Likewise, the required clarification that the Notice is not a form for voting should not add materially to the time to prepare the disclosure. We therefore believe the changes do not affect our burden estimates.

responding to requests for copies. Those provisions increase the current burden for the existing collection of information entitled "Rule 20a-1 under the Investment Company Act of 1940,[55] Solicitation of Proxies, Consents and Authorizations" (OMB Control No. 3235-0158). Rule 20a-1 under the Investment Company Act[56] requires that the solicitation of a proxy, consent, or authorization with respect to a security issued by an investment company be in compliance with Regulation 14A,[57] Schedule 14A,[58] and all other rules and regulations adopted under Section 14(a) of the Exchange Act.[59] It also requires a fund's investment adviser, or a prospective adviser, to transmit to the person making a proxy solicitation the information necessary to enable that person to comply with the rules and regulations applicable to the solicitation. The notice and access model requires all registered investment companies to post their proxy materials on an Internet Web site and furnish Notice of the materials' availability to shareholders.[60] The Notices, the proxy materials posted on the Web site, and copies of the proxy materials sent in response to shareholder requests are not kept confidential.

The following discussion summarizes the burden estimates for Rule 20a-1 that we provided in the Proposing Release. For purposes of the PRA, we estimate that the total annual reporting burden for Rule 20a-1 increased by approximately 1,378 hours and that the annual cost increased by approximately $735,000 for the services of outside professionals to comply with the disclosure provisions of the existing notice and access

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[55] 15 U.S.C. 80a-1 et seq.

[56] 17 CFR 270.20a-1.

[57] 17 CFR 240.14a-1 et seq.

[58] 17 CFR 240.14a-101.

[59] 15 U.S.C. 78n(a).

[60] See the Internet Availability of Proxy Material Adopting Release at note 9 above.

model. In addition, for purposes of the PRA, we estimate that a typical investment company issuer spends an additional five hours per year, or a total of 6,125 hours, to maintain these records as to which of its shareholders have made an election to receive proxy materials in paper or by e-mail. Further, we estimate that the additional burden to prepare an intermediary's Notice is approximately one hour, or a total annual burden of 1,225 hours for all investment company proxy solicitations. Finally, like investment company issuers, we estimate that the requirement to maintain records to keep track of which beneficial owners have made a permanent election to receive proxy materials in paper or by e-mail results in an additional annual burden of five hours, or a total of 6,125 hours, for intermediaries. We received no comments on the estimates and are making no adjustments. In total, we estimate that the annual PRA reporting burden for current Rule 20a-1 increased by 14,853 hours and $735,000 in professional costs to reflect compliance with the existing notice and access model.

With respect to the amendments in this release, we have made some additional clarifying changes, but we do not expect those changes to affect our estimates. We estimate that the amendments that permit, but do not require, an issuer or other soliciting person to include explanatory materials with the Notice, increase the PRA burden estimates under Rule 20a-1 by approximately 459 hours and $61,250 in professional costs.[61]

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[61] See the Proposing Release for calculations underlying the burden estimates.

IV. COST-BENEFIT ANALYSIS

A. Introduction

We are adopting amendments designed to improve implementation of the notice and access model by revising the legend requirements in the rule to make them more flexible, permitting the Notice to be accompanied by explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and reviewing the proxy materials and voting, and revising the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option.[62] We received no comments on the costs and benefits of the amendments.

We expect the amendments to:

- Facilitate participation by shareholders who may be confused by the operation of the notice and access model;
- Provide additional flexibility in describing the notice and access model; and
- Facilitate participation by some soliciting persons who may currently be effectively precluded from using the notice-only option.

B. Benefits

As discussed above, by permitting some additional flexibility in designing the Notice and permitting explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and reviewing the proxy materials and voting to accompany the Notice, the amendments are intended to reduce regulatory impediments and improve understanding of the notice and access model for participating

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[62] We do not expect our proposed conforming amendment, which would permit mutual funds to accompany the Notice with a summary prospectus, to have a substantive impact on a mutual fund's decision otherwise permitted under Rule 498 of the Securities Act to provide a summary

shareholders. Improved understanding of the model through an explanation of the reasons for the use of the Notice and the process of receiving and reviewing proxy materials and voting should reduce confusion and may thereby improve the efficiency and effectiveness of the proxy voting system. The benefits may be limited if issuers send notices to shareholders that are less likely to respond. Some commenters noted lower shareholder response rates under the notice and access model.[63]

Revising one of the two alternative Notice deadlines applicable to soliciting persons other than issuers is intended to facilitate use of the notice-only option by soliciting persons who may otherwise be precluded from using the notice-only option because of their inability to meet the deadline for sending the Notice. This would help lower costs for those persons by reducing impediments for certain soliciting persons to participate in the proxy process through use of the notice-only option.

C. Costs

Eliminating the specific limitations of the legend requirement may result in some soliciting persons providing a more confusing Notice. This may increase the cost of shareholder participation in the proxy process, and to the extent that it affects participation, could distort votes and outcomes. In addition, an issuer or other soliciting person that chooses to include explanatory materials in the same mailing with the Notice will incur the cost of preparing that information.[64] For purposes of the PRA, we estimate

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prospectus instead of a statutory prospectus to its shareholders. No commenters suggested it would have a substantial impact.

63 See, e.g., Broadridge, BNY, Computershare, and R&T.

64 Since intermediaries and their agents already have systems to prepare and deliver proxy materials and the nature of the proposed changes are relatively small, we do not expect the intermediaries' role in sending explanatory material to beneficial owners to affect their costs associated with the rule. In any event, since soliciting persons reimburse intermediaries for their reasonable expenses

that the amendments will cause an aggregate annual increase in the compliance burden for operating and investment company issuers and other soliciting persons preparing explanatory materials of approximately 3,450 hours of in-house personnel time and approximately $460,000 for the services of outside professionals.

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

Section 23(a) of the Exchange Act[65] requires the Commission, when making rules and regulations under the Exchange Act, to consider the impact a new rule would have on competition. 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. Section 2(b) of the Securities Act,[66] Section 3(f) of the Exchange Act[67] and Section 2(c) of the Investment Company Act[68] require the Commission, when engaging in rulemaking that requires it to consider whether an action is necessary or appropriate in the public interest, to also consider whether the action would promote efficiency, competition, and capital formation.

The amendments that we are adopting permit additional flexibility in designing the Notice, permit issuers and other soliciting persons to better communicate with shareholders by accompanying the Notice with explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and

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of forwarding proxy materials, we do not expect intermediaries to incur costs associated with the rule.

65 15 U.S.C. 78w(a).

66 15 U.S.C. 77b(b).

67 15 U.S.C. 78c(f).

68 15 U.S.C. 80a-2(c).

reviewing the proxy materials and voting, and revise the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option. The amendments are designed to reduce regulatory impediments and thereby increase shareholder participation, improve implementation of the notice and access model, and enhance investor understanding of the operation of the notice and access model. These changes are intended to improve the efficiency and effectiveness of the proxy process.

No commenters suggested, and we do not anticipate, any effect on competition or capital formation as a result of these revisions.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to revisions to Exchange Act Rule 14a-16 and related changes that would permit some additional flexibility in designing the Notice, permit issuers and other soliciting persons to better communicate with shareholders by accompanying the Notice with explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and reviewing the proxy materials and voting, and revise the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option. An Initial Regulatory Flexibility Analysis (IRFA) was prepared in accordance with the Regulatory Flexibility Act in conjunction with the Proposing Release. The Proposing Release included, and solicited comment on, the IRFA.

A. Reasons for, and Objectives of, the Amendments

The amendments are designed to improve implementation of the notice and access model. Based on our monitoring of the effects of the notice and access model on the proxy solicitation process and the experiences that issuers and shareholders have had with the notice and access model to date, we believe that these revisions will improve the operation of the model without adversely affecting soliciting persons' or shareholders' abilities to participate effectively in the proxy process.

Improved notice design and shareholder education should help to mitigate the difference in shareholder participation in the proxy voting process observed in the use of the notice and access model to the extent the difference was caused by the restrictions in our regulations. The amendment to the timing requirements for soliciting persons other than the issuer to file their preliminary proxy statements is designed to better enable soliciting persons other than the issuer to use the notice-only option.

B. Significant Issues Raised by Commenters

We did not receive comments specifically addressing the impact of the proposed amendments on small entities.

C. Small Entities Subject to the Amendments

The amendments affect issuers that are small entities. Exchange Act Rule 0-10(a)[69] defines an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,100 public companies, other than investment companies, that may be considered small entities.

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69 17 CFR 240.0-10(a).

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[70] Approximately 168 registered investment companies meet this definition. Moreover, approximately 33 business development companies may be considered small entities.

Paragraph (c)(1) of Rule 0-10 under the Exchange Act[71] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Exchange Act Rule 17a-5(d);[72] and is not affiliated with any person (other than a natural person) that is not a small business or small organization. The Commission has estimated that there were approximately 910 broker-dealers that qualified as small entities as defined above.[73] Small Business Administration regulations define "small entities" to include banks and savings associations with total assets of $165 million or less.[74] The Commission estimates that the amendments might apply to approximately 9,475 banks, approximately 5,816 of which could be considered small banks with assets of $165 million or less.[75]

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70 17 CFR 270.0-10.

71 17 CFR 240.0-10(c)(1).

72 17 CFR 240.17a-5(d).

73 These numbers are based on a review by the Commission's Office of Economic Analysis of 2005 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent in FOCUS Report filings.

74 13 CFR 121.201.

75 We note that while not subject to the amendments, the amendments may affect these entities because they are intermediaries that are required under the Commission's proxy rules to forward

D. Reporting, Recordkeeping and Other Compliance Requirements

The amendments revise the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option, require clarification that the Notice is not a form for voting and permit, but do not require, issuers or other soliciting persons to include additional, explanatory material in their Notice.

E. Agency Action to Minimize Effect on Small Entities

The purpose of the amendments is to improve the implementation of the notice and access model based on our experience with the model to date. The amendments are intended to improve the operation of the notice and access model by providing additional flexibility in designing the Notice, permitting issuers and other soliciting persons to better communicate with shareholders by accompanying the Notice with explanatory materials regarding the reasons for the use of the notice and access rules and the process of receiving and reviewing the proxy materials and voting, and revising the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option.

We considered the use of performance standards rather than design standards in the amendments. The amendments contain both performance standards and design standards. We are revising existing design standards, such as the deadline applicable to soliciting persons other than the issuer. However, we are imposing performance standards to provide issuers, other soliciting persons and intermediaries with the

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proxy materials, including the Notice or any explanatory materials, on to shareholders who beneficially own their shares through the intermediaries. An intermediary is not required to forward proxy materials to beneficial owners unless the issuer or other soliciting person provides assurance of reimbursement of the intermediary's reasonable expenses incurred in connection with forwarding those materials. 17 CFR 240.14b-2(c)(2)(i). Therefore, any costs imposed on intermediaries by the rules will be borne by the issuer or other soliciting person.

flexibility to devise the means through which they can comply with such standards. For example, the amendments regarding explanatory materials do not dictate wording of such information, but allow flexibility in how to communicate the information.

We considered different compliance standards for the small entities that will be affected by the amendments. In the Proposing Release, we solicited comment regarding the possibility of different standards for small entities. We did not receive comment on this particular issue. We are not aware of any different standards that would be consistent with the purposes of the amendments.

VII. STATUTORY AUTHORITY AND TEXT OF THE AMENDMENTS

The amendments described in this release are being adopted under the authority set forth in Sections 6, 7, 10, and 19 of the Securities Act of 1933, as amended, Sections 3(b), 13, 14, 15, and 23(a) of the Securities Exchange Act of 1934, as amended, and Sections 8, 20(a), 24(a), 24(g), 30, and 38 of the Investment Company Act of 1940, as amended.

List of Subjects

17 CFR Parts 230 and 240

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Commission amends Title 17, Chapter II of the Code of Federal Regulation as follows.

PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. Amend §230.498 by revising paragraph (f)(2) to read as follows:

§230.498 Summary Prospectuses for open-end management investment companies.

* * * * *

(f) * * *

(2) Greater prominence. If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund's Summary Prospectus shall be given greater prominence than any materials that accompany the Fund's Summary Prospectus, with the exception of other Summary Prospectuses, Statutory Prospectuses, or a Notice of Internet Availability of Proxy Materials under §240.14a-16 of this chapter.

* * * * *

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for Part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 et seq.; and 18 U.S.C. 1350 and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

4. Amend §240.14a-16 by:

a. Revising paragraph (d)(1).

b. Redesignating paragraphs (d)(2) through (d)(8) as paragraphs (d)(5) through (d)(11);

c. Adding new paragraphs (d)(2) through (d)(4);

d. Removing the word "and" at the end of paragraph (f)(2)(ii);

e. Revising paragraph (f)(2)(iii);

f. Adding paragraph (f)(2)(iv);

g. Revising paragraph (l)(2)(ii);

h. Revising paragraph (n)(4)(i); and

i. In paragraph (n)(4)(iii) removing the reference to "(d)(7)" and adding in its place "(d)(10)".

The revisions and additions read as follows:

§240.14a-16 Internet availability of proxy materials.

* * * * *

(d) * * *

(1) A prominent legend in bold-face type that states "Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting To Be Held on [insert meeting date]";

(2) An indication that the communication is not a form for voting and presents only an overview of the more complete proxy materials, which contain important information and are available on the Internet or by mail, and encouraging a security holder to access and review the proxy materials before voting;

(3) The Internet Web site address where the proxy materials are available;

(4) Instructions regarding how a security holder may request a paper or email copy of the proxy materials at no charge, including the date by which they should make the request to facilitate timely delivery, and an indication that they will not otherwise receive a paper or email copy;

* * * * *

(f) * * *

(2) * * *

(iii) In the case of an investment company registered under the Investment Company Act of 1940, the company's prospectus, a summary prospectus that satisfies the requirements of §230.498(b) of this chapter, or a report that is required to be transmitted to stockholders by section 30(e) of the Investment Company Act (15 U.S.C. 80a-29(e)) and the rules thereunder; and

(iv) An explanation of the reasons for a registrant's use of the rules detailed in this section and the process of receiving and reviewing the proxy materials and voting as detailed in this section.

* * * * *

(l) * * *

(2) * * *

(ii) The date on which it files its definitive proxy statement with the Commission, provided its preliminary proxy statement is filed no later than 10 calendar days after the date that the registrant files its definitive proxy statement.

* * * * *

(n) * * *

(4) * * *

(i) Instructions regarding the nature of the communication pursuant to paragraph (d)(2) of this section;

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: February 22, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61563 / February 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13786

In the Matter of **AXIOM CAPITAL MANAGEMENT, INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Axiom Capital Management, Inc. ("Axiom" 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 Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

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

Summary

These proceedings arise out of Respondent's failure reasonably to supervise Gary J. Gross ("Gross"), a registered representative formerly associated with Respondent, in connection with Gross's sale of private placement offerings and private issuances of public entities, commonly known as "PIPE" transactions (collectively "private placements"), from approximately January 2005 through at least September 2006.[2] Gross violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, among other things, making unsuitable investment recommendations. Respondent failed reasonably to supervise Gross because it failed to devise a reasonable system to implement the firm's policies and procedures regarding review for suitability of private placement investments and review of subsequent transactions to determine suitability of the transaction in light of the customer's current holdings. As a result, Respondent failed reasonably to supervise Gross within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Respondent

1. **Axiom Capital Management, Inc.**, a Delaware corporation with its principal place of business in New York, New York, has been registered with the Commission since June 1990 as a broker-dealer (File No. 8-42638) and as an investment adviser from June 2004 through October 2006 (File No. 801-61632).

Other Relevant Individual

2. **Gross**, 57, is a resident of Boca Raton, Florida. Gross lived in Boca Raton while associated with Respondent from December 2002 until his termination in January 2007 as a result of the misconduct discussed herein. During the period at issue, Gross held Series 7, 63 and 65 licenses.

Background

Gross's Employment with Respondent

3. Respondent hired Gross in December 2002 and established its first branch office in Boca Raton, Florida for him. The office was staffed primarily by Gross, his branch manager, and a sales assistant. Due to customer complaints from Gross's previous firms, the State of Florida required, among other things, that Respondent place Gross on strict supervision. Gross remained subject to strict supervision until Respondent terminated him in January 2007.

4. In May 2003, Respondent hired a branch manager to manage Respondent's Boca Raton branch office and supervise Gross. The branch manager's compensation was based on

[2] In September 2008, the Commission filed an action against Gross. SEC v. Gary J. Gross, Case No. 08-81039-CIV-Marra/Johnson (S.D. Fla. September 22, 2008), Litigation Release No. 20732 (September 22, 2008).

commissions he generated from his own customers and a two percent override he received of the branch office's net commissions.

Gross's Misconduct

5. Beginning in early 2005 through at least April 2006, Gross sold millions of dollars worth of private placements to his customers. Gross touted the purported profitability of private placements to some of his customers, but failed to disclose the substantial risks, namely that the investments were illiquid and the companies were start-up ventures that needed funding. Instead, Gross described the private placements as riskless investments, offered by high-quality companies. The private placements were unsuitable recommendations for a portion of Gross's customers, who were elderly, retired with limited annual income, and risk-averse. Given the customers' ages, financial circumstances, investment objectives and lack of prior experience in private placements, these investment recommendations and other subsequent investment recommendations, including non-private placement investments, Gross made between approximately January 2005 and September 2006 were unsuitable.

Respondent's Failure to Supervise Gross

6. Respondent failed reasonably to supervise Gross with a view to preventing and detecting his violations of the federal securities laws.

7. Respondent failed to have a reasonable system to implement its policies and procedures with respect to suitability review of private placements to address whether Gross's recommendations were suitable in light of his customers' investment objectives, risk tolerance, and other holdings. Respondent's written supervisory procedures manual ("WSP") required the registered representative to determine whether a private placement was a suitable investment to recommend to a customer, however, it failed to provide a clear mechanism for supervisory oversight of these determinations. Elsewhere, Respondent's WSP provided that the supervisor was responsible for reviewing transactions for suitability "where appropriate," but failed to define appropriate circumstances for this suitability review. In the absence of a meaningful system to implement Respondent's policies and procedures regarding suitability, the firm failed to prevent and detect Gross's unsuitable recommendations to his customers to purchase private placements.

8. Respondent had no system that included in suitability reviews by supervisors subsequent to the purchase of a private placement consideration of whether a new recommendation was suitable for a customer in light of that customer's other holdings. Respondent failed to provide guidance to supervisors regarding whether recommending additional private placements or other investments would be suitable for a customer in light of the investor's existing private placement holdings, and failed to develop systems to provide critical information to supervisors regarding customers' existing private placement holdings. Private placement transactions were not reflected on the systems supervisors used to review Gross's activities. If these systems had included complete records of customer transactions, supervisors could have detected Gross's unsuitable recommendations to customers with one or more private placements in their holdings.

Violations

9. As a result of the conduct described above, Gross violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

10. As a result of the conduct described above, Respondent failed reasonably to supervise Gross within the meaning of Section 15(b)(4)(E) of the Exchange Act with a view to preventing and detecting Gross's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

Undertaking

Respondent undertakes to:

a. retain, within 30 days of the date of entry of the Order, at its own expense, the services of an Independent Consultant not unacceptable to the Division of Enforcement of the Commission, to (i) review Axiom's written supervisory policies and procedures concerning suitability review of private placements; and (ii) review Axiom's systems to implement its written supervisory policies and procedures concerning suitability review of private placements and suitability reviews subsequent to the purchase of a private placement.

b. require the Independent Consultant, at the conclusion of the review, which in no event shall be more than 120 days after the entry of the Order, to submit a Report to Axiom and the Division. The report shall address the supervisory issues described above in Section IV.a. and shall include a description of the review performed, the conclusions reached, the Independent Consultant's recommendations for changes or improvements to the policies, procedures, and practices of Axiom and a procedure for implementing the recommended changes or improvements to such policies, procedures, and practices.

c. adopt, implement, and maintain all policies, procedures, and practices recommended in the Report of the Independent Consultant. As to any of the Independent Consultant's recommendations about which Axiom and the Independent Consultant do not agree, such parties shall attempt in good faith to reach agreement within 180 days of the date of the entry of the Order. In the event that Axiom and the Independent Consultant are unable to agree on an alternative proposal, Axiom will abide by the determinations of the Independent Consultant and adopt those recommendations deemed appropriate by the Independent Consultant.

d. cooperate fully with the Independent Consultant in its review, including making such information and documents available as the Independent Consultant may reasonably request, and by permitting and requiring Axiom's employees and agents to supply such information and documents as the Independent Consultant may reasonably request.

e. that, in order to ensure the independence of the Independent Consultant, Axiom (i) shall not have the authority to terminate the Independent Consultant without the prior written approval of the Division; and (ii) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to the Order at their reasonable and customary rates.

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

V.

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

Accordingly, pursuant to Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. Respondent Axiom is censured.

B. Respondent shall pay civil penalties of $60,000 to the United States Treasury. Payment shall be made in the following installments:

(a) within ten days of the entry of the Order, a payment of $20,000.00;
(b) within 30 days of entry of the Order, a payment of $8,000.00;
(c) within 60 days of entry of the Order, a payment of $8,000.00;
(d) within 90 days of entry of the Order, a payment of $8,000.00;
(e) within 120 days of entry of the Order, a payment of $8,000.00;
(f) within 150 days of entry of the Order, a payment of $8,000.00.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. 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 Axiom 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 Eric R. Busto, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Miami Regional Office, 801 Brickell Avenue, 18th Floor, Miami, Florida 33131.

C. Respondent shall comply with the undertaking enumerated in Section IV 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. 61564 / February 22, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 2985 / February 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13787

In the Matter of **DAVID V. SIEGEL,** **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**

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 David V. Siegel ("Respondent" or "Siegel").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. **Siegel**, 52, is a resident of Parkland, Florida who was associated with Axiom Capital Management, Inc. ("Axiom"), a broker-dealer registered with the Commission, from May 2003 through January 2007 ("the relevant period"). During the relevant period, Siegel was Axiom registered representative Gary J. Gross' ("Gross") immediate supervisor. Siegel has Series 3, 4, 7, 15, 24, and 30 licenses.

B. OTHER RELEVANT ENTITY AND INDIVIDUAL

1. **Axiom**, a Delaware corporation with its principal place of business in New York, New York, has been registered with the Commission since June 1990 as a broker-dealer and as an investment adviser from June 2004 through October 2006.

2. **Gross**, 57, is a resident of Boca Raton, Florida. Gross lived in Boca Raton while associated with Axiom from December 2002 until his termination in January 2007 as a result of the misconduct discussed below. During the relevant period, Gross held Series 7, 63 and 65 licenses.[1]

C. GROSS AND SIEGEL'S EMPLOYMENT WITH AXIOM AND GROSS' MISCONDUCT

1. Axiom hired Gross in December 2002 and established its first branch office in Boca Raton, Florida, mainly for Gross' use as an Axiom registered representative. Gross, Siegel, and a sales assistant ultimately comprised the office staff.

2. In May 2003, Axiom hired Siegel to manage its Boca Raton branch office and supervise Gross. During the relevant period, Siegel's compensation came from commissions he generated from his own customers and a two percent override he received of the branch office's net commissions.

3. Due to customer complaints about Gross from his work at previous firms, the State of Florida required, among other things, that Axiom place Gross on strict supervision. During the relevant period, Gross remained subject to strict supervision until Axiom terminated him in January 2007.

4. While under Siegel's supervision, from early 2004 through at least September 2006, Gross implemented several abusive sales practices, including, among others, unauthorized trading for customers, churning customer investments, and making unsuitable investment recommendations to customers.

5. Beginning in early 2005 through at least April 2006, Gross sold millions of dollars worth of private placements and private issuances of public entities, commonly known as "PIPE" transactions (collectively "private placements") to his customers. The private placements were unsuitable recommendations for a portion of Gross' customers, who were elderly, retired with limited annual income, and risk-averse. Gross touted the purported profitability of private placements to some of his customers, but never disclosed the substantial risks, namely that these were illiquid investments in start-up ventures that greatly needed funding. Instead, Gross fraudulently described the private placements as riskless investments offered by high-quality companies. Given the customers' ages, financial circumstances, investment objectives and lack of

[1] In September 2008, the Commission filed an action against Gross. SEC v. Gary J. Gross, Case No. 08-81039-CIV-Marra/Johnson (S.D. Fla. September 22, 2008), Litigation Release No. 20732 (September 22, 2008).

prior experience in private placements, these investment recommendations and other subsequent investment recommendations Gross made between approximately January 2005 and September 2006 were unsuitable.

D. SIEGEL'S FAILURE TO SUPERVISE GROSS

1. During the relevant period, Siegel was Gross' direct supervisor, but failed reasonably to supervise Gross with a view to preventing and detecting his violations of the federal securities laws.

2. Siegel knew his main responsibility was to supervise Gross, yet Siegel failed to follow both Axiom's written supervisory procedures manual and an internal Axiom memorandum entitled "Heightened Supervision of Gary Gross" in relation to his supervision of Gross.

3. Siegel did not reasonably monitor Gross' orders for unauthorized transactions, failed to ensure that Gross' customers' margin use was suitable, and failed to review Gross' customers' private placement transactions and subsequent investments for suitability. Because he failed to follow firm procedures, Siegel failed to notice on numerous occasions when several of Gross' customers entered unsolicited orders to purchase or sell the same obscure securities, often on the same day. Siegel also failed to regularly use the firm's monthly Active Account Report, review monthly customer account statements, or take other reasonable action to monitor for churning by Gross.

4. Siegel profited from Gross' violations of the federal securities laws in the form of commissions he received based on Gross' commissions.

E. VIOLATIONS

1. As a result of the conduct described above, Gross violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

2. As a result of the conduct described above, Siegel failed reasonably to supervise Gross within the meaning of Section 15(b)(4)(E), as incorporated by reference in Section 15(b)(6) of the Exchange Act, and Section 203(e)(6) of the Advisers Act with a view to preventing and detecting Gross' violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

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 proceeding be instituted to determine:

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

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

C. What, if any, remedial action is appropriate in the public interest against Siegel pursuant to Section 203(f) 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 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

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 29133 / February 23, 2010

In the Matter of	)
ASSURANT, INC. One Chase Manhattan Plaza, 41st Floor New York, New York 10005	)
UNION SECURITY INSURANCE COMPANY 2323 Grand Boulevard Kansas City, Missouri 64108-2670	)
UNION SECURITY LIFE INSURANCE COMPANY OF NEW YORK 212 Highbridge Street, Suite D Fayetteville, New York 13066	)
File No. 812-13746	)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

Assurant, Inc. ("Assurant"), Union Security Insurance Company ("USIC") and Union Security Life Insurance Company of New York ("USLICNY," collectively with Assurant and USIC, "Applicants") filed an application on January 21, 2010 and an amendment on January 26, 2010 requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which Assurant is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the United States District Court for the Southern District of New York on January 26, 2010.

On January 26, 2010, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act from January 26, 2010 until the Commission takes final action on the application for a permanent order (Investment Company Act Release No. 29125). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the prohibitions of section 9(a) as applied to the Applicants would be unduly and disproportionately severe and the conduct of the Applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations and subject to the conditions contained in the application filed by Assurant, USIC and USLICNY (File No. 812-13746), as amended, that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the United States District Court for the Southern District of New York on January 26, 2010.

By the Commission.

Florence E Harmon

Florence E. Harmon
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61567 / February 23, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13628

In the Matter of **Consumers Financial Corporation,** **Respondent.**	**AMENDED ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTIONS 12(g)(4) and 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 Sections 12(g)(4) and 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Consumers Financial Corporation ("CFC").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Consumers Financial Corporation (CIK No. 0000100320) is a dually-registered Pennsylvania and Nevada corporation with a principal place of business in Cedarhurst, New York. Its common stock, symbol CNSF, is registered with the Commission pursuant to Section 12(g) of the Exchange Act. As of August 19, 2009, the company's stock was quoted on the Pink Sheets, operated by Pink OTC Markets Inc. ("Pink Sheets"), had nine market makers, and was eligible for the "piggyback" exception under Rule 15c2-11(f)(3) of the Exchange Act.

B. DELINQUENT PERIODIC FILINGS

2. CFC is delinquent in its periodic filings with the Commission and has repeatedly failed to meet its obligation to file timely reports, having not filed any periodic or other required reports since it filed, on March 23, 2007, a Form 10-KSB for the year ended December 31, 2005.

3. On April 8, 2009, CFC filed a Form 15F seeking to terminate the registration of its securities, and certified that it had 600 holders of record of CFC securities.

4. On April 13, 2009, CFC filed a letter withdrawing its Form 15F filing and noting "a change in the number of shareholders to reflect 200." On that same date, CFC also filed a Form 15 seeking to terminate the registration of its securities and certified that it had 200 holders of record on that date.

5. According to the records of CFC's transfer agent, as of April 13, 2009, CFC had 3,092 holders of record of CFC securities.

6. Section 12(g) of the Exchange Act, and Rule 12g-4 thereunder, provide that deregistration of a class of an issuer's securities under Section 12(g) of the Exchange Act,

> shall take effect 90 days, or such shorter period as the Commission may determine, after the issuer certifies to the Commission on Form 15 (17 C.F.R. § 249.323) that the class of securities is held of record by: (1) Less than 300 persons; or (2) less than 500 persons where the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's most recent three fiscal years.

Exchange Act Rule 12g-4, 17 C.F.R. 240.12g-4

7. Because CFC had more than 500 holders of record of CFC securities as of April 13, 2009, CFC was not eligible to use Form 15 to terminate the registration of its securities.

8. Section 12(g)(4) of the Exchange Act provides that "[t]he Commission shall after notice and opportunity for hearing deny termination of registration if it finds that the [Form 15] certification is untrue."

9. CFC's Form 15 certification, filed on April 13, 2009, was untrue because CFC falsely claimed that it had only 200 shareholders of record, when in fact, it had 3,092 shareholders of record.

10. Because CFC's Form 15 certification, filed April 13, 2009, regarding the number of holders of record of CFC securities was untrue and CFC exceeded the statutorily-mandated number of record holders that allows an issuer to deregister its securities on Form 15, CFC's Form 15 was not valid and, therefore, could not effectively terminate the registration of CFC's securities.

11. 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).

12. As a result of the foregoing, CFC 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 CFC an opportunity to establish any defenses to such allegations;

B. Whether to deny CFC's termination of registration of its securities as requested on the Form 15 filed by CFC on April 13, 2009; and

C. 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 CFC identified in Section II. and 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 CFC 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 CFC fails to file the directed Answers, or fails to appear at a hearing after being duly notified, CFC 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 CFC personally or by certified 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

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey and Commissioner Paredes Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 211, 231 and 241

[Release Nos. 33-9106; 34-61469; FR-82]

Commission Guidance Regarding Disclosure Related to Climate Change

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is publishing this interpretive release to provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate change matters.

EFFECTIVE DATE: [insert date of publication in the FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Questions about specific filings should be directed to staff members responsible for reviewing the documents the registrant files with the Commission. For general questions about this release, contact James R. Budge at (202) 551-3115 or Michael E. McTiernan, Office of Chief Counsel at (202) 551-3500, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Background and purpose of interpretive guidance

A. Introduction

Climate change has become a topic of intense public discussion in recent years. Scientists, government leaders, legislators, regulators, businesses, including insurance companies, investors, analysts and the public at large have expressed heightened interest in climate change. International accords, federal regulations, and state and local laws and regulations in the U.S. address concerns about the effects of greenhouse gas emissions on our environment,[1] and international efforts to address the concerns on a global basis continue.[2] The Environmental Protection Agency is taking action to address climate change concerns,[3] and Congress is considering climate change legislation.[4] Some business leaders are increasingly recognizing the current and potential effects on their companies' performance and operations, both positive and negative, that are associated with climate change and with efforts to reduce greenhouse gas emissions.[5] Many companies are providing information to their peers and to the public about their carbon footprints and their efforts to reduce them.[6]

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1 For a listing of state and local government laws and regulations in this field, see http://www.epa.gov/climatechange/wycd/stateandlocalgov/index.html. Two significant international accords related to this topic are the Kyoto Protocol, which was adopted in Kyoto, Japan, on December 11, 1997 and became effective on February 16, 2005, and the European Union Emissions Trading System (EU ETS), which was launched as an international "cap and trade" system of allowances for emitting carbon dioxide and other greenhouse gases, built on the mechanisms set up under the Kyoto Protocol. See http://unfccc.int/kyoto_protocol/items/2830.php and http://ec.europa.eu/environment/climat/pdf/brochures/ets_en.pdf for a more detailed discussion of the Kyoto Protocol and EU ETS, respectively.

2 For example, in December 2009, Copenhagen, Denmark hosted the United Nations Climate Change Conference.

3 See e.g., Current and Near-Term Greenhouse Gas Reduction Initiatives, available at www.epa.gov/climatechange/policy/neartermghgreduction.html, for a discussion of EPA initiatives as well as other federal initiatives.

4 See e.g., American Clean Energy and Security Act of 2009, H.R.2454, 111th Cong., 1st Sess. (2009), passed by the House of Representatives on June 26, 2009, and Clean Energy Jobs and American Power Act of 2009, S. 1733, 111th Cong., 1st Session (2009), introduced in the Senate September 30, 2009.

5 See Appendix F to the Petition for Interpretive Guidance on Climate Risk Disclosure submitted September 18, 2007, File No. 4-547, for a sampling of comments by business leaders relating to climate change regulation and disclosure, available at http://www.sec.gov/rules/petitions/2007/petn4-547.pdf.

6 Companies are assessing and reporting on their greenhouse gas emissions and other climate change related matters using standards and guidelines promulgated by organizations with specific expertise in the field. Three such organizations are the Climate Registry, the Carbon Disclosure Project and the Global Reporting Initiative. We discuss this in more detail below.

This release outlines our views with respect to our existing disclosure requirements as they apply to climate change matters. This guidance is intended to assist companies in satisfying their disclosure obligations under the federal securities laws and regulations.

B. Background

1. Recent regulatory, legislative and other developments

In the last several years, a number of state and local governments have enacted legislation and regulations that result in greater regulation of greenhouse gas emissions.[7] Climate change related legislation is currently pending in Congress. The House of Representatives has approved one version of a bill,[8] and a similar bill was introduced in the Senate in the fall of 2009.[9] This legislation, if enacted, would limit and reduce greenhouse gas emissions through a "cap and trade" system of allowances and credits, among other provisions.

The Environmental Protection Agency has been taking steps to regulate greenhouse gas emissions. On January 1, 2010, the EPA began, for the first time, to require large emitters of greenhouse gases to collect and report data with respect to their greenhouse gas emissions.[10] This reporting requirement is expected to cover 85% of the nation's greenhouse gas emissions

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7 For example, in California, the Global Warming Solutions Act of 2006 and regulatory actions by the California Air Resources Board have resulted in restrictions on greenhouse gas emissions. In addition, state and regional programs, such as the Regional Greenhouse Gas Initiative (including ten Northeast and Mid-Atlantic states), the Western Climate Initiative (including seven Western states and four Canadian provinces) and the Midwestern Greenhouse Gas Reduction Accord (including six states and one Canadian province) have been developed to restrict greenhouse gas emissions. For a more detailed list of state action on climate change, see Pew Center on Global Climate Change, States News (available at http://www.pewclimate.org/states-regions/news?page=1).

8 See American Clean Energy and Security Act of 2009.

9 See Clean Energy Jobs and American Power Act of 2009.

10 See Mandatory Reporting of Greenhouse Gases, Docket No. EPA–HQ–OAR–2008–0508, 74 FR 56260 (October 30, 2009).

generated by roughly 10,000 facilities.[11] In December 2009, the EPA issued an "endangerment and cause or contribute finding" for greenhouse gases under the Clean Air Act, which will allow the EPA to craft rules that directly regulate greenhouse gas emissions.[12]

Some members of the international community also have taken actions to address climate change issues on a global basis, and those actions can have a material impact on companies that report with the Commission. One such effort in the 1990s resulted in the Kyoto Protocol. Although the United States has never ratified the Kyoto Protocol, many registrants have operations outside of the United States that are subject to its standards.[13] Another important international regulatory system is the European Union Emissions Trading System (EU ETS), which was launched as an international "cap and trade" system of allowances for emitting carbon dioxide and other greenhouse gases, based on mechanisms set up under the Kyoto Protocol.[14] In addition, the United States government is participating in ongoing discussions with other nations, including the recent United Nations Climate Conference in Copenhagen, which may lead to future international treaties focused on remedying environmental damage caused by greenhouse

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11 See EPA Press Release "EPA Finalizes the Nation's First Greenhouse Gas Reporting System / Monitoring to begin in 2010" dated September 22, 2009, available at http://yosemite.epa.gov/opa/admpress.nsf/d0cf6618525a9efb85257359003fb69d/194e412153fcffea8525763900530d75!OpenDocument.

12 Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, Docket ID No. EPA-HQ-OAR-2009-0171, 74 FR 66496 (December 15, 2009). The Clean Air Act is found in 42 U.S.C. ch. 85.

13 One of the major features of the Kyoto Protocol is that it sets binding targets for industrialized countries for reducing greenhouse gas emissions. These amount to an average of five per cent against 1990 levels over the five-year period 2008-2012.

14 See n. 1, supra.

gas emissions. Those accords ultimately could have a material impact on registrants that file disclosure documents with the Commission.[15]

The insurance industry is already adjusting to these developments. A 2008 study listed climate change as the number one risk facing the insurance industry.[16] Reflecting this assessment, the National Association of Insurance Commissioners recently promulgated a uniform standard for mandatory disclosure by insurance companies to state regulators of financial risks due to climate change and actions taken to mitigate them.[17] We understand that insurance companies are developing new actuarial models and designing new products to reshape coverage for green buildings, renewable energy, carbon risk management and directors' and officers' liability, among other actions.[18]

2. Potential impact of climate change related matters on public companies

For some companies, the regulatory, legislative and other developments noted above could have a significant effect on operating and financial decisions, including those involving capital expenditures to reduce emissions and, for companies subject to "cap and trade" laws,

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15 The terms of the Kyoto Protocol are set to expire in 2012. Ongoing international discussions, including the United Nations Climate Change Conference held in Copenhagen, Denmark in mid-December 2009, are intended to further develop a framework to carry on international greenhouse gas emission reduction standards beyond 2012.

16 Strategic business risk 2008 - Insurance, a report prepared by Ernst & Young and Oxford Analytica. See Ernst & Young press release dated March 12, 2008, available at http://www.ey.com/GL/en/Newsroom/News-releases/Media---Press-Release---Strategic-Risk-to-Insurance-Industry.

17 On March 17, 2009, the NAIC adopted a mandatory requirement that insurance companies disclose to regulators the financial risks they face from climate change, as well as actions the companies are taking to respond to those risks. All insurance companies with annual premiums of $500 million or more will be required to complete an Insurer Climate Risk Disclosure Survey every year, with an initial reporting deadline of May 1, 2010. The surveys must be submitted in the state where the insurance company is domesticated. See Insurance Regulators Adopt Climate Change Risk Disclosure, available at www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm.

18 See Klein, Christopher, Climate Change, Part IV: (Re)insurance Industry response, May 28, 2009, available at www.gccapitalideas.com/2009/05/28/climate-change-part-iv-reinsurance-industry-response.

expenses related to purchasing allowances where reduction targets cannot be met. Companies that may not be directly affected by such developments could nonetheless be indirectly affected by changing prices for goods or services provided by companies that are directly affected and that seek to reflect some or all of their changes in costs of goods in the prices they charge. For example, if a supplier's costs increase, that could have a significant impact on its customers if those costs are passed through, resulting in higher prices for customers. New trading markets for emission credits related to "cap and trade" programs that might be established under pending legislation, if adopted, could present new opportunities for investment. These markets also could allow companies that have more allowances than they need, or that can earn offset credits through their businesses, to raise revenue through selling these instruments into those markets. Some companies might suffer financially if these or similar bills are enacted by the Congress while others could benefit by taking advantage of new business opportunities.

In addition to legislative, regulatory, business and market impacts related to climate change, there may be significant physical effects of climate change that have the potential to have a material effect on a registrant's business and operations. These effects can impact a registrant's personnel, physical assets, supply chain and distribution chain. They can include the impact of changes in weather patterns, such as increases in storm intensity, sea-level rise, melting of permafrost and temperature extremes on facilities or operations. Changes in the availability or quality of water, or other natural resources on which the registrant's business depends, or damage to facilities or decreased efficiency of equipment can have material effects on companies.[19] Physical changes associated with climate change can decrease consumer

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19 For one view of the anticipated business-related physical risks resulting from climate change, see Industry Update: Global Warming & the Insurance Industry -- Will Insurers Be Burned by the Climate Change Phenomenon?, available at http://www.aon.com/about-aon/intellectual-capital/attachments/risk-services/will_insurers_be_burned_by_the_climate_change_phenomenon.pdf. Another example of how

demand for products or services; for example, warmer temperatures could reduce demand for residential and commercial heating fuels, service and equipment.

For some registrants, financial risks associated with climate change may arise from physical risks to entities other than the registrant itself. For example, climate change-related physical changes and hazards to coastal property can pose credit risks for banks whose borrowers are located in at-risk areas. Companies also may be dependent on suppliers that are impacted by climate change, such as companies that purchase agricultural products from farms adversely affected by droughts or floods.

3. Current sources of climate change related disclosures regarding public companies

There have been increasing calls for climate-related disclosures by shareholders of public companies. This is reflected in the several petitions for interpretive advice submitted by large institutional investors and other investor groups.[20] The New York Attorney General's Office

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physical risks attributable to climate change are changing business and risk assessments is the Federal Emergency Management Agency's plan to update its risk mapping, assessment and planning to better reflect the effects of climate change, such as changing rainfall data, and hurricane patterns and intensities. See "Risk Mapping, Assessment, and Planning (Risk MAP): Fiscal Year 2009 Flood Mapping Production Plan," Version 1, May 2009, available at http://www.fema.gov/library/viewRecord.do?id=3680.

[20] See Petition for Interpretive Guidance on Climate Risk Disclosures, dated September 19, 2007, File No. 4-547, available at http://www.sec.gov/rules/petitions/2007/petn4-547.pdf; supplemental petition dated June 12, 2008, available at http://www.sec.gov/rules/petitions/2008/petn4-547-supp.pdf; second supplemental petition dated November 23, 2009, available at http://www.sec.gov/rules/petitions/2009/petn4-547-supp.pdf. For other petitions on point, see also Petition for Interpretive Guidance on Business Risk of Global Warming Regulation, submitted on behalf of the Free Enterprise Action Fund on October 22, 2007, File Number 4-549, available at http://www.sec.gov/rules/petitions/2007/petn4-549.pdf. One petition urges the Commission to issue guidance warning companies not to include information on climate change that may be false and misleading; see Petition for Interpretive Guidance on Public Statements Concerning Global Warming and Other Environmental Issues, submitted on behalf of the Free Enterprise Action Fund on July 21, 2008, File No. 4-563, available at http://www.sec.gov/rules/petitions/2008/petn4-563.pdf. While not a formal petition, Ceres has provided the Commission with the results of a study it commissioned in conjunction with the Environmental Defense Fund regarding climate risk disclosure in SEC filings and suggests that the Commission issue guidance on this topic. See Climate Risk Disclosure in SEC Filings: An Analysis of 10-K Reporting by Oil and Gas, Insurance, Coal, and Transportation and Electric Power Companies, June 2009, available at http://www.ceres.org/Document.Doc?id=473.

The Subcommittee on Securities, Insurance, and Investment of the Senate Committee on Banking, Housing, and Urban Development held a hearing on corporate disclosure of climate-related issues on October 31, 2007; representatives of signatories to the September 19, 2007 petition, among others, testified in that hearing. See recently has entered into settlement agreements with three energy companies under its investigation regarding their disclosures about their greenhouse gas emissions and potential liabilities to the companies resulting from climate change and related regulation. The companies agreed in the settlement agreements to enhance their disclosures relating to climate change and greenhouse gas emissions in their annual reports filed with the Commission.[21]

Although some information relating to greenhouse gas emissions and climate change is disclosed in SEC filings,[22] much more information is publicly available outside of public company disclosure documents filed with the SEC as a result of voluntary disclosure initiatives or other regulatory requirements. For example, in addition to the disclosure requirements mandated in several states[23] and the disclosure that the EPA began requiring at the start of 2010, The Climate Registry provides standards for and access to climate-related information. The

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"Climate Disclosure: Measuring Financial Risks and Opportunities," available at http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ed7a4968-1019-411d-9a22-c193c6b689ea. Following the hearing, Senators Christopher Dodd and Jack Reed wrote to Chairman Christopher Cox urging the Commission to issue guidance regarding climate disclosure. See http://dodd.senate.gov/multimedia/2007/120607_CoxLetter.pdf.

21 For information about the settlement agreements, see the New York Attorney General's Office press releases relating to: Xcel Energy, available at http://www.oag.state.ny.us/media_center/2008/aug/aug27a_08.html; Dynegy Inc., available at http://www.oag.state.ny.us/media_center/2008/oct/oct23a_08.html; and AES Corporation, available at http://www.oag.state.ny.us/media_center/2009/nov/nov19a_09.html.

22 For example, in the electric utility industry, we have been informed by the Edison Electric Institute that 95% of the member companies it recently surveyed reported that they included at least some disclosure related to greenhouse gas emissions in their SEC filings, with 34% discussing quantities of greenhouse gases emitted and 23% discussing costs of climate-related compliance. Registrants include this type of disclosure in the risk factors, business description, legal proceedings, executive compensation, MD&A and financial statements sections of their annual reports. The Edison Electric Institute is an association of U.S. shareholder-owned electric companies. Their members serve 95 percent of the customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. The EEI also has more than 80 international electric companies as affiliate members, and nearly 200 industry suppliers and related organizations as associate members. The EEI described the results of its survey in a presentation to staff members of the Division of Corporation Finance.

23 State requirements include CO_2 emissions disclosure requirements for electricity providers, greenhouse gas registries for reporting of entity emissions levels and emissions changes, and required reporting of greenhouse gas emissions. For a discussion of specific state requirements, see http://epa.gov/climatechange/wycd/stateandlocalgov/state_reporting.html.

Registry is a non-profit collaboration among North American states, provinces, territories and native sovereign nations that sets standards to calculate, verify and publicly report greenhouse gas emissions into a single public registry. The Registry supports both voluntary and state-mandated reporting programs and provides data regarding greenhouse gas emissions.[24]

The Carbon Disclosure Project collects and distributes climate change information, both quantitative (emissions amounts) and qualitative (risks and opportunities), on behalf of 475 institutional investors.[25] Over 2500 companies globally reported to the Carbon Disclosure Project in 2009; over 500 of those companies were U.S. companies. Sixty-eight percent of the companies that responded to the Carbon Disclosure Project's investor requests for information made their reports available to the public.[26]

The Global Reporting Initiative has developed a widely used sustainability reporting framework.[27] That framework is developed by GRI participants drawn from business, labor and professional institutions worldwide. The GRI framework sets out principles and indicators that organizations can use to measure and report their economic, environmental, and social performance, including issues involving climate change. Sustainability reports based on the GRI framework are used to benchmark performance with respect to laws, norms, codes, performance standards and voluntary initiatives, demonstrate organizational commitment to sustainable development, and compare organizational performance over time.

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24 The Climate Registry's Web site is at www.theclimateregistry.org. Reports are publicly available through their Web site at no charge. See http://www.theclimateregistry.org/resources/climate-registry-information-system-cris/public-reports/.

25 The Carbon Disclosure Project's Web site is at www.cdproject.net.

26 These figures were provided to the Commission staff by representatives of the Carbon Disclosure Project.

27 The GRI's Web site is at www.globalreporting.org.

These and other reporting mechanisms can provide important information to investors outside of disclosure documents filed with the Commission. Although much of this reporting is provided voluntarily, registrants should be aware that some of the information they may be reporting pursuant to these mechanisms also may be required to be disclosed in filings made with the Commission pursuant to existing disclosure requirements.

II. Historical background of SEC environmental disclosure

The Commission first addressed disclosure of material environmental issues in the early 1970s. The Commission issued an interpretive release stating that registrants should consider disclosing in their SEC filings the financial impact of compliance with environmental laws, based on the materiality of the information.[28] Throughout the 1970s, the Commission continued to explore the need for specific rules mandating disclosure of information relating to litigation and other business costs arising out of compliance with federal, state and local laws that regulate the discharge of materials into the environment or otherwise relate to the protection of the environment. These topics were the subject of several rulemaking efforts, extensive litigation, and public hearings, all of which resulted in the rules that now specifically address disclosure of environmental issues.[29] The Commission adopted these rules, which we discuss below, in final and current form in 1982, after a decade of evaluation and experience with the subject matter.[30]

Earlier, beginning in 1968, we began to develop and fine-tune our requirements for management to discuss and analyze their company's financial condition and results of operations

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28 Release No. 33-5170 (July 19, 1971) [36 FR 13989].

29 See Interpretive Release No. 33-6130 (September 27, 1979) [44 FR 56924] (the "1979 Release"), which includes a brief summary of the legal and administrative actions taken with regard to environmental disclosure during the 1970s. More information relating to the Commission's efforts in this area is chronicled in Release No. 33-6315 (May 4, 1981) [46 FR 25638].

30 Release No. 33-6383 (March 3, 1982) [47 FR 11380].

in disclosure documents filed with the Commission.[31] During the 1970s and 1980s, materiality standards for disclosure under the federal securities laws also were more fully articulated.[32] Those standards provide that information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information.[33] In the articulation of the materiality standards, it was recognized that doubts as to materiality of information would be commonplace, but that, particularly in view of the prophylactic purpose of the securities laws and the fact that disclosure is within management's control, "it is appropriate that these doubts be resolved in favor of those the statute is designed to protect."[34] With these developments, registrants had clearer guidance about what they should disclose in their filings.

More recently, the Commission reviewed its full disclosure program relating to environmental disclosures in SEC filings in connection with a Government Accountability Office review.[35] The Commission also has had the opportunity to consider the thoughtful

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31 See Release No. 33-6835 (May 18, 1989) [54 FR 22427] (the "1989 Release") and Release No. 33-8350 (December 19, 2003) [68 FR 75055] (the "2003 Release") for detailed histories of Commission releases that outline the background of, and interpret, our MD&A rules.

32 See TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) (adopting a standard for materiality in connection with proxy statement disclosures supported by the Commission, see id. at n. 10) and Basic Inc. v. Levinson, 485 U.S. 224 (1988).

33 Basic at 231, quoting TSC Industries at 449.

34 TSC Industries at 448.

35 "Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information," United States Government Accountability Office Report to Congressional Requesters, GAO-04-808 (July 2004). Eleven years before, at the request of the Chairman of the House Committee on Energy and Commerce, the GAO had prepared a report relating to environmental liability disclosure involving property and casualty insurers and Superfund cleanup costs. See "Environmental Liability: Property and Casualty Insurer Disclosure of Environmental Liabilities," GAO/RCED-93-108 (June 1993), available at http://74.125.93.132/search?q=cache:tWeHLDHoIcUJ:www.gao.gov/cgi-bin/getrpt%3FGAO/RCED-93-108+GAO/RCED-93-108&cd=1&hl=en&ct=clnk&gl=us.

suggestions that many organizations have provided us recently about how the Commission could direct registrants to enhance their disclosure about climate change related matters.[36]

III. Overview of rules requiring disclosure of climate change issues

When a registrant is required to file a disclosure document with the Commission, the requisite form will largely refer to the disclosure requirements of Regulation S-K[37] and Regulation S-X.[38] Securities Act Rule 408 and Exchange Act Rule 12b-20 require a registrant to disclose, in addition to the information expressly required by Commission regulation, "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."[39] In this section, we briefly describe the most pertinent non-financial statement disclosure rules that may require disclosure related to climate change; in the following section, we discuss their application to disclosure of certain specific climate change related matters.

A. Description of business.

Item 101 of Regulation S-K requires a registrant to describe its business and that of its subsidiaries. The Item lists a variety of topics that a registrant must address in its disclosure documents, including disclosure about its form of organization, principal products and services, major customers, and competitive conditions. The disclosure requirements cover the registrant and, in many cases, each reportable segment about which financial information is presented in the financial statements. If the information is material to individual segments of the business, a registrant must identify the affected segments.

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36 See n. 20, supra.

37 17 CFR Part 229.

38 17 CFR Part 210.

39 17 CFR 230.408 and 17 CFR 240.12b-20.

Item 101 expressly requires disclosure regarding certain costs of complying with environmental laws.[40] In particular, Item 101(c)(1)(xii) states:

> Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material.[41]

A registrant meeting the definition of "smaller reporting company" may satisfy its disclosure obligation by providing information called for by Item 101(h). Item 101(h)(4)(xi) requires disclosure of the "costs and effects of compliance with environmental laws (federal, state and local)."[42]

B. Legal proceedings.

Item 103 of Regulation S-K[43] requires a registrant to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party. A registrant also must describe material pending legal actions in which its property is the subject of the litigation.[44] If a registrant is aware of similar actions contemplated by governmental authorities, Item 103

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[40] The Commission first addressed disclosure of material costs and other effects on business resulting from compliance with existing environmental law in its first environmental disclosure interpretive release in 1971. See Release 33-5170 (July 19, 1971) [36 FR 13989]. The Commission codified that interpretive position in the disclosure forms two years later. See Release 33-5386 (April 20, 1973) [38 FR 12100]. The Commission provided additional interpretive guidance in the 1979 Release. With some adjustments to reflect experience with the subject matter, the requirements were moved to Item 101 in 1982, and they have not changed since that time. See Release No. 33-6383 (March 3, 1982) [47 FR 11380].

[41] 17 CFR 229.101(c)(1)(xii).

[42] 17 CFR 229.101(h)(4)(xi).

[43] 17 CFR 229.103.

[44] Id.

requires disclosure of those proceedings as well. A registrant need not disclose ordinary routine litigation incidental to its business or other types of proceedings when the amount in controversy is below thresholds designated in this Item.

Instruction 5 to Item 103 provides some specific requirements that apply to disclosure of certain environmental litigation.[45] Instruction 5 states:

> Notwithstanding the foregoing, an administrative or judicial proceeding (including, for purposes of A and B of this Instruction, proceedings which present in large degree the same issues) arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary for the purpose of protecting the environment shall not be deemed "ordinary routine litigation incidental to the business" and shall be described if:
>
> (A) Such proceeding is material to the business or financial condition of the registrant;
>
> (B) Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or
>
> (C) A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically.

[45] Instruction 5 in its current form was the product of the Commission's experience with environmental litigation disclosure. In 1973, we added provisions to the legal proceedings requirements of various disclosure forms singling out legal actions involving environmental matters. See Release No. 33-5386 (Apr. 20, 1973) [38 FR 12100]. The new rules required disclosure of any pending legal proceeding arising under environmental laws if a governmental entity was involved in the proceeding, and any other legal proceeding arising under environmental laws unless it was not material, or if in a civil suit for damages, unless it involved less than 10% of the current assets of the registrant on a consolidated basis. The Commission provided additional interpretive guidance regarding environmental litigation in the 1979 Release. When the Commission, in connection with its development of the integrated disclosure system, moved these rules out of various forms and into Item 103 of Regulation S-K, the Commission modified the requirements related to actions involving governmental authorities to allow registrants to omit disclosure of a proceeding if they reasonably believed the action would result in a monetary sanction of less than $100,000. See Release No. 33-6383 (Mar. 3, 1982) [47 FR 11380]. At the time, the Commission noted that the reason for the revision was to address the problem that disclosure documents were being filled with descriptions of minor infractions that distracted from the other material disclosures included in the document.

C. Risk factors.

Item 503(c) of Regulation S-K[46] requires a registrant to provide where appropriate, under the heading "Risk Factors," a discussion of the most significant factors that make an investment in the registrant speculative or risky. Item 503(c) specifies that risk factor disclosure should clearly state the risk and specify how the particular risk affects the particular registrant; registrants should not present risks that could apply to any issuer or any offering.[47]

D. Management's discussion and analysis.

Item 303 of Regulation S-K[48] requires disclosure known as the Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A. The MD&A requirements are intended to satisfy three principal objectives:

- to provide a narrative explanation of a registrant's financial statements that enables investors to see the registrant through the eyes of management;
- to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
- to provide information about the quality of, and potential variability of, a registrant's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.[49]

MD&A disclosure should provide material historical and prospective textual disclosure enabling investors to assess the financial condition and results of operations of the registrant, with

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46 17 CFR 229.503(c).

47 Id.

48 17 CFR 229.303.

49 2003 Release.

particular emphasis on the registrant's prospects for the future.[50] Some of this information is itself non-financial in nature, but bears on registrants' financial condition and operating performance.

The Commission has issued several releases providing guidance on MD&A disclosure, including on the general requirements of the item and its application to specific disclosure matters.[51] Over the years, the flexible nature of this requirement has resulted in disclosures that keep pace with the evolving nature of business trends without the need to continuously amend the text of the rule. Nevertheless, we and our staff continue to have to remind registrants, through comments issued in the filing review process, public statements by staff and Commissioners and otherwise, that the disclosure provided in response to this requirement should be clear and communicate to shareholders management's view of the company's financial condition and prospects.[52]

Item 303 includes a broad range of disclosure items that address the registrant's liquidity, capital resources and results of operations. Some of these provisions, such as the requirement to provide tabular disclosure of contractual obligations,[53] clearly specify the disclosure required for compliance. But others instead identify principles and require management to apply the principles in the context of the registrant's particular circumstances. For example, registrants must identify and disclose known trends, events, demands, commitments and uncertainties that

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50 1989 Release.

51 See, e.g., the 2003 Release; Release No. 33-8182 (Jan. 28, 2003) [68 FR 5982]; Release No. 33-8056 (Jan. 22, 2002) [67 FR 3746]; Release. No. 33-7558 (Jul. 29, 1998) [63 FR 41394]; and 1989 Release.

52 See, e.g., speech by Commissioner Cynthia A. Glassman to the Corporate Counsel Institute (Mar. 9, 2006) available at www.sec.gov/news/speech/spch030906cag.htm; and speech by Commissioner Elisse B. Walter to the Corporate Counsel Institute (Oct. 2, 2009) available at www.sec.gov/news/speech/2009/spch100209ebw.htm.

53 17 CFR 229.303(a)(5).

are reasonably likely[54] to have a material effect on financial condition or operating performance. This disclosure should highlight issues that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating performance or of future financial condition.[55] Disclosure decisions concerning trends, demands, commitments, events, and uncertainties generally should involve the:

- consideration of financial, operational and other information known to the registrant;
- identification, based on this information, of known trends and uncertainties; and
- assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the registrant's liquidity, capital resources or results of operations.[56]

The Commission has not quantified, in Item 303 or otherwise, a specific future time period that must be considered in assessing the impact of a known trend, event or uncertainty that is reasonably likely to occur. As with any other judgment required by Item 303, the necessary time period will depend on a registrant's particular circumstances and the particular trend, event or uncertainty under consideration. For example, a registrant considering its disclosure obligation with respect to its liquidity needs would have to consider the duration of its known capital requirements and the periods over which cash flows are managed in determining the time period of its disclosure regarding future capital sources.[57] In addition, the time horizon of a known trend, event or uncertainty may be relevant to a registrant's assessment of the

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54 "Reasonably likely" is a lower disclosure standard than "more likely than not." Release No. 33-8056 (Jan. 22, 2002) [67 FR 3746].

55 2003 Release.

56 Id.

57 Id. at n.43.

materiality of the matter and whether or not the impact is reasonably likely. As with respect to other subjects of disclosure, materiality "with respect to contingent or speculative information or events . . . 'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'"[58]

The nature of certain MD&A disclosure requirements places particular importance on a registrant's materiality determinations. The Commission has recognized that the effectiveness of MD&A decreases with the accumulation of unnecessary detail or duplicative or uninformative disclosure that obscures material information.[59] Registrants drafting MD&A disclosure should focus on material information and eliminate immaterial information that does not promote understanding of registrants' financial condition, liquidity and capital resources, changes in financial condition and results of operations.[60] While these materiality determinations may limit what is actually disclosed, they should not limit the information that management considers in making its determinations. Improvements in technology and communications in the last two decades have significantly increased the amount of financial and non-financial information that management has and should evaluate, as well as the speed with which management receives and is able to use information. While this should not necessarily result in increased MD&A disclosure, it does provide more information that may need to be considered in drafting MD&A disclosure. In identifying, discussing and analyzing known material trends and uncertainties, registrants are expected to consider all relevant information even if that information is not

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58 Basic at 238, quoting Texas Gulf Sulfur Co., 401 F. 2d 833 (2d Cir. 1968) at 849.

59 2003 Release.

60 Id.

required to be disclosed,[61] and, as with any other disclosure judgments, they should consider whether they have sufficient disclosure controls and procedures to process this information.[62]

Analyzing the materiality of known trends, events or uncertainties may be particularly challenging for registrants preparing MD&A disclosure. As the Commission explained in the 1989 Release, when a trend, demand, commitment, event or uncertainty is known, "management must make two assessments:

- Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
- If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur."[63]

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61 Id.

62 Pursuant to Exchange Act Rules 13a-15 and 15d-15, a company's principal executive officer and principal financial officer must make certifications regarding the maintenance and effectiveness of disclosure controls and procedures. These rules define "disclosure controls and procedures" as those controls and procedures designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is (1) "recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms," and (2) "accumulated and communicated to the company's management ... as appropriate to allow timely decisions regarding required disclosure." As we have stated before, a company's disclosure controls and procedures should not be limited to disclosure specifically required, but should also ensure timely collection and evaluation of "information potentially subject to [required] disclosure," "information that is relevant to an assessment of the need to disclose developments and risks that pertain to the [company's] businesses," and "information that must be evaluated in the context of the disclosure requirement of Exchange Act Rule 12b-20." Release No. 33-8124 (Aug. 28, 2002) [67 FR 57276].

63 1989 Release.

Identifying and assessing known material trends and uncertainties generally will require registrants to consider a substantial amount of financial and non-financial information available to them, including information that itself may not be required to be disclosed.[64]

Registrants should address, when material, the difficulties involved in assessing the effect of the amount and timing of uncertain events, and provide an indication of the time periods in which resolution of the uncertainties is anticipated.[65] In accordance with Item 303(a), registrants must also disclose any other information a registrant believes is necessary to an understanding of its financial condition, changes in financial condition and results of operations.

E. Foreign private issuers.

The Securities Act and Exchange Act disclosure obligations of foreign private issuers are governed principally by Form 20-F's[66] disclosure requirements and not those under Regulation S-K. However, most of the disclosure requirements applicable to domestic issuers under Regulation S-K that are most likely to require disclosure related to climate change have parallels under Form 20-F, although some of the requirements are not as prescriptive as the provisions applicable to domestic issuers. For example, the following provisions of Form 20-F may require a foreign private issuer to provide disclosure concerning climate change matters that are material to its business:

- Item 3.D, which requires a foreign private issuer to disclose its material risks;
- Item 4.B.8, which requires a foreign private issuer to describe the material effects of government regulation on its business and to identify the particular regulatory body;

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64 2003 Release

65 Id.

66 17 CFR 249.220f.

- Item 4.D, which requires a foreign private issuer to describe any environmental issues that may affect the company's utilization of its assets;
- Item 5, which requires management's explanation of factors that have affected the company's financial condition and results of operations for the historical periods covered by the financial statements, and management's assessment of factors and trends that are anticipated to have a material effect on the company's financial condition and results of operations in future periods; and
- Item 8.A.7, which requires a foreign private issuer to provide information on any legal or arbitration proceedings, including governmental proceedings, which may have, or have had in the recent past, significant effects on the company's financial position or profitability.

Forms F-1[67] and F-3,[68] Securities Act registration statement forms for foreign private issuers, also require a foreign private issuer to provide the information, including risk factor disclosure, required under Regulation S-K Item 503.

IV. Climate change related disclosures

In the previous section we summarized a number of Commission rules and regulations that may be the source of a disclosure obligation for registrants under the federal securities laws. Depending on the facts and circumstances of a particular registrant, each of the items discussed above may require disclosure regarding the impact of climate change. The following topics are some of the ways climate change may trigger disclosure required by these rules and

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[67] 17 CFR 239.31.

[68] 17 CFR 239.33.

regulations.[69] These topics are examples of climate change related issues that a registrant may need to consider.

A. Impact of legislation and regulation.

As discussed above, there have been significant developments in federal and state legislation and regulation regarding climate change. These developments may trigger disclosure obligations under Commission rules and regulations, such as pursuant to Items 101, 103, 503(c) and 303 of Regulation S-K. With respect to existing federal, state and local provisions which relate to greenhouse gas emissions, Item 101 requires disclosure of any material estimated capital expenditures for environmental control facilities for the remainder of a registrant's current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material. Depending on a registrant's particular circumstances, Item 503(c) may require risk factor disclosure regarding existing or pending legislation or regulation that relates to climate change. Registrants should consider specific risks they face as a result of climate change legislation or regulation and avoid generic risk factor disclosure that could apply to any company. For example, registrants that are particularly sensitive to greenhouse gas legislation or regulation, such as registrants in the energy sector, may face significantly different risks from climate change legislation or regulation compared to registrants that currently are reliant on products that emit greenhouse gases, such as registrants in the transportation sector.

Item 303 requires registrants to assess whether any enacted climate change legislation or regulation is reasonably likely to have a material effect on the registrant's financial condition or

69 In addition to the Regulation S-K items discussed in this section, registrants must also consider any financial statement implications of climate change issues in accordance with applicable accounting standards, including Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 450, Contingencies, and FASB Accounting Standards Codification Topic 275, Risks and Uncertainties.

results of operation.[70] In the case of a known uncertainty, such as pending legislation or regulation, the analysis of whether disclosure is required in MD&A consists of two steps. First, management must evaluate whether the pending legislation or regulation is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, it must proceed on the assumption that the legislation or regulation will be enacted. Second, management must determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the registrant, its financial condition or results of operations. Unless management determines that a material effect is not reasonably likely,[71] MD&A disclosure is required.[72] In addition to disclosing the potential effect of pending legislation or regulation, the registrant would also have to consider disclosure, if material, of the difficulties involved in assessing the timing and effect of the pending legislation or regulation.[73]

A registrant should not limit its evaluation of disclosure of a proposed law only to negative consequences. Changes in the law or in the business practices of some registrants in response to the law may provide new opportunities for registrants. For example, if a "cap and trade" type system is put in place, registrants may be able to profit from the sale of allowances if their emissions levels end up being below their emissions allotment. Likewise, those who are not covered by statutory emissions caps may be able to profit by selling offset credits they may qualify for under new legislation.

70 See 1989 Release.

71 Management should ensure that it has sufficient information regarding the registrant's greenhouse gas emissions and other operational matters to evaluate the likelihood of a material effect arising from the subject legislation or regulation. See n. 62, supra.

72 In 2003 we issued additional guidance with respect to how registrants could improve MD&A disclosure, including ideas about how to focus on material issues and how to present information in a more effective manner to be of more value to investors. See 2003 Release.

Examples of possible consequences of pending legislation and regulation related to climate change include:

- Costs to purchase, or profits from sales of, allowances or credits under a "cap and trade" system;
- Costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a "cap and trade" regime; and
- Changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

We reiterate that climate change regulation is a rapidly developing area. Registrants need to regularly assess their potential disclosure obligations given new developments.

B. International accords.

Registrants also should consider, and disclose when material, the impact on their business of treaties or international accords relating to climate change. We already have noted the Kyoto Protocol, the EU ETS and other international activities in connection with climate change remediation. The potential sources of disclosure obligations related to international accords are the same as those discussed above for U.S. climate change regulation. Registrants whose businesses are reasonably likely to be affected by such agreements should monitor the progress of any potential agreements and consider the possible impact in satisfying their disclosure obligations based on the MD&A and materiality principles previously outlined.

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[73] See 2003 Release for a discussion of how companies should address, where material, the difficulties involved in assessing the effect of the amount and timing of uncertain events.

C. Indirect consequences of regulation or business trends.

Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for registrants. These developments may create demand for new products or services, or decrease demand for existing products or services. For example, possible indirect consequences or opportunities may include:

- Decreased demand for goods that produce significant greenhouse gas emissions;
- Increased demand for goods that result in lower emissions than competing products;[74]
- Increased competition to develop innovative new products;
- Increased demand for generation and transmission of energy from alternative energy sources; and
- Decreased demand for services related to carbon based energy sources, such as drilling services or equipment maintenance services.

These business trends or risks may be required to be disclosed as risk factors or in MD&A. In some cases, these developments could have a significant enough impact on a registrant's business that disclosure may be required in its business description under Item 101. For example, a registrant that plans to reposition itself to take advantage of potential opportunities, such as through material acquisitions of plants or equipment, may be required by Item 101(a)(1) to disclose this shift in plan of operation. Registrants should consider their own particular facts and circumstances in evaluating the materiality of these opportunities and obligations.

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[74] For example, recent legislation will ultimately phase out most traditional incandescent light bulbs. This has resulted in the acceleration of the development and marketing of compact fluorescent light bulbs. See Energy Independence and Security Act of 2007, Pub. L. No. 110-140, 121 Stat. 1492 (2007).

Another example of a potential indirect risk from climate change that would need to be considered for risk factor disclosure is the impact on a registrant's reputation. Depending on the nature of a registrant's business and its sensitivity to public opinion, a registrant may have to consider whether the public's perception of any publicly available data relating to its greenhouse gas emissions could expose it to potential adverse consequences to its business operations or financial condition resulting from reputational damage.

D. Physical impacts of climate change.

Significant physical effects of climate change, such as effects on the severity of weather (for example, floods or hurricanes), sea levels, the arability of farmland, and water availability and quality,[75] have the potential to affect a registrant's operations and results. For example, severe weather can cause catastrophic harm to physical plants and facilities and can disrupt manufacturing and distribution processes. A 2007 Government Accountability Office report states that 88% of all property losses paid by insurers between 1980 and 2005 were weather-related.[76] As noted in the GAO report, severe weather can have a devastating effect on the financial condition of affected businesses. The GAO report cites a number of sources to support the view that severe weather scenarios will increase as a result of climate change brought on by an overabundance of greenhouse gases.

Possible consequences of severe weather could include:

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75 See "Climate Change: Financial Risks to Federal and Private Insurers in Coming Decades Are Potentially Significant: U.S. Government Accountability Office Report to the Committee on Homeland Security and Governmental Affairs, U.S. Senate," GAO-07-285 (March 2007).

76 Id. at p.17.

- For registrants with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products;
- Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
- Increased insurance claims and liabilities for insurance and reinsurance companies[77];
- Decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
- Increased insurance premiums and deductibles, or a decrease in the availability of coverage, for registrants with plants or operations in areas subject to severe weather.

Registrants whose businesses may be vulnerable to severe weather or climate related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents.

V. Conclusion

This interpretive release is intended to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents to be filed with us and provided to investors. We will monitor the impact of this interpretive release on company filings as part of our ongoing disclosure review program. In addition, the Commission's Investor Advisory Committee[78] is

[77] Many insurers already have plans in place to address the increased risks that may arise as a result of climate change, with many reducing their near-term catastrophic exposure in both reinsurance and primary insurance coverage along the Gulf Coast and the eastern seaboard. Id. at 32.

[78] The Investor Advisory Committee was formed on June 3, 2009 to advise the Commission on matters of concern to investors in the securities markets, provide the Commission with investors' perspectives on current, non-enforcement, regulatory issues and serve as a source of information and recommendations to the Commission regarding the Commission's regulatory programs from the point of view of investors. See Press

considering climate change disclosure issues as part of its overall mandate to provide advice and recommendations to the Commission, and the Commission is planning to hold a public roundtable on disclosure regarding climate change matters in the spring of 2010. We will consider our experience with the disclosure review program together with any advice or recommendations made to us by the Investor Advisory Committee and information gained through the planned roundtable as we determine whether further guidance or rulemaking relating to climate change disclosure is necessary or appropriate in the public interest or for the protection of investors.

VI. Codification Update

The "Codification of Financial Reporting Policies" announced in Financial Reporting Release No. 1 (April 15, 1982) [47 FR 21028] is updated by adding new Section 501.15, captioned "Climate change related disclosures," and under that caption including the text in Sections III and IV of this release.

The Codification is a separate publication of the Commission. It will not be published in the Federal Register/Code of Federal Regulations.

List of Subjects

17 CFR Part 211

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 231 and 241

Securities.

Release No. 2009-126, "SEC Announces Creation of Investor Advisory Committee," available at http://www.sec.gov/news/press/2009/2009-126.htm.

Amendments to the Code of Federal Regulations

For the reasons set forth above, the Commission is amending Title 17, Chapter II of the Code of Federal Regulations as set forth below:

PART 211 -- INTERPRETATIONS RELATING TO FINANCIAL REPORTING MATTERS

1. Part 211, Subpart A, is amended by adding Release No. FR-82 and the release date of February 2, 2010 to the list of interpretive releases.

PART 231 -- INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER

2. Part 231 is amended by adding Release No. 33-9106 and the release date of February 2, 2010 to the list of interpretive releases.

PART 241 -- INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

3. Part 241 is amended by adding Release No. 34-61469 and the release date of February 2, 2010 to the list of interpretive releases.

By the Commission

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: February 2, 2010

SECURITIES AND EXCHANGE COMMISSION

RELEASE NOS. 33-9109; 34-61578

Commission Statement in Support of Convergence and Global Accounting Standards

AGENCY: Securities and Exchange Commission.

ACTION: Commission statement.

SUMMARY: The Securities and Exchange Commission (the "Commission") is publishing this statement to provide an update regarding its consideration of global accounting standards, including its continued support for the convergence of U.S. Generally Accepted Accounting Principles ("U.S. GAAP") and International Financial Reporting Standards ("IFRS") and the implications of convergence with respect to the Commission's ongoing consideration of incorporating IFRS into the financial reporting system for U.S. issuers.

FOR FURTHER INFORMATION CONTACT: Eloise Quarles Bavaria, Special Counsel, Office of International Corporate Finance, Division of Corporation Finance, at (202) 551-3450, Jeffrey S. Cohan, Senior Special Counsel, Office of the Chief Accountant, at (202) 551-5300, or Nili Shah, Associate Chief Accountant, Office of the Chief Accountant, at (202) 551-5300, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

The Commission continues to believe that a single set of high-quality globally accepted accounting standards will benefit U.S. investors and that this goal is consistent with our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. As a step toward this goal, we continue to encourage the convergence of U.S. GAAP and IFRS and expect that the differences will become fewer and narrower, over time, as a result of the convergence project.

The Commission last addressed this topic in November 2008 when it issued a proposed "Roadmap" for a possible path to a single set of globally accepted accounting standards.[1] The Proposed Roadmap generated significant interest and thoughtful comment from investors, issuers, accounting firms, regulators, and others regarding factors that the Commission should consider as it moves forward in its evaluation of whether and how to incorporate IFRS into the financial reporting system for U.S. issuers. In addition to reaffirming the Commission's strong commitment to a single set of global standards, the recognition that IFRS is best-positioned to be able to serve the role as that set of standards for the U.S. market, and the convergence process ongoing between the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB"), this statement outlines certain of these factors that are of particular importance to the Commission as it continues to evaluate IFRS through 2011.

The Commission has directed its staff to develop and execute a work plan (the "Work Plan") to enhance both understanding of the Commission's purpose and public transparency in this area.[2] Execution of the Work Plan, combined with the completion of the convergence projects of the FASB and the IASB according to their current work plan, will position the Commission in 2011 to make a determination regarding incorporating IFRS into the financial reporting system for U.S. issuers.

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[1] See *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*, Release No. 33-8982 (November 14, 2008) [73 FR 70816 (November 21, 2008)] ("Proposed Roadmap").

[2] The Work Plan is included as an appendix to this statement. A summary of the key areas of the Work Plan is provided in section IV of this statement.

I. Overview

A. History of the Commission's Steps to Foster a Single Set of High-Quality Globally Accepted Accounting Standards

The Commission has long promoted a single set of high-quality globally accepted accounting standards.[3] This position advances the dual goals of improving financial reporting within the United States and reducing country-by-country disparity in financial reporting. This, in turn, would facilitate cross-border capital formation while also helping to provide investors with the comparable and material information they need to make informed decisions about investment opportunities. In 1988, the Commission issued a policy statement supporting the establishment of mutually acceptable international accounting standards, provided that investor protections were not compromised.[4] The Commission cited the establishment of such standards as a critical goal to reduce regulatory impediments to cross-border capital transactions that result from disparate national accounting standards.[5]

In a 1997 report to Congress, the Commission encouraged the efforts of the International Accounting Standards Committee to develop a core set of accounting standards that could serve as a framework for financial reporting in cross-border offerings. In that report, the Commission also expressed its intent to remain active in the development of those standards.[6] These standards are now known as IFRS, and the

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[3] See, e.g., *Integrated Disclosure System for Foreign Private Issuers*, Release No. 33-6360 (November 20, 1981) [46 FR 58511 (December 2, 1981)].

[4] See *Regulation of the International Securities Markets*, Release No. 33-6807 (November 14, 1988) [53 FR 46963 (November 21, 1988)].

[5] Id.

[6] See "Pursuant to Section 509(5) of the National Securities Markets Improvement Act of 1996 Report on Promoting Global Preeminence of American Securities Markets" (October 1997).

International Accounting Standards Committee was succeeded by the IASB.

In 2000, the Commission issued a concept release on international accounting standards, seeking comment on the requisite elements to encourage convergence toward a global financial reporting framework that would not diminish the quality of domestic financial reporting.[7] The 2000 Concept Release discussed generally the circumstances under which the Commission would consider accepting financial statements from foreign private issuers[8] that are prepared using IFRS without a reconciliation to U.S. GAAP.[9]

In the 2000 Concept Release, the Commission set out some fundamental attributes for a high-quality set of accounting standards that continue to be important today. These attributes require that the standards (a) be of sufficiently high quality to support the Commission's mission of protecting investors and facilitating capital formation, and (b) be supported by an infrastructure that ensures that the standards are established by independent standard setters, and are rigorously and consistently interpreted and applied.

After enactment of the Sarbanes-Oxley Act of 2002 (the "Act"), the Commission reaffirmed its recognition of the financial accounting and reporting standards of the

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[7] See *International Accounting Standards*, No. 33-7801 (February 16, 2000) [65 FR 8896 (February 23, 2000)] ("2000 Concept Release").

[8] The term "foreign private issuer" is defined in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer means any foreign issuer other than a foreign government, except an issuer that meets the following conditions: (1) more than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States.

[9] In 2007, the Commission adopted rules permitting foreign private issuers to file financial statements using IFRS as issued by the IASB and to omit a reconciliation to U.S. GAAP. See *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP*, Release No. 33-8879 (December 21, 2007) [73 FR 986 (January 4, 2008)] ("2007 Adopting Release").

FASB as "generally accepted" for purposes of the federal securities laws.[10] One of the criteria that Congress required the Commission to consider, when recognizing an accounting standard setter, was whether that standard setter considers "international convergence on high-quality accounting standards as necessary or appropriate in the public interest and for the protection of investors."[11]

Also as required by Congress in the Act, in 2003, our staff issued a study on the adoption in the United States of a principles-based accounting system.[12] That study stated that global accounting standardization through convergence would lead to the following benefits:

- greater comparability for investors across firms and industries on a global basis;
- reduced listing costs for companies with multiple listings;
- increased competition among exchanges;
- better global resource allocation and capital formation;
- lowered cost of capital; and
- a higher global economic growth rate.[13]

Beginning in 2002, the FASB and the IASB began a formal process to converge U.S. GAAP and IFRS. In 2002, the FASB and the IASB announced the issuance of a memorandum of understanding to collaborate on the development of common, high-quality standards with the ultimate goal of a single set of high-quality global accounting

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[10] See *Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter*, Release No. 33-8221 (April 25, 2003) [68 FR 23333 (May 1, 2003)] ("2003 Policy Statement").

[11] See Section 19 of the Securities Act of 1933, as amended (15 U.S.C. 77a).

[12] See "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System" (July 25, 2003) ("2003 Study").

standards.[14] In 2006, the FASB and the IASB issued an updated memorandum of understanding that set forth the scope of their joint work program to improve and promote convergence of their accounting standards.[15] The 2006 memorandum of understanding was updated in September 2008 to identify targets for completion of convergence projects that the FASB and the IASB believed were most critical.[16] Throughout this process the Commission has monitored, and will continue to monitor, the activities of the FASB and the IASB and the progress in their efforts.

In 2007, the Commission took two additional actions. First, it issued a concept release on whether U.S. issuers should be allowed to prepare financial statements in accordance with IFRS.[17] Second, the Commission adopted rules that allow foreign private issuers to make filings with the Commission using financial statements prepared in accordance with IFRS, as issued by the IASB, and without reconciliation to U.S. GAAP.[18]

Recently, the leaders of the Group of Twenty nations ("G-20") requested that international accounting bodies redouble their efforts to achieve a single set of high-

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[13] Id.

[14] See "Memorandum of Understanding, 'The Norwalk Agreement,'" (September 18, 2002). (available at: http://www.fasb.org/news/memorandum.pdf)

[15] See "Memorandum of Understanding between the FASB and the IASB" (February 27, 2006). (available at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156245558)

[16] See "Completing the February 2006 Memorandum of Understanding: A progress report and timetable for completion" (September 2008). (available at: http://www.fasb.org/intl/MOU_09-11-08.pdf)

[17] See *Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards*, Release No. 33-8831 (August 7, 2007) [72 FR 45600 (August 14, 2007)] ("2007 Concept Release").

[18] See 2007 Adopting Release.

quality, global accounting standards through their independent standard-setting processes and complete their convergence project in June 2011.[19] The FASB and IASB recently reaffirmed their commitment to improving and converging their respective accounting standards, and further committed to intensify their efforts to meet a 2011 timeline.[20] Chairman Mary L. Schapiro also recently noted the Commission's commitment "to the goal of a global set of high-quality accounting standards."[21]

B. The Proposed Roadmap

In November 2008, the Commission proposed a path to evaluating the further role of IFRS in the U.S. capital markets.[22] The Proposed Roadmap sought comment on a number of suggested "milestones" that the Commission might consider.

The Proposed Roadmap contemplated that, subject to an assessment of the milestones and other considerations, and after consideration of public comment, the Commission could be in a position in 2011 to decide whether to require the use of IFRS by U.S. issuers beginning in 2014, potentially allowing earlier use by certain U.S. issuers beginning with filings for fiscal years ending on or after December 15, 2009.[23]

II. Public Feedback on the Commission's Proposed Roadmap

We received over 200 comment letters on the Proposed Roadmap from a wide

[19] See "Leaders' Statement from the Pittsburgh Summit" (September 24-25, 2009). (available at: https://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf)

[20] See "FASB and IASB Reaffirm Commitment to Memorandum of Understanding: A Joint Statement of the FASB and IASB" (November 5, 2009). (available at: http://www.iasb.org/NR/rdonlyres/D56F53A2-1FFE-425B-824B-9092E8A2D545/0/JointCommunique_October2009FINAL4.pdf)

[21] See Speech by SEC Chairman Mary L. Schapiro: Remarks at IOSCO Technical Committee Conference (October 8, 2009).

[22] See Proposed Roadmap. Unless otherwise noted, the phrase "IFRS" refers to "IFRS as issued by the IASB."

[23] The Proposed Roadmap did not address the method the Commission might use to mandate IFRS for U.S.

variety of market participants, including those representing investors, regulators, issuers, accounting, legal, and other professions, academia, standard setters, and international organizations.[24] Commenters generally expressed widespread support for the ultimate goal of having a single set of high-quality globally accepted accounting standards.[25] However, commenters differed in their views about the approach in the Proposed Roadmap to achieve further use of IFRS in the U.S. capital markets. Several commenters asserted that there are many transition questions and issues arising from the proposed approach that the Commission should consider further.[26]

A. Potential for High-Quality Globally Accepted Accounting Standards

There was widespread support across all commenters for a single set of high-quality globally accepted accounting standards.[27] While commenters offered differing perspectives, some commenters identified the following potential benefits from a single set of global accounting standards:

- improved financial statement comparability among companies worldwide;
- streamlined accounting processes for multinational companies; and

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issuers. See Id.

[24] Comment letters in response to the Proposed Roadmap are available on the Commission's Web site (at http://www.sec.gov/comments/s7-27-08/s72708.shtml). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

[25] See, e.g., Abbott Inc. ("Abbott"), Air Products and Chemicals, Inc., California Public Employees' Retirement System ("CalPERS"), CFA Institute ("CFA"), Council of Institutional Investors ("CII"), International Corporate Governance Network ("ICGN"), Institute of International Finance, Investors Technical Advisory Committee ("ITAC"), RiskMetrics Group, Inc. ("RiskMetrics"), and Standard & Poor's Ratings Services ("S&P").

[26] See, e.g., AT&T Services, Inc., The Boeing Company ("Boeing"), and Chevron Corporation.

[27] See, e.g., Accretive Solutions, Alcoa Inc ("Alcoa"), CalPERS, Center for Audit Quality, Cleary Gottlieb Steen & Hamilton LLP, General Mills, Inc., Institute of Management Accountants, State of New York Banking Department, PricewaterhouseCoopers LLP ("PwC"), and RiskMetrics,

- easier access to foreign capital and improved liquidity, leading to a reduced cost of capital.[28]

The potential benefits identified by commenters generally are consistent with the perceived benefits discussed in the staff's 2003 Study. Improved comparability was the most frequently cited potential benefit from the use of a single set of global accounting standards.[29] However, some commenters, while expressing support for the concept of a single set of global accounting standards, expressed reservations regarding whether the adoption of global accounting standards is a feasible objective.[30] Some of these concerns are discussed below.

B. The Proposed Roadmap

Opinions regarding the approach outlined in the Proposed Roadmap diverged. The key areas of concern expressed by the commenters include the readiness of IFRS to serve as the set of accounting standards for U.S. issuers, the need for continued convergence of IFRS and U.S. GAAP, and the timeframe set for, and potential costs of, transitioning U.S. GAAP to IFRS.[31]

Opinions regarding the potential of IFRS, in its current state, to serve as the single set of global accounting standards varied broadly across and within categories of commenters. While larger, multinational firms and commenters from the accounting profession generally saw IFRS as best positioned for the role of the single set of global

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[28] See, e.g., Liberty Global and Graybar Electric Company, Inc. ("Graybar") comment letters for lists of potential benefits from the use of a single set of global standards.

[29] See, e.g., American Institute of Certified Public Accountants ("AICPA"), Federation of European Accountants ("FEE"), and Institute of Chartered Accountants of Scotland.

[30] See, e.g., Liberty Global, The Lubrizol Corporation ("Lubrizol"), National Association of State Boards of Accountancy ("NASBA"), and Reznick Group, P.C.

accounting standards,[32] a number of other commenters expressed concerns regarding the capability of these standards, in their current state, to serve that role.[33]

Many investors and investor groups that addressed this issue expressed the view that it was too early to judge the potential of IFRS to serve as the single set of global accounting standards.[34] Commenters who expressed this view noted that:

- IFRS is not sufficiently developed or applied in practice to be adopted as a single set of global standards (e.g., either IFRS lacks guidance in certain significant areas, or the guidance it does contain appears to or may allow too much latitude to achieve more comparable financial reporting than U.S. GAAP);
- jurisdictional variants in the application of IFRS pose a significant challenge to the adoption of IFRS as a truly global reporting model; and
- the achievement of a genuine common global financial reporting model would require consistent application, auditing, and enforcement across countries.[35]

In addition, some commenters expressed concern that a "business case" has not been sufficiently demonstrated to support moving from existing U.S. GAAP directly to IFRS. These commenters contend that existing U.S. GAAP is already widely accepted worldwide and is seen as high-quality, and that not all U.S. companies compete for capital globally or issue securities outside the U.S. market, so the primary effect of the

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[31] See, e.g., Boeing, FPL Group, Inc., and Kohl's Corporation.

[32] See, e.g., AICPA, Alcoa, Association of Chartered Certified Accountants, California Society of Certified Public Accountants, Center for Audit Quality, IBM Corporation, and The Ohio Society of CPAs.

[33] See, e.g., Aerospace Industries Association and Committee of Annuity Insurers ("CAI").

[34] See, e.g., CalPERS, CII, ICGN, ITAC, and S&P.

[35] See, e.g., American Insurance Association, CAI, Center for Capital Markets Competitiveness, Dominion Resources Services, Hot Topic Inc., McDonald's Corporation ("McDonald's"), and National Association of Real Estate Investment Trusts.

Proposed Roadmap would be increased costs in return for minimal and largely conceptual benefits.[36] Others noted that significant challenges likely would arise in having an international organization as the ultimate body that would set standards for U.S. issuers.[37] Commenters in this area questioned whether this would be a wise policy, given the Commission's long-standing statutory role of setting and overseeing financial reporting standards for the United States.[38]

In contrast to the varying perspectives on the potential use of IFRS to serve as the common set of global accounting standards, commenters were more consistent with respect to their concerns on the approach and schedule outlined in the Proposed Roadmap. Many commenters, particularly investors, believed that the Commission should articulate how it intended to mandate the use of IFRS in the United States before they would be willing to support such a move.[39] Also, many commenters believed the proposal either underestimated or did not adequately address the many critical issues and costs (both quantitative and qualitative) that would be involved in meeting the transition timing suggested in the Proposed Roadmap. For example, while many commenters believed the proposal identified in concept many of the factors to be considered in choosing a particular path forward for the U.S. capital markets, they also believed that it did not sufficiently articulate a plan for identifying and addressing the specific issues and the criteria against which they would be judged.[40] As a result, several commenters

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[36] See, e.g., Darden Restaurant, Inc. ("Darden"), McDonald's, and PPL Corporation ("PPL").

[37] See, e.g., CMS Energy Corporation and Consumers Energy Company, Darden, Lubrizol, and McDonald's.

[38] See, e.g., Darden, Intel Corporation ("Intel"), and MetLife, Inc.

[39] See, e.g., CalPERS and S&P.

[40] See, e.g., CFA, CII, JPMorgan Chase, and The New York State Society of Certified Public Accountants.

recommended that the Commission further develop a plan to determine the appropriate path forward, including the affirmative actions and specific steps that need to be taken.[41]

III. Approach Forward for the U.S. Capital Markets

We continue to support the objective of financial reporting in the global markets pursuant to a single set of high-quality globally accepted accounting standards. As evidenced by the recent economic crisis, the activities and interests of investors, companies, and markets are increasingly global. This continued globalization of our markets reinforces the idea that the pursuit of this goal is consistent with our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

Since the second half of 2007, the world economy has experienced economic conditions not seen since the Great Depression. What at one time was viewed by some as an isolated crisis in the subprime mortgage sector spread to the global economy as a whole. The current environment has highlighted certain of the existing differences in the accounting standards used in the major capital markets. Some believe that these differences in accounting standards contributed to difficulty in the ability of investors and other stakeholders to assess the financial results of companies operating and competing in the global markets in determining how to allocate capital.[42] As part of the G-20's efforts to address the economic crisis, it specifically requested that accounting bodies redouble their efforts to achieve a single set of high-quality, global accounting standards through

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[41] See, e.g., CalPERS, ICGN, Intel, ITAC, Northrop Grumman Corporation ("Northrop Grumman"), and S&P.

[42] See "Report of the Financial Crisis Advisory Group" (July 28, 2009). (available at: http://www.iasb.org/NR/rdonlyres/2D2862CC-BEFC-4A1E-8DDC-F159B78C2AA6/0/FCAGReportJuly2009.pdf)

their independent standard-setting processes and complete their convergence project by 2011.[43]

The Commission's statutory mandate with respect to determining the accounting standards to be used in the United States requires it to promote full, fair, and reliable disclosure for the protection of U.S. investors.[44] The U.S. capital markets are among the largest and most liquid in the world. We believe that the acceptance, comprehensiveness, reliability, and enforceability of U.S. GAAP are important reasons for the pre-eminence of our capital markets. U.S. GAAP is a well-established basis for financial reporting that is applied by all U.S. issuers, many foreign companies and many U.S. private companies. Preparers and users of financial statements, such as investors and analysts, are familiar with U.S. GAAP. Thus, we acknowledge the magnitude of the task that would be involved to incorporate IFRS into our financial reporting environment for U.S. issuers. It is therefore important that, before we mandate any such change, careful consideration and deliberation, as well as a sufficient transition time for users and preparers of financial statements, occur to assure that such a change is in the best interest of U.S. investors and markets.

We have considered carefully the input contained in the comment letters we received. We believe that a more comprehensive work plan is necessary to lay out transparently the work that must be done to support our decision on the appropriate course to incorporate IFRS into the U.S. financial reporting system for U.S. issuers, including the scope, timeframe, and methodology for any such transition. Toward this

[43] See "Leaders' Statement from the Pittsburgh Summit" (September 24-25, 2009). (available at: http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf)

[44] See 2003 Policy Statement.

end, we have directed the staff of the Office of the Chief Accountant, with appropriate consultation with other Divisions and Offices of the Commission, to develop and carry out the Work Plan. The Work Plan accompanies this statement as an appendix.

The Work Plan sets forth specific areas and factors for the staff to consider before potentially transitioning our current financial reporting system for U.S. issuers to a system incorporating IFRS. Specifically, the Work Plan addresses areas of concern that were highlighted by commenters, including:

- Sufficient development and application of IFRS for the U.S. domestic reporting system;
- The independence of standard setting for the benefit of investors;
- Investor understanding and education regarding IFRS;
- Examination of the U.S. regulatory environment that would be affected by a change in accounting standards;
- The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies; and
- Human capital readiness.

The staff will provide public progress reports on the Work Plan beginning no later than October 2010 and frequently thereafter until the work is complete. The Work Plan is designed to provide the Commission the information it needs to evaluate the implications of incorporating IFRS into the U.S. domestic reporting system. Following successful completion of the Work Plan and the FASB-IASB convergence projects according to their current work plan, the Commission will be in a position in 2011 to determine whether to incorporate IFRS into the U.S. domestic reporting system.

Commenters on the Proposed Roadmap expressed a view that U.S. issuers would need approximately four to five years to successfully implement a change in their financial reporting systems to incorporate IFRS.[45] Therefore, assuming that the Commission determines in 2011 to incorporate IFRS into the U.S. domestic reporting system, we believe that the first time U.S. issuers would report under such a system would be approximately 2015 or 2016. We have asked the staff as part of the Work Plan to further evaluate this timeline.

IV. Summary of the Key Areas of the Work Plan

The Commission staff will analyze each of the six areas identified in its Work Plan, as discussed further below. The first two areas consider characteristics of IFRS and its standard setting that would be the most relevant to a future determination by the Commission regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. The remaining four areas relate to transitional considerations that will enable the Staff to better evaluate the scope of, timing of, and approach to changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to do so.

While an ultimate determination of any specific methods (e.g., convergence, standard-by-standard adoption, wholesale adoption) or dates for the possible incorporation of IFRS into the financial reporting system for U.S. issuers is beyond the scope of the Work Plan, the information obtained through the Work Plan will facilitate

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[45] See, e.g., Boeing, Northrop Grumman, PepsiCo, Inc., and tw telecom inc.

future Commission consideration of those matters. The Work Plan provides additional detail about the analysis that the staff will perform in each of these six areas.

A. Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System

As described in the 2000 Concept Release, the Commission's efforts to support a globally accepted high-quality financial reporting framework have been guided by its mission of protecting investors, maintaining fair, orderly, and efficient capital markets, and facilitating capital formation.[46] A necessary element for a set of global accounting standards to meet these objectives is that they must be high quality, consisting of a "comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions."[47] The Commission continues to believe that high-quality global accounting standards "must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied"[48] both within and outside the United States.

The increasing acceptance and use of IFRS in major capital markets throughout the world over the past several years, and its anticipated use in other countries in the near future, demonstrate that IFRS has the greatest potential to provide a common platform for capital markets regulators. The IASB has made significant progress in developing high-quality accounting standards, as noted in the 2007 Adopting Release.[49] However, as the

[46] See 2000 Concept Release.

[47] See 2000 Concept Release, at II.A.

[48] Id. See also 2007 Concept Release.

[49] See 2007 Adopting Release.

Commission noted in the Proposed Roadmap, there are areas where completion of the IASB's standard-setting initiatives, including those included in its convergence agenda with the FASB, should improve and further develop IFRS.[50] The successful completion of these efforts would be a significant accomplishment toward improving financial reporting for investors worldwide. In addition, the Commission in the Proposed Roadmap stated that, in further considering IFRS, it would "consider whether those accounting standards are of high quality and sufficiently comprehensive."[51] As part of the staff's efforts under the Work Plan, the staff will evaluate the IASB's efforts to improve IFRS, including through those joint IASB-FASB projects scheduled to be completed in 2011.

1. Comprehensiveness

In the Proposed Roadmap, the Commission stated that "IFRS is not as developed as U.S. GAAP in certain areas."[52] For example, IFRS does not provide broad guidance for certain topical areas, such as accounting for certain common control transactions, recapitalization transactions, reorganizations, and acquisitions of minority shares not resulting in a change of control and similar transactions.[53] IFRS also lacks guidance for certain broad industries, including those the IASB is currently developing related to utilities, insurance, extractive activities, and investment companies.[54] As part of the Work Plan, the staff will assess the overall level of comprehensiveness of IFRS.

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[50] See Proposed Roadmap.

[51] Id.

[52] Id.

[53] Id.

[54] Id.

2. Auditabilitity and Enforceability

The Proposed Roadmap noted the challenges that can exist with IFRS's less prescriptive guidance. Commenters on the Proposed Roadmap raised several concerns regarding the auditability and enforceability of IFRS, including the risk of opportunistic accounting; diminished comparability; and the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors.

The auditability and enforceability of a set of accounting standards are essential aspects of investor protection. Under the Work Plan, the staff will analyze factors that may influence the auditability and enforceability of financial statements prepared under IFRS.

3. Consistent and High-Quality Application

The Commission has based its continued strong support for a single set of high-quality globally accepted accounting standards, including the consideration of incorporating IFRS into its financial reporting system, on the premise that U.S. investors ultimately will benefit from the comparability of financial information from issuers on a worldwide basis. Consistent and high-quality implementation is necessary for investors to benefit from a set of high-quality global accounting standards.[55] To assess the consistent and faithful application of IFRS, the staff will analyze the factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis and their consequences in practice. The staff also will assess the relative effect on comparability of financial reporting in the United States, if IFRS were

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[55] See, e.g., comment letters from Maverick Capital, CII, and CFA on the proposing release: *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP*, Release No. 33-8818 (July 2, 2007) [72 FR 37962 (July 11, 2007)].

incorporated into the financial reporting system for U.S. issuers.

B. The Independence of Standard Setting for the Benefit of Investors

Another important element for a set of high-quality global accounting standards is whether the accounting standard setter's funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors. This is an area of significant concern to the investors and investor groups that commented on the Proposed Roadmap.[56] The Work Plan includes an ongoing review of the functioning of the IASB's governance structure and developments to secure a stable, broad-based source of funding.[57] This review will help the staff assess whether these factors promote standard setting that is accountable, independent, and free from undue influence that could affect the ability of U.S. investors to receive full, fair, and reliable disclosure. Full, fair, and reliable disclosure is essential to facilitate the meaningful comparison of financial information across national borders.

C. Investor Understanding and Education Regarding IFRS

The Commission's Proposed Roadmap reflects its belief that U.S. investors would benefit from the use of a single set of high-quality accounting standards that are used consistently in the global capital markets. In the Proposed Roadmap, the Commission

[56] See, e.g., comment letters from CalPERS and CFA.

[57] The IASB, an accounting standard-setting body based in London, was established to develop global standards for financial reporting. The IASB is overseen by the IFRS Foundation (formerly called the "IASC Foundation," this organization has been renamed as a result of recent amendments to its Constitution, effective March 1, 2010). The IFRS Foundation is responsible for the activities of the IASB. While national accounting standard setters traditionally have been accountable to a national securities regulator or other government authority, until 2009, the IFRS Foundation did not have a formal link with any national securities regulators. Recognizing that a relationship with national securities regulators would enhance the public accountability of the IFRS Foundation, its trustees agreed on amendments to its Constitution to establish a link between the IFRS Foundation and a Monitoring Board composed of public capital markets authorities, including the Commission, charged with the adoption or recognition of accounting standards used in their respective jurisdictions. For further information on the governance structure and operation of the IASB, see www.iasb.org.

stated that a single set of global accounting standards could enhance the ability of investors to compare financial information of U.S. companies with that of non-U.S. companies. Improved comparability was the most commonly cited reason commenters believed that U.S. capital markets would benefit from the use of a single set of global accounting standards.[58] Because the benefits of adopting a single set of high-quality globally accepted accounting standards would be realized only if investors understood and had confidence in the financial reporting system, the Commission believes that in order to assess incorporation of IFRS into the U.S. financial reporting system, further work is necessary to assess investor understanding and education regarding IFRS. The staff's performance of the steps in the Work Plan should provide the staff with insight into investors' understanding of IFRS and actions that need to be taken to increase investors' understanding.

D. Examination of the U.S. Regulatory Environment that Would Be Affected by a Change in Accounting Standards

The Commission acknowledges that the incorporation of IFRS into the financial reporting system for U.S. issuers could have far-reaching effects on financial reporting by U.S. issuers for other purposes. In addition to filing financial statements with the Commission, U.S. issuers commonly provide financial information to a wide variety of other parties for different purposes. While the federal securities laws provide the Commission with the authority to prescribe accounting principles and standards to be followed by public companies and other entities that provide financial information to the Commission and investors, the Commission does not directly prescribe the provision and

[58] See, e.g., AICPA, FEE, PPL, and TransCanada Corporation.

content of information that U.S. issuers provide to parties other than it and investors.[59] However, changes to the Commission's accounting standards could affect issuers and the information they provide to regulatory authorities and others that rely on U.S. GAAP as a basis for their reporting regimes.[60] In accordance with the Work Plan, the staff will study and consider other regulatory effects of mandating IFRS for U.S. issuers.

E. The Impact on Issuers, Both Large and Small, Including Changes to Accounting Systems, Changes to Contractual Arrangements, Corporate Governance Considerations, and Litigation Contingencies

In considering incorporation of IFRS into the U.S. financial reporting system, the Commission must assess the significant effects that such changes would have on the preparers of financial statements – the thousands of companies that file financial statements with the Commission under the federal securities laws. In addition to the significant effects that a transition would have on investors, the issuers of financial statements would incur costs, effort, and time as a result of a transition. Smaller companies and those without international operations will bear those costs and efforts differently than larger companies and those that compete globally. As part of the Work Plan, the staff will consider the impact of the logistical changes involved in incorporating IFRS into the U.S. financial reporting system. The extent of that impact may be decreased by ongoing convergence efforts between the IASB and the FASB.

F. Human Capital Readiness

As contemplated by the Proposed Roadmap, incorporation of IFRS would require

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[59] Id.

[60] Id. For example, U.S. issuers often provide U.S. GAAP-based financial information to various federal and state regulators, including regulators of financial institutions, insurance companies and public utilities. Another example of the effect on reporting to others relates to federal and state income taxes. Existing U.S. GAAP is the predominant set of accounting standards used in the United States, and the Internal Revenue Code has developed over time in reliance on such accounting standards.

consideration of the readiness of all parties involved in the financial reporting process, including investors, preparers, auditors, regulators, and educators. As a result, any change involving the incorporation of IFRS into the financial reporting system for U.S. issuers would require greater familiarity of IFRS for investors, preparers, auditors, regulators, academics, and many others. Under the Work Plan, the staff will review the effect of the incorporation of IFRS on the education and training of professionals involved in the financial reporting process as well as any impact on auditor capacity.

V. Potential Transition Matters

Many commenters on the Proposed Roadmap expressed concern about having appropriate transition time to plan for and implement any changes that would be needed in connection with a further move toward incorporation of IFRS in domestic financial reporting.[61] Commenters also indicated that the Proposed Roadmap had created a significant amount of uncertainty for market participants about how any proposed changes would affect them and whether they should begin immediately to allocate resources to prepare for use of IFRS.[62]

We acknowledge that the changes to our current financial reporting system that would be necessary to transition to a single set of global accounting standards, including the incorporation of IFRS for U.S. issuers, could represent a fundamental change that would require significant transition time and effort for issuers, investors, and others. Several steps in the Work Plan, including progress toward completion of convergence, focus on providing the Commission with additional information about the magnitude of

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[61] See, e.g., AICPA, Cymer, Inc., and Graybar.

[62] See, e.g., Best Buy Co., Inc., Cisco Systems, Inc., and Fannie Mae.

these changes and the logistics necessary for implementing them. This information will enable the Commission to consider the plans that would need to be implemented in a move to incorporate IFRS into the financial reporting system for U.S. issuers, including providing sufficient time to efficiently and effectively implement any changes in accounting standards.

The Proposed Roadmap proposed to allow certain large U.S. issuers the option of preparing their financial statements using IFRS beginning with filings for fiscal years ending on or after December 15, 2009. A significant group of commenters disagreed with an early use option, generally because of the increased complexity, lack of comparability between U.S. issuers under a dual system, and the possibility of companies opportunistically selecting which system of accounting standards to apply.[63] Alternative strategies proposed by this group varied widely, and included the optional use of IFRS during any contemplated transition period to a single set of global accounting standards.[64] Some commenters suggested an open option for all issuers or, at least, a significantly expanded group of issuers.[65]

The Commission is not foreclosing the possibility in the future that issuers may be permitted to choose between IFRS and U.S. GAAP, nor is the Commission foreclosing the possibility of some manner of early use or adoption approach. The conditions for early adoption, however, would depend on the overall approach to incorporate IFRS into the U.S. financial reporting system for U.S. issuers. As that overall approach remains under evaluation, we are not actively pursuing rulemaking to provide for an early use

[63] See, e.g., CalPERS, CFA, CII, ICGN, and ITAC.

[64] See, e.g., Ernst & Young LLP and PwC.

[65] See, e.g., Abbott, AICPA, and S&P.

option at this time.[66]

VI. Role of the FASB

The FASB is the independent, private-sector accounting standard-setting body for the United States. Since 1973, the Commission has recognized the FASB's pronouncements establishing and amending accounting principles as "authoritative" and "generally accepted" for purposes of the federal securities laws, absent any contrary determination by the Commission.[67] After enactment of the Act, the Commission reaffirmed the recognition of the financial accounting and reporting standards of the FASB as "generally accepted" for purposes of the federal securities laws.[68]

Some commenters believed the lack of clarity in the Proposed Roadmap regarding the future role of the FASB has created unnecessary uncertainty. Commenters offered divergent opinions about whether the Commission should maintain a relationship with the FASB as the U.S. national accounting standard setter in lieu of directly relying on the IASB.[69]

We believe the FASB will continue to play a critical and substantive role in achieving the goal of global accounting standards. The FASB is the accounting standard setter for the U.S. capital markets, and it should continue to work with the IASB to improve accounting standards. Moreover, that role would remain critical after adoption

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[66] Accordingly, we are withdrawing the proposed rules for limited early use of IFRS by certain U.S. issuers.

[67] See *Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards*, Accounting Series Release No. 150 (December 20, 1973) (expressing the Commission's intent to continue to look to the private sector for leadership in establishing and improving accounting principles and standards through the FASB) and the 2003 Policy Statement.

[68] See 2003 Policy Statement.

[69] NASBA and CalPERS expressed the view that the Commission should maintain a relationship with the FASB, whereas KPMG LLP expressed the view that the Commission should recognize the IASB as the single accounting standard setter.

of global standards. In this regard, we have considered the role that other national standard setters have maintained in connection with their consideration of IFRS. In particular, one organization with national regulatory responsibilities noted in its comment letter on the Proposed Roadmap that the continued existence of a national standard setter allows for more effective working relationships with the IASB and helps the IASB have an effective dialogue with constituents in that country.[70] We note many developed countries have maintained a national standard setter or other mechanisms in connection with the incorporation of IFRS into their capital markets.[71]

As part of the staff's execution of the Work Plan, it will continue to analyze the nature of the appropriate and ongoing role of the FASB should IFRS be incorporated into the U.S. financial reporting system for U.S. issuers.

VII. Regulatory Requirements

This statement is not an agency rule requiring notice of proposed rulemaking, opportunities for public participation, and prior publication under the provisions of the

[70] See U.K. Financial Reporting Council.

[71] For example, the European Union ("EU"), which required the use of IFRS as the accounting standards for companies incorporated in one of its Member States and whose securities are listed on an EU-regulated market beginning with their 2005 financial year, uses the European Financial Reporting Advisory Group to provide technical advice to the European Commission in connection with the EU's mechanism for endorsement of IFRS.

Administrative Procedure Act ("APA"). Similarly, the provisions of the Regulatory Flexibility Act, which apply only when notice and comment are required by the APA or another statute, are not applicable.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

February 24, 2010

Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers

OFFICE OF THE CHIEF ACCOUNTANT
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

This is a report by the Staff of the U.S. Securities and Exchange Commission. The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

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Background

In the 2010 Statement,[1] the U.S. Securities and Exchange Commission ("SEC" or "Commission") directs the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the Commission (collectively, the "Staff"), to develop and execute a work plan ("Work Plan"). The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination of whether, when, and how our current financial reporting system for U.S. issuers should be transitioned to a system incorporating International Financial Reporting Standards ("IFRS").[2] Specifically, the Work Plan addresses areas of concern that were highlighted by commenters on the Commission's proposed *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*,[3] including:

1. Sufficient development and application of IFRS for the U.S. domestic reporting system;
2. The independence of standard setting for the benefit of investors;
3. Investor understanding and education regarding IFRS;
4. Examination of the U.S. regulatory environment that would be affected by a change in accounting standards;
5. The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies; and
6. Human capital readiness.

The first two areas above consider characteristics of IFRS and its standard setting that would be the most relevant to a future determination by the Commission regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. The remaining four areas above relate to transitional considerations that will enable the Staff to better evaluate the scope of, timing of, and approach to changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to do so.

In formulating this initial Work Plan, the Staff considered commenters' views that U.S. issuers would need approximately four to five years to successfully implement a change

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[1] See *Commission Statement in Support of Convergence and Global Accounting Standards*, Release No. 33-9109 (February 24, 2010) ("2010 Statement").

[2] Hereafter, the term "IFRS" refers to "IFRS as issued by the International Accounting Standards Board ('IASB')" unless otherwise noted.

[3] Release No. 33-8982 (November 14, 2008) [73 FR 70816 (November 21, 2008)] ("Proposed Roadmap").

in their financial reporting systems to incorporate IFRS.[4] Therefore, assuming that the Commission determines in 2011 to incorporate IFRS into the U.S. financial reporting system, the first time U.S. issuers would report under such a system would be approximately 2015 or 2016. The Staff will further evaluate this timeline as a part of the Work Plan.

While an ultimate determination of any specific methods (e.g., convergence, standard-by-standard adoption, wholesale adoption) or dates for the possible incorporation of IFRS into the financial reporting system for U.S. issuers is beyond the scope of the Work Plan, the information obtained through the Work Plan will facilitate future Commission consideration of those matters. Further, while the Work Plan focuses on the implications of incorporation of IFRS into the financial reporting system for U.S. issuers on U.S. constituents, the Staff also will consider the effects of its recommendations to the Commission on other jurisdictions that have incorporated or have committed to incorporate IFRS into their financial reporting systems.

Each area is important to the Staff's consideration of the most effective approach to advance the Commission's objective of achieving a single set of high-quality globally accepted accounting standards. The Staff, however, did not develop the Work Plan with the intention that any one step is individually determinative of the optimal path forward. Further, for many of the steps, the Staff is seeking to assess the degree to which a particular attribute or condition exists for consideration of how the topic interacts with policy considerations. The Staff does not view the objective of its efforts as being to determine whether an attribute "passes" or "fails" a pre-determined standard.

The Staff has developed this Work Plan based on its understanding of the current environment. The Staff intends to continually re-assess this Work Plan and adjust it as new information is obtained or developments occur. Further, of necessity, the Staff will modify this Work Plan in response to constraints encountered, such as limited availability of information, with the intention of accomplishing each section's stated objective to the maximum extent possible.

In executing this Work Plan, the Staff will gather information using a variety of methods, including, but not limited to, performing its own research; seeking comment from, holding discussions with, and analyzing information from constituents, including investors, issuers, auditors, attorneys, other regulators, standard setters, and academics; considering academic research; and researching the experiences of other jurisdictions that have incorporated or have committed to incorporate IFRS into their financial reporting systems and foreign private issuers who currently report under IFRS. The Staff will

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[4] See, e.g., The Boeing Company ("Boeing"), Northrop Grumman Corporation ("Northrop Grumman"), PepsiCo, Inc. ("Pepsi"), and tw telecom inc ("tw telecom"). Comment letters in response to the Proposed Roadmap are available on the Commission's Web site (at http://www.sec.gov/comments/s7-27-08/s72708.shtml). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Unless otherwise noted, comment letters referenced in this Work Plan were submitted in response to the Proposed Roadmap and are cited by author.

provide public progress reports beginning no later than October 2010 and frequently thereafter until the work is complete.

I. Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System

A. Introduction

The 2010 Statement notes that "[a] necessary element for a set of global accounting standards to meet [the agency's mission] is that they must be high-quality…." The Commission previously has described high-quality standards as consisting of a "comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions."[5] The Commission also has expressed its belief that high-quality accounting standards "must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied."[6]

In the Proposed Roadmap, the Commission stated that, in further considering IFRS, it would "consider whether those accounting standards are of high-quality and sufficiently comprehensive." Accordingly, the Staff believes that an evaluation of whether IFRS is sufficiently developed and applied to be the single set of globally accepted accounting standards for U.S. issuers requires consideration of the following areas:

- The comprehensiveness of IFRS;
- The auditability and enforceability of IFRS; and
- The comparability of IFRS financial statements within and across jurisdictions.

As the Commission noted in the Proposed Roadmap, there are areas where completion of the IASB's standard-setting initiatives, including those included in its convergence agenda with the Financial Accounting Standards Board ("FASB"), as discussed in the 2010 Statement, should improve and further develop IFRS. The Commission further notes in the 2010 Statement, "[t]he successful completion of these efforts would be a significant accomplishment toward improving financial reporting for investors worldwide." As such, the Staff's efforts in the above areas will include consideration of the IASB's efforts to improve IFRS.

B. Comprehensiveness of IFRS

The Commission stated in the Proposed Roadmap that "IFRS is not as developed as [U.S. generally accepted accounting principles ('U.S. GAAP')] in certain areas." This is due, in part, to IFRS's relative youth, as articulated by one commenter:

> [W]e are concerned about quality and maturity of IFRS in comparison to…[U.S.

[5] *International Accounting Standards*, Release No. 33-7801 (February 16, 2000) [65 FR 8896 (February 23, 2000)] ("2000 Concept Release").

[6] 2000 Concept Release.

GAAP]. U.S. GAAP has a long history and has been tested and refined through multiple and complex economic events and developments. Many of the standards in U.S. GAAP have emerged as a direct result of circumstances and events that demonstrated the need for better and more transparent financial reporting (for example, the rise of derivative instruments and recent financial scandals such as the collapse of Enron)....[7]

The Commission and commenters have noted limited IFRS guidance in two respects. First, IFRS lacks broad guidance for: (1) certain topical areas, such as accounting for certain common control transactions, recapitalization transactions, reorganizations, acquisitions of minority shares not resulting in a change of control and similar transactions, and the push down of a new accounting basis in an entity's separate financial statements; (2) certain industries, such as those related to utilities, insurance, extractive activities, and investment companies; and (3) disclosures in order to provide better transparency regarding the application of accounting principles.[8]

Second, where IFRS provides broad guidance, the IASB, as a matter of operating practice, has elected to make guidance less detailed and prescriptive than U.S. GAAP.[9] Commenters' views were mixed as to whether the lesser degree of detailed guidance under IFRS, as compared to U.S. GAAP, is indicative of a higher quality set of accounting standards. Commenters who preferred IFRS's approach asserted that it is less complex than U.S. GAAP and allows companies to capture the substance of transactions.[10] On the other hand, commenters who preferred U.S. GAAP's approach expressed that IFRS relies too much on management discretion, thereby increasing the potential for opportunistic accounting; creating challenges for auditors, as discussed in section I.C below; and reducing comparability, as discussed in section I.D below.[11]

Other commenters have argued, however, that this debate may not be relevant in the U.S.

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[7] CMS Energy Corporation and Consumers Energy Company. See also, e.g., FedEx Corporation, Hess Corporation, Honeywell International ("Honeywell"), Northrop Grumman, and Andrea Psoras ("Psoras").

[8] See, e.g., Proposed Roadmap. See also, e.g., Financial Accounting Foundation ("FAF"), Investors Technical Advisory Committee ("ITAC"), Liberty Global, and Standard & Poor's Ratings Services. The Staff acknowledges that in certain of these specified areas, these concerns are equally applicable to U.S. GAAP.

[9] See, e.g., Proposed Roadmap. See also, e.g., Accretive Solutions, First Commonwealth Financial Corporation ("First Commonwealth"), and ITAC.

For example, as the FASB staff discussed in "Board Meeting Handout: Joint Revenue Recognition Project" (April 9, 2008) (available at: http://www.fasb.org/04-09-08_rev.pdf)), revenue recognition guidance under U.S. GAAP (prior to the FASB Codification) consisted of over 200 pieces of literature from various sources, whereas revenue recognition guidance under IFRS "lacks explicit measurement guidance. Although such measurement guidance exists in abundance in U.S. GAAP, IFRS suffers from the opposite extreme."

[10] See, e.g., Alcoa Inc. ("Alcoa"), The Bank of New York Mellon, Federation of European Accountants ("FEE"), Institute of Chartered Accountants in England and Wales ("ICAEW"), and Gregory Misiorek.

[11] See, e.g., First Commonwealth, Fund of Stockowners Rights ("Fund Stockowners Rights"), State of New York Banking Department ("NYBD"), Psoras, Sanctuary Financial Group, Inc., and tw telecom.

environment. For example, the FAF asserted in its comment letter that:

> [W]hile it is perceived that IFRS provides financial statement preparers more discretion in application than U.S. GAAP, such additional discretion may not result in major differences in the application of IFRS by U.S. companies because the U.S. institutional framework plays a major role in shaping how companies would apply the discretion.

The Staff will analyze for the Commission's benefit the extent to which IFRS is comprehensive so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Inventory areas in which IFRS does not provide guidance or where it provides less guidance than U.S. GAAP.

- Analyze how issuers, auditors, and investors currently manage these situations in practice.

- Identify areas in which issuers, auditors, and investors would most benefit from additional IFRS guidance.

C. Auditability and Enforceability

IFRS's less detailed and prescriptive guidance may or may not create challenges in its auditability and enforceability. If it were to do so, IFRS may "[make] litigation or enforcement outcomes more difficult to predict."[12] This outcome may be true not only within jurisdictions, but also across jurisdictions, as the existence of differing regulatory regimes and legal environments across jurisdictions may exacerbate the inconsistent interpretation and enforcement of IFRS. For example, the CFA Institute stated the following in its comment letter:

> Investors need greater assurance regarding the divergence of application within the principles-based standards of IFRS prior to adoption. Conversion to more principles-based standards that are applied inconsistently in different regulatory environments, auditing regimes and cultures may not be beneficial to investors.

Commenters raised several concerns regarding the auditability and enforceability of IFRS, including the risk of opportunistic accounting; the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors; and diminished comparability.

First, regarding the risk of opportunistic accounting, some commenters expressed that IFRS allows for increased flexibility, as compared to U.S. GAAP, and may result in standards being less auditable and enforceable, which would not be in the public

[12] Proposed Roadmap.

interest.[13] For example, one commenter stated:

> The international standards (IFRS) are widely viewed as less specific and providing less prescriptive guidance than U.S. GAAP (i.e., IFRS are more principles based), as well as more subjective primarily due to more use of fair value measurements. The downgrading of verifiability as a key concept guiding accounting standard setting and the resulting focus on fair value measurement significantly impairs the ability of an auditor to limit opportunistic actions of management and improve financial reporting.[14]

Second, regarding the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors, some commenters have expressed concerns that IFRS's less detailed and prescriptive guidance could expose companies to increased claims by shareholders and others seeking to challenge its application, given the perceived litigious environment in the United States.[15] The Staff has acknowledged similar concerns in the context of an objectives-oriented system, noting:

> We believe that the existence of a strong and consistently applied enforcement mechanism is a necessary component to the success of an objectives-oriented system. Preparers and auditors have expressed concern that those charged with enforcement in a principles-based environment will question reasonable judgments made in good faith (footnote omitted). In fact, some have asked whether the Commission staff would be willing to accept reasonable views and interpretations by preparers and auditors in the application of accounting principles (citation omitted).[16]

However, the Staff also stated:

> We believe...that the concern over litigation uncertainty is sometimes overstated....If preparers and auditors maintain contemporaneous documentation that demonstrates that they properly determined the substance of a covered transaction or event, applied the proper body of literature to it, had a sound basis for their conclusions-particularly those involving the exercise of judgment-and ensured through disclosure that their method was transparent, their exposure to litigation may be reduced.[17]

Some commenters stated that the U.S. legal system, which relies, to a larger extent, on guidance, rules, and bright lines, ultimately will drive IFRS to evolve, similar to U.S.

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[13] See, e.g., Fund Stockowners Rights, National Association of State Boards of Accountancy ("NASBA"), and Psoras.

[14] American Accounting Association, Financial Accounting Standards Committee ("AAA-FASC").

[15] See, e.g., FPL Group, Inc. ("FPL") and tw telecom.

[16] "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System" (July 25, 2003) ("Principles-Based Accounting System Study").

[17] Principles-Based Accounting System Study.

GAAP, into a rules-based set of standards.[18] Accordingly, commenters advocated addressing the causes of rules-based standards, such as through changes to the U.S. legal and regulatory environment, and development of an accounting and auditing judgment framework to reassure issuers that they will not be penalized for the use of reasonable judgment in the application of IFRS.[19]

The Staff also observed that the exercise of professional judgment in an objectives-oriented regime would require certain cultural changes, including: (1) a reduction in the tendency to ask questions like "where does the literature say I cannot do this," (2) a reduction in an audit checklist mentality, (3) an improvement in accounting professionals' understanding of the economic substance of a transaction, and (4) an improvement in the transparency of disclosures.[20]

Finally, IFRS's less detailed and prescriptive guidance, coupled with any diversity of perspectives amongst issuers, auditors, and regulators on a global basis may affect the comparability of financial statements prepared under IFRS. For example, in the auditing context, commenters raised concerns regarding the possibility that each audit firm will develop its own interpretations of IFRS,[21] resulting in reduced comparability across companies using different auditors. Some commenters went further by echoing concerns raised in the 2007 Concept Release[22] that IFRS also may contribute to reduced comparability within audit firms, due to the lack of internationally integrated accounting firms with a single global accounting perspective.[23]

Similarly, commenters expressed concern that differing regulation and enforcement structures and practice on a global basis may undermine the comparability of financial statements prepared under IFRS.[24] The Commission has noted that securities regulators have developed and continue to improve infrastructure to foster the consistent and

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[18] See, e.g., Air Products and Chemicals, Inc. ("Air Products"), Community Health Systems, Inc. ("Community Health"), JPMorgan Chase ("JP Morgan"), The London Centre for International Corporate Governance Law ("London Ctr Int'l Corp Gov Law"), and Edward Randle.

[19] See, e.g., American Institute of Certified Public Accountants ("AICPA"), California Society of Certified Public Accountants ("CA CPAs"), Center for Audit Quality ("CAQ"), Deloitte & Touche LLP ("Deloitte"), McGladrey & Pullen LLP ("McGladrey"), Morgan Stanley, NYBD, and The Ohio Society of CPAs ("Ohio CPAs").

[20] See Principles-Based Accounting System Study.

[21] See, e.g., Community Health, Eli Lilly and Company ("Eli Lilly"), and Marriott International, Inc. ("Marriott").

[22] In *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards*, Release No. 33-8831 (August 7, 2007) [72 FR 45600 (August 14, 2007)] ("2007 Concept Release"), the Commission stated, "for the U.S. firms that are members of global audit networks, systems of quality control need to foster the high quality and consistent application of IFRS across national borders."

[23] See, e.g., London Ctr Int'l Corp Gov Law.

[24] See, e.g., California Public Employees' Retirement System ("CalPERS"), Cleary Gottlieb Steen & Hamilton LLP, Group of North American Insurance Enterprises, and International Corporate Governance Network ("ICGN").

faithful application and enforcement of IFRS around the world.[25] For example, in January 2007, an International Organization of Securities Commissions ("IOSCO") database for cataloguing and sharing securities regulators' experiences on IFRS application around the world became operational.[26] Further, the Commission and the Committee of European Securities Regulators ("CESR") published a work plan in August 2006, covering information sharing in regular meetings and the confidential exchange of issuer-specific information.[27] In addition to the coordination with organizations of securities regulators and under the CESR work plan, the Commission also has developed bilateral dialogues with particular securities regulators to discuss accounting and enforcement matters.

These recent developments were noted by the CFA Institute in its comment letter:

> [T]his coordinated effort and related processes [by members of IOSCO] are still being developed and the overall effectiveness of their regulatory oversight has not been fully demonstrated (i.e., that the interpretation and enforcement of IFRS is consistent). The SEC should focus on how IFRS is being applied and ensure that studies about this are undertaken and widely circulated to all interested parties.

The Staff believes that the auditability and enforceability of financial statements prepared under IFRS is a key component in considering whether to incorporate IFRS into the financial reporting system for U.S. issuers. Accordingly, the Staff intends to gather data to inform the Commission in this regard. Specifically, the Staff will:

- Analyze factors that may influence the auditability of financial statements prepared under, and the enforceability of, IFRS.
- Evaluate factors that may influence the consistent audit of financial statements prepared under, and the enforcement of, IFRS.
- Identify potential changes to improve the auditability and enforceability of financial statements prepared under IFRS and to facilitate their consistent audit and enforcement.

D. Comparability Within and Across Jurisdictions

One of the primary benefits of a single set of global accounting standards is increased comparability of financial statements. However, as the Proposed Roadmap stated:

> The advantages to U.S. investors of increased comparability across investment alternatives, as contemplated under this Roadmap, are dependent upon financial

[25] See 2007 Concept Release.

[26] See Id.

[27] See Id.

reporting under IFRS that is, in fact, consistent across companies, industries and countries.

A number of factors may undermine the comparability of IFRS financial statements. As discussed above, the lesser degree of comprehensiveness and the challenges of consistent audit and enforcement of IFRS financial statements may affect their comparability. In addition, jurisdictional variations in the application of IFRS, the optionality within IFRS, and inconsistencies arising from differences in the translation of IFRS also may reduce the benefits of IFRS as a single set of global accounting standards.[28]

Some sources indicate that more than 100 countries "require or allow the use" of IFRS.[29] At the same time, there is the real possibility of jurisdictional variations, which could undermine comparability. Jurisdictional variations may arise from both authoritative and informal application guidance, changes made to the standards for purposes of use within a jurisdiction, and variations in the times it may take separate jurisdictions to complete their respective processes to enact into law or otherwise adopt new or amended standards. Historical approaches and cultural differences also may give rise to jurisdictional variations.

Commenters frequently cited concerns regarding the existence of and future potential for jurisdictional variations of IFRS.[30] Similarly, the Commission noted that "the extent to which IFRS is adopted and applied globally, and whether IFRS is adopted and applied in foreign jurisdictions as issued by the IASB or as jurisdictional variations of IFRS" "may influence the degree to which comparability may be achieved through widespread adoption of IFRS."[31]

Regarding optionality, the SEC's Advisory Committee on Improvements to Financial Reporting ("CIFiR") and others have asserted that IFRS's permitted alternative accounting treatments in a number of areas "contribute to avoidable complexity by making financial reports less comparable."[32]

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[28] See Proposed Roadmap.

[29] See, e.g., Deloitte Touche Tohmatsu, "Use of IFRSs by Jurisdiction." (available at: http://www.iasplus.com/country/useias.htm)

[30] See, e.g., Corporate Roundtable on International Financial Reporting ("CRIFR"), The Davey Tree Expert Company ("Davey Tree"), Institute of Chartered Accountants of Scotland ("ICAS"), KPMG LLP ("KPMG"), The Lubrizol Corporation, McDonald's Corporation ("McDonald's"), Mead Westvaco Corporation ("Mead Westvaco"), NASBA, The Travelers Companies, Inc. ("Travelers"), and Tuesday Morning Corporation ("Tuesday Morning").

[31] Proposed Roadmap.

[32] "Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission" (August 1, 2008) ("CIFiR Final Report"), page 50. (available at: http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf)

In the Proposed Roadmap, the Commission expressed that:

> IFRS…in certain areas permits a greater amount of options than in U.S. GAAP….[This] greater optionality in IFRS could reduce comparability of reported financial information, as different issuers may account or provide disclosure for similar transactions or events in different ways[,] but this flexibility also allows a financial statement that may more closely reflect the economics of transactions.

To counter any diminished comparability, commenters expressed the need for greater transparency around divergence in application.[33] However, as one commenter noted, extensive footnote disclosures explaining how management has applied its discretion "will place the burden upon the user of the financial statements to understand and interpret the differences between companies...."[34]

In light of the these concerns, the Staff will analyze for the Commission's benefit the extent to which financial statements prepared under IFRS are comparable within and across jurisdictions so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis.
- Assess the extent to which financial statements prepared under IFRS may not be comparable in practice and how investors manage these situations.
- Identify ways to improve the comparability of financial statements prepared under IFRS on a cross-border basis to provide the most benefit for investors.

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[33] See, e.g., CFA Institute ("CFA") and ITAC.

[34] tw telecom.

II. Independent Standard Setting for the Benefit of Investors

A. Introduction

The 2010 Statement notes that "[a]nother important element for a set of high-quality global accounting standards is whether the accounting standard setter's funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors." To provide the Commission with the information necessary to determine whether the IASB is sufficiently independent for IFRS to be the single set of high-quality globally accepted accounting standards for U.S. issuers, the Staff will analyze four areas in particular:

- Oversight of the IFRS Foundation (formerly called the "International Accounting Standards Committee ('IASC') Foundation");[35]
- Composition of the IFRS Foundation and the IASB;
- Funding of the IFRS Foundation; and
- IASB standard-setting process.

B. Oversight of the IFRS Foundation

The IASB was established to develop global standards for financial reporting.[36] The IASB is overseen by the IFRS Foundation, which is responsible for the activities of the IASB and other work that centers on IFRS, such as initiatives related to translation of IFRS from the English language, education about IFRS, and the development of interactive data taxonomies for IFRS.[37]

National accounting standard setters traditionally have been accountable to a national securities regulator or other government authority. In the United States, the FASB is overseen by the Commission. Until 2009, the IFRS Foundation did not have a similar link with any national securities regulators and public capital market authorities.[38]

The Commission has long supported enhanced governance of the IFRS Foundation (and its predecessor, the IASC), which includes independent oversight representing the public

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[35] In January 2010, the IFRS Foundation Trustees ("Trustees") agreed to a number of changes to their Constitution, including changes to the names of several bodies within the organization, effective March 1, 2010. This Work Plan uses the revised names, except when citing a document issued under the predecessor name. See IASC Foundation, Trustees Announce Further Governance Enhancements (February 15, 2010). (available at: http://www.iasb.org/News/Press+Releases/further+governance+enhancements.htm)

[36] For more information on the structure and operation of the IASB, see www.iasb.org.

[37] See Proposed Roadmap.

[38] See Id.

interest.[39]

Recognizing that a relationship with public capital market authorities would enhance the public accountability of the IFRS Foundation, the Trustees amended the IFRS Foundation's Constitution to establish a connection between the IFRS Foundation and a Monitoring Board[40] composed of public capital market authorities charged with the adoption or recognition of accounting standards used in their respective jurisdictions.

Commenters noted that recent events have demonstrated the significant pressure that can be exerted on a standard setter and acknowledged that the establishment of the Monitoring Board was an important step in improving the public accountability of the IFRS Foundation.[41] However, some commenters suggested improvements to the Monitoring Board[42] and urged that the Monitoring Board should include representatives from the investment community, analysts, auditors, and preparers, as well as national and regional regulators.[43] A number of commenters noted that additional time is needed to determine the effect that the Monitoring Board will have on the public accountability of the IFRS Foundation and the IASB.[44]

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[39] See Id.; *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP*, Release No. 33-8879 (December 21, 2007) [73 FR 986 (January 4, 2008)] ("2007 FPI Adopting Release"); 2007 Concept Release; and 2000 Concept Release.

[40] For more information on the mission, duties, structure, and operation of the Monitoring Board, see "Charter of the IASCF Monitoring Board" (available at: http://www.iasb.org/NR/rdonlyres/28B9BB17-79C8-4623-B043-B15F8D7A774D/0/Monitoring_Board_Charter.pdf) and Memorandum of Understanding To Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation (April 2009) (available at: http://www.iasb.org/NR/rdonlyres/67B0EE51-56B8-4183-9958-CDAC52BC505C/0/MGMou060409.pdf).

[41] See, e.g., Alcoa, Ernst & Young LLP ("EY"), FEE, U.K. Financial Reporting Council ("FRC"), Potash Corporation of Saskatchewan Inc. ("Potash"), and Securities Industry and Financial Markets Association ("SIFMA").

[42] See, e.g., Council of Institutional Investors ("CII") (suggested, for example, that the Monitoring Board duties include: (1) explicit responsibility for protecting and defending the independence of the IASB and (2) focus primarily on educating and communicating with the representatives of public authorities about the benefits of independent private-sector standard setting), Institut der Wirtschaftsprüfer in Deutschland (Institute of Public Auditors in Germany) ("IDW") (suggested the Monitoring Board participate in the appointment process and approve the appointment of Trustees, but not assume responsibility for Trustee appointment directly, so as to avoid overstepping the fine line between oversight and control of the IFRS Foundation).

[43] See, e.g., CalPERS, CII, FRC (expressed the view that in due course the IFRS Foundation Monitoring Board should be extended to encompass official global organizations with a wider range of responsibilities, notably those with financial stability, banking, and insurance mandates, provided that the primary aim of accounting standards to improve information to providers of capital is respected), ICGN, and Nicholas Véron (observed that the current Monitoring Board is badly designed as it excludes important stakeholders. This commenter suggested that the Commission should promote the transformation of the Monitoring Board into a broader body that represents all the stakeholders, especially investor groups).

[44] See, e.g., AICPA, Alcoa, Deloitte, Deutsche Bank AG ("Deutsche Bank"), FAF, FEE, FRC, IBM Corporation, ICAEW, IDW, Potash, tw telecom, and XenoPort, Inc. ("XenoPort").

The Staff believes that effective oversight is critical to any decision to incorporate IFRS into the financial reporting system for U.S. issuers. The Staff will analyze for the Commission's benefit the extent to which the Monitoring Board is functioning as designed so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will analyze the operations of the Monitoring Board and assess any areas for improvement.

C. Composition of the IFRS Foundation and the IASB

The IFRS Foundation is governed by 22 trustees with geographically diverse backgrounds.[45] Trustees are appointed for a term of three years that is renewable once.

The IASB is currently composed of 15 full-time members who serve five-year terms subject to one re-appointment.[46] Full-time members are required to sever all employment relationships and positions that may give rise to economic incentives that might compromise a member's independent judgment in setting accounting standards. The IASB members come from ten countries[47] and have a variety of backgrounds (e.g., auditors, investors, and preparers). In selecting IASB members, the Trustees must seek an appropriate mix, such that the IASB is not dominated by any particular constituency.

In response to feedback received through its current Constitution review, the IFRS Foundation has approved amendments to its Constitution, which:

- Emphasize the organization's commitment to developing standards for investors.
- Provide for enhanced guidelines regarding the Trustees' geographical diversity.[48]
- Provide additional guidelines regarding geographical diversity of the IASB members to help ensure that membership of the IASB represents a broad international basis.[49]
- Increase the maximum number of members of the IASB to 16 by July 2012, with up to three positions being permitted for part-time members (There are no part-time

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[45] Six of the Trustees must be selected from the Asia/Oceania region, six from Europe, six from North America, one from Africa, one from South America, and two from any region, subject to maintaining overall geographical balance.

[46] As a result of changes to the IFRS Foundation's Constitution in January 2010, second terms will be limited to three years for IASB members not serving as the chair or vice chair. See Trustees Announce Further Governance Enhancements (February 15, 2010). (available at: http://www.iasb.org/News/Press+Releases/further+governance+enhancements.htm)

[47] As of February 2010.

[48] See footnote 45, above.

[49] Membership of the IASB will be four members drawn from each of the Asia/Oceania region, Europe, and North America; one member from South America; one member from Africa; and two members from any area, subject to overall geographical balance.

members currently).[50]

Some commenters argued that all IASB members should be full time – for example, in order to avoid potential conflicts of interest with their outside employers.[51] Further, these commenters expressed the view that the IASB should include greater representation from investors, as the primary consumers of financial reports.

The Staff believes the composition of the IFRS Foundation and the IASB affects the independence of the IASB's standard-setting process. The Staff will analyze for the Commission's benefit the extent to which the composition of the IFRS Foundation and the IASB promotes the independent development of accounting standards for the ultimate benefit of investors so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will analyze the changes to the composition of the IFRS Foundation and the IASB and their effect on the IASB's ability to independently develop accounting standards for the ultimate benefit of investors.

D. Funding of the IFRS Foundation

Until 2008, the IFRS Foundation financed IASB operations largely through voluntary contributions from a wide range of market participants from across the world's capital markets, including from a number of firms in the accounting profession, companies, international organizations, central banks, and governments. Funding commitments were made for the period 2001–2005 and then were extended for an additional two years through 2007. In June 2006, the Trustees agreed on four characteristics[52] that should govern the establishment of a funding approach designed to enable the IFRS Foundation to remain a private-sector organization with the necessary resources to conduct its work in a timely fashion. The IFRS Foundation has no authority to impose funding regimes on countries, but the Trustees have worked closely with regulatory and other public authorities and key stakeholder groups on the creation of national regimes. Since 2008, efforts to change the financing basis of the IFRS Foundation have continued. Most funds are now obtained on a national basis from national standard setters and national capital market authorities.[53] The number of narrowly-based voluntary regimes is decreasing. Contributions from the major accounting firms also are decreasing.

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[50] The Trustees concluded that the expansion of the IASB to 16 members would enable the IASB to discharge its increasing liaison functions in an improved manner, while not negatively affecting the efficiency of the IASB's deliberative processes.

[51] See, e.g., CII and ICGN.

[52] The Trustees determined that characteristics of the new plan for 2008 would be broad-based, compelling, open-ended, and country-specific. See IASC Foundation, Annual Report 2006. (available at: http://www.iasb.org/NR/rdonlyres/D95B6BF3-A12A-4C6C-BDA1-BDC98B4F2A45/0/IASCFoundationAnnualReportFinal.pdf)

[53] See the list of long-term funding commitments on the IASB's Web site. (available at: http://www.iasb.org/The+organisation/Governance+and+accountability/Financing/Long-term+funding+commitments.htm)

The Commission previously has expressed concern that the IASB may be subject to a perceived or, potentially, an actual connection between the availability of funding and the outcome of its standard-setting process.[54] Similarly, the FCAG Final Report stated that in order for the IASB to protect its independence from undue influence, "the IASB must have a permanent funding structure under which sufficient funds are provided to it on an equitable and mandatory basis." In the Proposed Roadmap, the Commission expressed the view that its "future determination regarding the required use of IFRS for all U.S. issuers should only occur after the IFRS Foundation reaches its goal of securing a stable funding mechanism that supports the independent functioning of the IASB."

Similarly, many comment letters raised concerns about the independence and stability of the IASB's funding.[55] A number of commenters were concerned that the current voluntary nature of the contributions, as well as the source, might impact the apparent, or actual independence of the IASB.[56] Commenters expressed the view that establishing a stable, transparent funding framework for the IFRS Foundation would significantly reduce the concern that financial pressure could compromise the independence of the IASB's decision-making.[57]

The Staff recognizes that the United States has a significant interest in the stable funding of the IFRS Foundation[58] and is committed to exploring strategies to address this issue. Accordingly, the Staff will analyze for the Commission's benefit: (1) the extent to which the IFRS Foundation's sources of funding promote the independence of the IASB, and (2) possible funding mechanisms to provide the U.S.-based contribution to the IFRS Foundation. Specifically, the Staff will:

- Evaluate whether the Trustees' four characteristics governing the establishment of a funding approach are appropriate.

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[54] See Proposed Roadmap and 2007 FPI Adopting Release. See also "Report of the Financial Crisis Advisory Group" (July 28, 2009) ("FCAG Final Report"). (available at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156365880). The Financial Crisis Advisory Group ("FCAG") was formed to advise the FASB and the IASB (collectively, the "Boards") about the standard-setting implications of the financial crisis and potential changes in the global regulatory environment. The members of the FCAG are senior leaders with broad international experience in the financial markets, observed by key global banking, insurance and securities regulators.

[55] See, e.g., Association of Chartered Certified Accountants ("ACCA"), Alcoa, BEP, CAQ, Grant Thornton LLP ("GT"), McGladrey, PPL Corporation ("PPL"), PricewaterhouseCoopers LLP ("PwC"), UBS AG ("UBS"), United Technologies Corporation ("UTC"), and WellPoint, Inc.

[56] See, e.g., American Accounting Association, Financial Reporting Standing Committee; CalPERS; CRIFR; and Institute of Management Accountants ("IMA").

[57] See, e.g., CalPERS and IMA.

[58] In 2009, 33 companies based in the United States were expected to provide voluntary contributions, ranging widely in amount. See IASC Foundation, Information for Observers: IASCF Meeting with Monitoring Board (April 1, 2009). (available at: http://www.iasb.org/NR/rdonlyres/B0B1770C-F414-4DCA-968D-505D521D1839/0/APMB2CFundingreport.pdf)

- Monitor the IFRS Foundation's funding arrangements to determine whether voluntary funding from individual organizations continues to be reduced and a stable, independent funding platform is secured.

- Explore alternatives for funding mechanisms in the United States.

E. IASB Standard-Setting Process

The IASB conducts projects necessary to develop high-quality standards. The *Due Process Handbook for the IASB* details procedures to be followed when setting standards, with an emphasis on how each stage of the process must address transparency and accessibility, extensive consultation and responsiveness, and accountability.[59]

The IASB solicits views and seeks input from the public throughout the standard-setting process, starting with selecting items for its agenda and including developing and publishing a discussion paper and/or exposure draft and issuing a final standard. Input is received from discussions at its project working group and roundtable meetings as well as written submissions from constituents.[60]

In the 2003 Policy Statement, the Commission stressed the importance of three components in the standard-setting process, as follows:

- Consideration of international convergence on high-quality accounting standards for the public interest and for the protection of investors;[61]

- Timeliness in completing projects, while satisfying appropriate public notice and comment requirements; and

- Objectivity in decision-making and careful consideration of the views of constituents and the expected benefits and perceived costs of each standard.

The following discussion will consider each of these components in the context of the IASB's standard-setting process.

1. Pre-eminence of Investors

In its final report, CIFiR asserted that:

> Investor perspectives are critical to effective standards-setting, as investors are the

[59] See IASC Foundation, *Due Process Handbook for the IASB* (October 2008) ("Handbook"). (available at: http://www.iasb.org/NR/rdonlyres/1E8D75B7-927F-495B-BE4A-04C9BE967097/0/DueProcess09.pdf)

[60] See Id.

[61] The effect of international convergence on the quality of IFRS will be evaluated in section I. Accordingly, in this section, this component of the standard-setting process will focus on accounting standards for the public interest and the protection of investors.

primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting.[62]

Several commenters, including investor groups, expressed the view that greater investor representation on the IASB (and FASB) and related oversight groups would assist in meeting the primary objective of general purpose financial reporting (i.e., providing useful information to investors in making business and economic decisions).[63] One commenter expressed the view that the lack of investor representation may expose those charged with governance to pressure from special interest groups to act in a manner that may not be compatible with the best interests of investors.[64]

The Staff notes the IFRS Foundation's recent efforts involving investor groups. Recently, two new members from the U.S. investor community have been appointed to the IASB.[65] In addition, the IASB has an advisory council – the IFRS Advisory Council (formerly called the "Standards Advisory Council")[66] – that is composed of approximately 40 individuals[67] drawn from geographically-diverse countries, some of which use IFRS and others that do not. The IFRS Advisory Council has an investor sub-group representing major investment organizations in the U.S. and internationally to allow for better engagement of the IASB and its staff with investor representatives.

The Staff intends to explore the extent to which the IASB promotes the pre-eminence of investor views. For example, the Staff will review the IASB's practices, as compared to the requirements detailed in the Constitution, Handbook, and other relevant IFRS Foundation and IASB documents and constituent expectations, to assess the IASB's focus on the pre-eminence of investor views.

2. Timeliness

The IASB normally allows a period of 120 days for comment on a discussion paper and exposure draft. For major projects (which are those projects involving pervasive or difficult conceptual or practical issues), the IASB normally will allow a period of more than 120 days for comments.

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[62] See CIFiR Final Report, page 57.

[63] See, e.g., ICGN.

[64] See CFA.

[65] See "Two leading US analysts appointed to the IASB," IASB press release (May 21, 2009). (available at: http://www.iasb.org/NR/rdonlyres/2BA72D82-ACFD-4899-89D9-4DB8151B44F2/0/PRTwoleadingUSanalystsappointedtotheIASB210509.pdf)

[66] The IFRS Advisory Council supports the IASB and provides a forum where the IASB consults individuals and representatives of organizations affected by its work that are committed to the development of high-quality IFRS.

[67] A list of members is available at: http://www.iasb.org/NR/rdonlyres/A0D53C88-8988-4B3F-8B0A-07B01DCBF975/0/MembershipSAC.pdf.

A commenter noted that the IASB's standard-setting process could be improved through prompt consideration to keep standards current and reflect emerging accounting issues and changing business practices. The commenter also noted that in rare circumstances, the IASB may need to shorten its due process period in order to achieve a timely solution.[68]

The Handbook allows for the IASB to have a shorter period of consultation, if required, of 30 days. Effective March 1, 2010, the Trustees revised their Constitution to include a provision to allow them, in exceptional circumstances, to authorize a shorter due process period. Authority would be given only with the approval of 75 percent of the Trustees after the IASB had made a formal request. The due process periods could be reduced but never dispensed with completely.

Recently, the FCAG addressed situations in which it may be appropriate for the Boards to expedite due process. The FCAG Final Report urged the Boards to adequately define the circumstances under which it is appropriate to act on the basis of expedited due process and develop procedures to ensure that, in such circumstances, the maximum consultation practicable is obtained.

The Staff believes that the standard-setting process requires a careful balance between timely resolution of emerging issues and sufficient due process. The Staff will analyze for the Commission's benefit the extent to which the IASB balances timely resolution of emerging issues and due process so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will review the IASB's practices, as compared to the requirements detailed in relevant IFRS Foundation and IASB documents and constituent expectations, to assess the IASB's ability to resolve emerging issues in a timely and effective manner without compromising due process.

3. Objectivity

The Monitoring Board, of which the SEC Chairman is a member, recently stated that "[c]onfidence in the quality and integrity of the standards depends upon independence and transparency in the standard setter's due process."[69] The Monitoring Board statement expressed the view that robust participation by all interested parties is an essential element of due process.

Commenters expressed concerns regarding whether the independence of the IASB recently has been compromised.[70] A commenter further questioned whether the IFRS

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[68] See FRC.

[69] Statement of the Monitoring Board for the International Accounting Standards Committee Foundation on Principles for Accounting Standards and Standard Setting (September 22, 2009). (available at: http://www.iosco.org/monitoring_board/pdf/Monitoring_Board_of_IASCF_Statement_22092009.pdf)

[70] See, e.g., BEP, CFA, and ITAC.

Foundation and the IASB have the ability and infrastructure to confront political pressure from governments around the world.[71]

Similarly, the FCAG observed that:

> [T]o develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest.[72]

The IASB relies on a number of practices and other factors to ensure that it considers a diversity of views, including:

- The IASB's meetings are open to public observers and broadcast over the internet.

- Meeting materials, comment letters received, and staff summaries of comment letters on discussion papers and exposure drafts are publicly available on the IASB Web site.[73]

- The IASB is assisted on IFRS interpretive matters by its IFRS Interpretations Committee (formerly called the "International Financial Reporting Interpretations Committee," or "IFRIC").[74]

- The IASB consults with the IFRS Advisory Council on single projects with a particular emphasis on practical application and implementation issues.[75]

- The IASB cooperates with national accounting standard setters and other official bodies concerned with standard setting in order to promote the convergence in accounting standards around the world.[76]

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[71] See MetLife, Inc. ("MetLife").

[72] See FCAG Final Report.

[73] See the IASB's Web site at http://www.iasb.org for more information on IASB process.

[74] The IFRS Interpretations Committee interprets IFRS and reviews accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment. The IFRS Interpretations Committee is comprised of fourteen voting members, appointed by the IFRS Foundation Trustees for renewable terms of three years, and two observers (IOSCO and the European Commission). Interpretations by the IFRS Interpretations Committee are ratified by the IASB prior to becoming effective.

[75] In 2008, the Trustees agreed to change the membership structure of the SAC, so that members would serve primarily as representatives of organizations. The Trustees believe that this adaptation of the IFRS Advisory Council will enable the IASB to receive views reflecting a wider range of interested parties and would give greater authority to views received. The Commission also participates as an observer of the IFRS Advisory Council.

[76] For additional information, see IASB, Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters (February 2006). (available at:

- The due process of the IASB is subject to the active oversight of the Trustee Due Process Oversight Committee.

The Staff will analyze for the Commission's benefit the extent to which the IASB's standard-setting process is independent and objective. Specifically, in conjunction with the other steps in this section related to the oversight, composition, and funding of the IFRS Foundation and the IASB, the Staff will review the IASB's practices, as compared to the requirements detailed in relevant IFRS Foundation and IASB documents and constituent expectations, to assess the adequacy of the IASB's independence and objectivity during recent standard-setting efforts.

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http://www.iasb.org/NR/rdonlyres/8F20428C-BC3C-4CFE-A194-4386174C949D/0/SOBPFebruary2006final.pdf)

III. Investor Understanding and Education Regarding IFRS

A. Introduction

Incorporation of IFRS into the financial reporting system for U.S. issuers requires consideration of the impact on investors. This consideration includes focus on the extent to which the accounting standards and the standard-setting process promote the reporting of transparent and useful financial information to support investors in their investment decision-making process. In addition, this consideration requires an assessment of investor understanding and education regarding IFRS, as the main benefits to investors of a single set of high-quality globally accepted accounting standards would be realized only if investors understand and have confidence in the basis for the reported results.

Investor considerations regarding IFRS and investor confidence in IFRS and its standard setting are discussed in more detail in sections I and II, respectively. This section focuses on investor understanding and education regarding IFRS. In particular, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to investor understanding and education regarding IFRS require evaluation to assess the scope of, timing of, and approach to changes that would be necessary for effective incorporation.

B. Investor Understanding and Education

IFRS currently differs from U.S. GAAP in a number of areas; consequently, incorporation of IFRS into the financial reporting system for U.S. issuers may require significant investor education regarding IFRS. However, as noted by one commenter, many U.S. investors already possess some understanding of IFRS due to global industry focus, cross-border investment decisions, and investments in foreign private issuers.[77] Moreover, through the convergence process undertaken by the Boards, we expect the differences between the two sets of standards should become fewer and narrower. As part of this Work Plan, the Staff will consider U.S. investors' current familiarity with IFRS and how they currently become educated about changes to accounting standards, in order to better assess the extent of investor educational effort necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers.

Because standard setters are continually improving accounting standards, mechanisms already exist for investors to become educated about the effects of changes to the accounting standards. By considering the general education process currently used by investors in understanding changes to U.S. GAAP, the Staff will evaluate how this process could apply to investor education with respect to IFRS in preparation for its potential incorporation into the financial reporting system for U.S. issuers. In addition, the staff will consider whether additional educational efforts are needed.

Existing mechanisms to educate investors traditionally are considered in the context of

[77] See EY.

education after a standard has been developed. Also important, however, is investor education during the standard-setting process, which may occur in two ways. First, active investor outreach by the standard setters may increase both the extent and quality of understanding of new standards. In the past, both Boards have used a number of tools to facilitate investor, issuer, and auditor education about new standards, including education sessions, roundtables, and Web casts. Second, the Boards' convergence projects will be completed in accordance with their due process procedures, providing investors with time to become familiar with the new converged standards as they are developed. The Staff believes the effectiveness of these two areas in educating investors during the standard-setting process needs to be evaluated.

The Staff will analyze for the Commission's benefit how to promote investor understanding of IFRS, as well as the existing mechanisms to educate investors about changes in the accounting standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Conduct research aimed at understanding U.S. investors' current knowledge of IFRS and preparedness for incorporation of IFRS into the financial reporting system for U.S. issuers.

- Gather input from various investor groups to understand how investors educate themselves on changes in accounting standards and the timeliness of such education.

- Consider the extent of, logistics for, and estimated time necessary to undertake changes to improve investor understanding of IFRS and the related education process to ensure investors have a sufficient understanding of IFRS prior to potential incorporation.

IV. Regulatory Environment

A. Introduction

In addition to filing financial statements with the Commission, U.S. issuers commonly provide financial information to a wide variety of other parties for different purposes. While the federal securities laws provide the Commission with the authority to prescribe accounting principles and standards to be followed by public companies and other regulated entities that file financial statements with the Commission, the provision and content of information to other regulators generally is not determined by the Commission.[78] However, these other regulators frequently rely on U.S. GAAP as a basis for their regulatory reporting regimes.

Therefore, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to the role of financial reporting in various regulatory regimes and how such incorporation would affect issuers, investors, and others in those contexts, require evaluation to assess the magnitude and logistics of changes that would be necessary for effective incorporation.

Accordingly, this section explores considerations related to the following:

- Manner in which the SEC fulfills its mission;
- Industry regulators;
- Federal and state tax impacts;
- Statutory dividend and stock repurchase restrictions;
- Audit regulation and standard setting;
- Broker-dealer and investment company reporting; and
- Public versus private companies.

B. Manner in which the SEC Fulfills its Mission

Incorporation of IFRS into the financial reporting system for U.S. issuers may affect the manner in which the Commission fulfills its mission in two ways. First, the Commission must consider how to incorporate IFRS into its rules and regulations and Staff application guidance, to the extent they refer to accounting standards and requirements. Second, as stated in the Commission's 2003 Policy Statement:

> The federal securities laws set forth the Commission's broad authority and

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[78] See Proposed Roadmap.

> responsibility to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed under those laws (citations omitted), as well as its responsibility to ensure that investors are furnished with other information necessary for investment decisions. To assist it in meeting this responsibility, the Commission historically has looked to private-sector standard-setting bodies designated by the accounting profession to develop accounting principles and standards.

Commenters questioned how a move to IFRS would affect the Commission's relationship with the standard setter. For example, some questioned whether, under securities law, as amended by the Sarbanes-Oxley Act, the SEC has the ability to designate the IASB as the U.S. standard setter.[79] If the IASB were designated as the U.S. standard setter, commenters observed that the Proposed Roadmap is unclear as to how the Commission would exercise oversight of the IASB. Accordingly, commenters urged the Commission to determine how it would react in a crisis situation and how the Commission would protect U.S. investors if the IASB did not address U.S.-specific issues in a timely manner.[80] For example, some commenters indicated the Commission should retain the authority to interpret IFRS.[81]

At the same time, other commenters have cautioned against a "U.S. version of IFRS,"[82] as follows:

> We do not believe the Commission should supplement any missing accounting or disclosure requirements or the financial statements would not be considered to be prepared in accordance with IFRS as issued by the IASB. We believe any additional disclosures the Commission would consider requiring should be included outside of the audited financial statements.[83]

In response to these concerns, the 2010 Statement states:

> [The Commission] believe[s] the FASB will continue to play a critical and substantive role in achieving the goal of global accounting standards. The FASB is the accounting standard setter for the U.S. capital markets, and it should continue to work with the IASB to improve accounting standards. Moreover, that role would remain critical after adoption of global standards.

The Staff will analyze for the Commission's benefit the impact on Commission rules and procedures and potential approaches for the ongoing role of the FASB in accounting standard setting and interpretation, should the Commission determine in the future to

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[79] See, e.g., American Bar Association Business Law Section ("ABA Committee").

[80] See, e.g., Darden Restaurant, Inc. ("Darden") and Intel Corporation ("Intel").

[81] See, e.g., ABA Committee and Travelers.

[82] See section I.D for further discussion regarding jurisdictional variations of IFRS.

[83] PPL. See also, e.g., Cisco Systems, Inc. ("Cisco") and Liberty Global.

incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze references to accounting standards and requirements in existing Commission rules and interpretations and Staff application guidance to identify the extent of, logistics for, and estimated time necessary to implement any changes prior to such incorporation.

- Consider how, if at all, such incorporation would affect the nature, manner, or frequency in which the Commission and its Staff provide interpretative accounting guidance and enforce accounting standards, and the extent of, logistics for, and estimated time necessary to implement any changes.

- Analyze approaches to the FASB's ongoing role in accounting standards used in the United States, and the extent of, logistics for, and estimated time necessary to undertake these approaches.

C. Industry Regulators

In the Proposed Roadmap, the Commission observed:

> Various federal and state regulators, including regulators of financial institutions, insurance companies and public utilities, are provided with periodic financial information on an on-going basis. For example, U.S. GAAP financial statements frequently are used as the basis for determining capital requirements for financial institutions.

Due to the prevalence of financial information provided to different U.S. regulators, incorporation of IFRS into the financial reporting system for U.S. issuers may significantly affect different regulators and issuers subject to those regulators' compliance requirements. As such, it is important to identify the full range of regulatory regimes that rely on information developed for financial reporting purposes.

A number of commenters suggested that the Commission determine the extent to which industry regulators would continue to accept financial statements prepared for SEC reporting purposes as a starting point for regulatory filings.[84] Otherwise, commenters cautioned that a move to IFRS for financial reporting purposes risks creating costly dual-reporting requirements for issuers.[85] Further, if regulators continue to accept reporting prepared for SEC purposes, any changes in the reporting as a result of incorporating IFRS

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[84] See, e.g., Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of Thrift Supervision (collectively, "BankReg"), Committee of Annuity Insurers, Dominion Resources Services ("Dominion"), First Data Corporation ("First Data"), and National Association of Regulatory Utility Commissioners ("NARUC").

[85] See, e.g., Boeing and Honeywell.

could have regulatory impacts. The Staff recognizes that acceptance of IFRS-based financial statements by industry regulators may have consequences on issuers and others that require analysis.

The Staff will analyze for the Commission's benefit the effects on issuer compliance with industry regulatory requirements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects on issuer compliance with industry regulatory requirements.
- Consider the impact of a change in SEC reporting on industry regulators.
- Analyze constituent concerns associated with any potential changes, or lack thereof, to regulatory regimes.

D. Federal and State Tax Impacts

Incorporation of IFRS into the financial reporting system for U.S. issuers also could affect federal and state tax regulations (e.g., Internal Revenue Code).[86] As explained in the Proposed Roadmap:

> As the Internal Revenue Code has developed over an extended period of time with existing U.S. GAAP as the predominant set of accounting standards used in the United States, certain interactions exist between certain provision of U.S. GAAP and income tax requirements. For example, the Internal Revenue Code has conformity provisions related to the method of accounting for inventory for tax reporting purposes and the method used for reporting to shareholders (and other owners or beneficiaries) or for credit purposes.[87] IFRS does not allow for the use of last-in, first-out, or LIFO, method of accounting for inventory. As a result, a company that reports in accordance with IFRS would be required to use a method of accounting for inventory that is acceptable under IFRS, for example the first-in, first-out, or FIFO, method. U.S. issuers changing to FIFO for financial reporting purposes may experience a change in taxable income based on the difference between inventory valued on a LIFO basis and on a FIFO basis.

If federal and state tax regulators maintained their current tax codes, companies may experience a significant increase in the number of book-tax differences they would be required to track upon incorporation of IFRS into the financial reporting system for U.S. issuers. Several commenters expressed that because of the high cost that otherwise would be incurred in maintaining two sets of records, the U.S. Internal Revenue Code, as well as state and local tax codes and related regulations, would need to be modified.[88]

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[86] 26 U.S.C. § 1 *et seq.* [1986.]

[87] See Section 472 of the Internal Revenue Code (26 U.S.C. 472).

[88] See, e.g., Allergan, Inc. and tw telecom.

Alternatively, if federal and state tax regulators continued to align their tax codes with reporting for SEC purposes, companies may experience significant changes to their expected tax liabilities. Commenters expressed that the SEC should work with the Internal Revenue Service and other tax authorities to mitigate the LIFO transitional issue,[89] as well as address the transfer pricing arrangements and franchise tax considerations that may be affected in the transition.[90]

The Staff will analyze for the Commission's benefit the effects on federal and state tax regulations, as well as issuers subject to such regulations, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects on federal and state tax regulations, as well as issuers subject to such regulations.
- Consider the impact of a change in SEC reporting on federal and state tax regulators.
- Analyze constituent concerns associated with any potential changes, or lack thereof, to federal and state tax regulation.

E. Statutory Dividend and Stock Repurchase Restrictions

Certain legal standards may be tied to amounts determined for financial reporting purposes. For example, companies may declare dividends to or repurchase stock from shareholders. While the amount, timing, and manner of payment of dividend distributions and stock repurchases are typically determined by the companies' boards of directors, the amount available may be restricted by state statute. For example, some jurisdictions provide that dividends may only be paid from retained earnings or may be paid from current earnings despite an accumulated deficit.

To the extent that jurisdictions base legal standards on amounts determined for financial reporting purposes, incorporation of IFRS into the financial reporting system for U.S. issuers could affect a company's ability to undertake certain actions and an investor's expectations in that regard. In addition, to the extent that legal standards do not change based on changes in SEC reporting, companies would need to maintain two sets of records. Accordingly, the Staff will analyze for the Commission's benefit the effects on such legal standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effect of such incorporation on legal standards, such as a company's ability to pay dividends or repurchase stock, on issuers and investors.

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[89] See, e.g., KPMG, The LIFO Coalition ("LIFO"), and National Association of Wholesaler-Distributors.

[90] See KPMG.

- Consider the impact of a change in SEC reporting on state statutes in this regard.

- Analyze constituent concerns associated with any potential changes, or lack thereof, to such state statutes.

F. Audit Regulation and Standard Setting

Another regulatory body that may be affected by incorporation of IFRS into the financial reporting system for U.S. issuers is the Public Company Accounting Oversight Board ("PCAOB"), which is responsible for overseeing public company audit firms and establishing audit, quality control, ethics, and independence standards used by those firms.[91] The Proposed Roadmap and commenters raised two primary considerations related to the PCAOB. First, commenters questioned whether a move to global accounting standards should be coupled with a move to global auditing standards in the United States, for example, through convergence of PCAOB standards with or adoption of auditing standards issued by the International Accounting and Assurances Standards Board.[92] Second, commenters noted that PCAOB auditing standards may require better alignment with IFRS. For example, one commenter expressed a general concern that there would be a mismatch between the less prescriptive standards in IFRS and U.S. auditing standards.[93] In addition, the Proposed Roadmap identified a general need for conforming amendments to PCAOB standards where they refer to current U.S. GAAP literature.

Commenters also provided specific examples of PCAOB auditing standards that may require better alignment with IFRS. For example, commenters suggested that the PCAOB issue additional guidance for auditors engaged in auditing market risk information included in the audited financial statements pursuant to IFRS 7 (currently U.S. issuers provide similar information outside the financial statements pursuant to Item 305 of Regulation S-K).[94]

Further, the Proposed Roadmap discussed the audit of legal contingencies as follows:

> One of the conditions under IFRS for recognizing a provision for a legal contingency is that it is more likely than not that an obligation exists (footnote omitted). This recognition threshold is lower than the current recognition threshold in U.S. GAAP, resulting in the potential for an earlier income statement recognition of costs associated with litigation (footnote omitted). Concerns have been raised about an auditor's ability to corroborate the information furnished by management related to litigation, claims, and assessments by obtaining an audit inquiry letter from a client's

[91] See Section 101 of the Sarbanes-Oxley Act (15 U.S.C. 7211).

[92] See, e.g., CalPERS and FEE.

[93] See AAA-FASC.

[94] See, e.g., KPMG.

attorney.[95]

Notwithstanding the above examples of areas where PCAOB auditing standards may require better alignment with IFRS, most auditors that responded to the Proposed Roadmap did not have concerns regarding their ability to opine on financial statements prepared under IFRS.[96]

The Staff will analyze for the Commission's benefit the effects on audit standard setting and auditor requirements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Consider the impact of such incorporation on PCAOB standards.

- Consider the extent of, logistics for, and estimated time necessary to undertake any changes to the auditing standards.

G. Broker-Dealer and Investment Company Reporting

The Proposed Roadmap excluded investment companies registered under the Investment Company Act of 1940 and certain other regulated entities that are required to file or furnish certain types of financial reports (e.g., broker-dealers).

Some commenters expressed that no issuers should be exempt from the scope of the Proposed Roadmap[97] and that the final Roadmap should include a plan so that all filings with the SEC are based on IFRS and allow adequate time for the IASB and SEC to consider the appropriate financial reporting model for these entities.[98]

Alternatively, some commenters supported the exclusion of investment companies from

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[95] As further discussed in the Proposed Roadmap:

> Some believe that changes to the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information may be necessary. See AU § 337C. The Statement of Policy, commonly referred to as the "Treaty," recognizes the professional responsibilities of attorneys and auditors and seeks to preserve confidentiality while providing the necessary level of assurance for the audit. The Treaty recognizes that the confidentiality of communications between an attorney and a client may be impaired by the disclosure of the substance of such communications to third parties, including auditors. By describing thresholds for disclosure and limitations on responses, the Treaty sets the scope of the attorney's responses to audit requests for information on legal matters. Some believe that the thresholds and limitations described in the Treaty are inconsistent with certain provisions within IFRS.

See also, e.g., ABA Committee (echoed the Commission's statements in the Proposed Roadmap regarding the audit of legal contingencies).

[96] See, e.g., CAQ (stated that the U.S. auditing profession stands ready to support the use of IFRS by all U.S. issuers, including early adopters under an option), J.H. Cohn LLP (confirmed its readiness to prepare for audits of IFRS financial statements once the SEC reaches a decision), and PwC.

[97] See, e.g., BDO Seidman, LLP ("BDO"), CAQ, and Verizon Communications, Inc.

[98] See, e.g., EY.

the rule proposal.[99] Another commenter expressed the view that the Commission has not sufficiently articulated its rationale for excluding investment companies and other regulated entities from the scope of the Proposed Roadmap and would agree with excluding these issuers "only if there are unique considerations surrounding these entities that could delay the Commission's decision making process."[100]

Finally, commenters also expressed concerns regarding costs imposed by the reduced comparability introduced by the continued use of another basis of accounting (e.g., for private companies (see below), and/or Investment Company Act registrants).[101] As another example, excluding broker-dealer reporting could result in a broker-dealer subsidiary being required to report to the Commission under one set of standards with the public holding company that consolidates that subsidiary required to report under another. Also, to the extent reporting results changed if IFRS were to be incorporated for these entities, such a change could impact compliance with financial responsibility rules, such as net capital requirements.

In light of the different views noted above, the Staff will analyze for the Commission's benefit possible approaches for financial reporting requirements for broker-dealers and investment companies, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Assess the effects of such incorporation on broker-dealers, investment companies, and investors, including whether IFRS includes sufficient standards, and the extent of, logistics for, and estimated time necessary to undertake any changes, should broker-dealers and investment companies be included in the scope any potential Commission decision.

- Evaluate the effect on investors of excluding broker-dealers and investment companies from the scope of any potential Commission decision.

H. Public versus Private Companies

The Proposed Roadmap focused only on companies that file with the Commission. However, existing U.S. GAAP also is used by private companies.

Commenters expressed concern over the impact a move to IFRS would have on U.S. private companies.[102] One concern raised in the Proposed Roadmap and echoed by commenters was that, to the extent two sets of standards existed, a requirement to file different financial statements with the Commission would increase costs of capital for

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[99] See, e.g., AICPA and Investment Company Institute (who expressed that convergence in accounting standards as applied to investment companies and resolution of conflicts between IFRS and Article 6 of Regulation S-X should be prerequisites to a move to IFRS).

[100] GT.

[101] See, e.g., Private Equity Council.

[102] See, e.g., The New York State Society of Certified Public Accountants ("NY CPAs") and Ohio CPAs.

private companies considering an initial public offering.[103] It could also impact the evaluation of business combinations between public and private companies. Some commenters acknowledged that private company reporting is largely outside of the mandate of the Commission, but stated that the Commission should assess the consequences its decision on IFRS would have to this large and important part of the U.S. economy. Specifically, certain of these commenters believed that if a "dual-GAAP" system emerged for private versus public companies, this could adversely affect the efficiency of the U.S. capital markets.[104] Even if U.S. private companies were to report under IFRS, a "dual-GAAP" system may evolve, if private companies followed IFRS for small- and medium-sized entities ("SMEs"), which:

> [I]s a self-contained standard of about 230 pages tailored for the needs and capabilities of smaller [private] businesses. Many of the principles in full IFRSs for recognising and measuring assets, liabilities, income and expenses have been simplified, topics not relevant to SMEs have been omitted, and the number of required disclosures has been significantly reduced. To further reduce the reporting burden for SMEs revisions to the IFRS will be limited to once every three years.[105]

The Staff will analyze for the Commission's benefit the effects on U.S. private companies, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects of such incorporation for U.S. issuers on private companies, auditors, and investors.
- Assess the extent of, logistics for, and estimated time necessary to undertake changes to accommodate any resulting implications on private companies.

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[103] See, e.g., ABA Committee, Center for Capital Markets Competitiveness ("CCMC"), Davey Tree, First Data, and ITAC.

[104] See, e.g., CA CPAs and CIGNA Corporation.

[105] "IASB publishes IFRS for SMEs," IASB press release (July 9, 2009). (available at: http://www.iasb.org/News/Press+Releases/IASB+publishes+IFRS+for+SMEs.htm)

V. Impact on Issuers

A. Introduction

Incorporation of IFRS into the financial reporting system for U.S. issuers would significantly affect preparers of financial statements – the several thousand issuers that file reports with the Commission. Numerous commenters expressed the view that the costs, effort, and time involved with a move to IFRS would be considerable,[106] with many asserting that the benefits of such a move may not outweigh those costs.[107] A number of commenters further asserted that the transition time articulated in the Proposed Roadmap was not sufficient[108] and may cause confusion, thereby damaging investor confidence.[109]

Accordingly, this aspect of the Work Plan explores the magnitude and logistics of changes that issuers would need to undertake to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers in the following areas:[110]

- Accounting systems, controls, and procedures;
- Contractual arrangements; and
- Corporate governance.

The Work Plan will also consider the effect of such incorporation on the following:

- Accounting for litigation contingencies; and
- Smaller issuers versus larger issuers.

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[106] See, e.g., Phil Ameen ("Ameen"), Chevron Corporation, Eli Lilly, Shawn S. Fahrer, Hot Topic Inc. ("Hot Topic"), Intel, Graduating Seniors - Jacksonville University (Georgia), Kohl's Department Stores, Inc. ("Kohl's"), Molson Coors Brewing Company, NARUC, PPL, Psoras, Mark A. Supin, SIFMA, U.S. Congressman Lee Terry, Tuesday Morning; and U.S. Congressman Zach Wamp.

[107] See, e.g., Davey Tree, Exxon Mobil Corporation ("Exxon Mobil"), Marriott, McDonald's, Pfizer Inc. ("Pfizer"), Plantronics, Inc. ("Plantronics"), Regions Financial Corp., and tw telecom.

[108] See, e.g., ABA Committee, American Insurance Association ("AIA"), AICPA, BankReg, Best Buy Co., Inc., CAQ, Cisco, Cymer Inc., Deloitte, EY, Fannie Mae, Graybar Electric Company, Inc., ICAEW, IMA, KPMG, National Association of Real Estate Investment Trusts, NARUC, Progress Energy, Inc., PwC, Reznick Group, P.C., TransCanada Corporation, and XenoPort.

[109] See, e.g., Association of the Bar of the City of New York, Community Health, CSX Corporation, and Plantronics.

[110] The human resource impact on issuers is discussed separately in section VI.

B. Accounting Systems, Controls, and Procedures

U.S. issuers may be required to significantly modify their accounting systems, controls, and procedures, if the Commission incorporates IFRS into the financial reporting system. As stated in the Proposed Roadmap:

> Use of any new accounting standards requires changes to financial reporting systems and procedures to identify, collect, analyze and report financial information and the corresponding controls. Changing numerous accounting standards at the same time, regardless of the starting point, would require numerous changes in a company's policies and procedures and system of internal controls.

For example, commenters expressed the need for:

- A complete survey of accounting policies as a first step because IFRS explicitly requires that all similar transactions in the enterprise (including affiliates) be accounted for similarly;[111]

- More detailed company policies, as IFRS is viewed as less developed than U.S. GAAP;[112] and

- Changes to systems, including ledgers and related internal controls, and related testing of such changes,[113] particularly to ensure effectiveness for reporting purposes under section 404 of the Sarbanes-Oxley Act.

Commenters noted that the burden of changes to accounting systems, controls, and procedures would be exacerbated in a number of ways. First, issuers may be required to maintain dual-accounting systems for a period of time (e.g., (1) for periods reported under existing U.S. GAAP after the opening balance sheet date under IFRS 1, *First-time Adoption of International Financial Reporting Standards*, but before the initial filing under a system incorporating IFRS, (2) if the SEC were to require supplemental U.S. GAAP information for a period of time to aid in transition, (3) if such incorporation were effective in the financial statements of consolidated entities prior to those of the consolidated entities' stand-alone subsidiaries, and (4) if other regulators continued to require reporting based on U.S. GAAP). One commenter stated:

> Maintaining dual reporting presents U.S. issuers with a significant burden since all of the processes, controls, and checks must occur twice for each transaction. Indeed, it is likely that the Sarbanes Oxley control testing requirements could nearly double during the period of parallel reporting.[114]

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[111] See, e.g., Ameen.

[112] See, e.g., Air Products, Community Health, Darden, and Mead Westvaco.

[113] See, e.g., Ameen.

[114] UTC.

Second, changes to accounting systems, controls, and procedures require sufficient lead time. However, if IFRS continues to change at a rapid pace during this lead time, U.S. issuers will experience additional challenges in planning for incorporation of IFRS into the financial reporting system. As such, some commenters expressed the need for a "stable platform" for a period of time during which accounting standards do not change.[115] However, a "stable platform" may constrain the standard setters' ability to address emerging issues.

Third, some commenters asserted that certain industries would be disproportionately impacted by incorporation of IFRS into the financial reporting system for U.S. issuers because of differences between existing U.S. GAAP and IFRS that are specific to their circumstances. One commenter stated that financial institutions will need sufficient time to prepare for conversion to IFRS, given the extent of systems changes and communications that will need to occur.[116] Other commenters expressed concerns about specific differences between U.S. GAAP and IFRS for which they believed the accounting under IFRS would be onerous.[117]

The Staff will analyze for the Commission's benefit the effects on U.S. issuers' accounting systems, controls, and procedures, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Determine the extent of, logistics for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures to facilitate such incorporation.
- Consider the implications of a "stable platform," including the length of time and means of addressing emerging issues.

C. Contractual Arrangements

The Proposed Roadmap also noted that companies' contracts often, either explicitly or implicitly, require the use of U.S. GAAP or are based off of current U.S. GAAP reporting. For example, companies may have issued debt instruments which include financial covenants based on U.S. GAAP or require periodic reporting of financial statements prepared under U.S. GAAP. Similarly, lease contracts and employee compensation plans may be based on metrics computed using U.S. GAAP financial

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[115] See, e.g., Eli Lilly, Exxon Mobil, EY, and SIFMA.

[116] See ICAEW.

[117] See, e.g., Mead Westvaco, Plum Creek Timber Company, Inc., Potlatch Corporation, and Rayonier Inc. (who expressed concerns regarding the costs of complying with the requirement in International Accounting Standard 41, *Agriculture*, to fair value timberlands). See also, e.g., Hot Topic, J.C. Penney Company, Inc., Kohl's, and Tuesday Morning (who expressed concerns about the IFRS disallowance of the retail inventory method).

information.

Commenters indicated that a move to IFRS for U.S. issuers may require contract renegotiation or the preparation of two sets of financial statements, depending on how IFRS is incorporated in the U.S. capital markets.[118] In addition, performance under the existing agreements could be affected if the reported information changes. Accordingly, the Staff will analyze for the Commission's benefit the effects on contractual arrangements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Assess the types and pervasiveness of contractual arrangements that would be affected by such incorporation and the manner in which they would be affected.

- Determine the costs, ability, plans, and estimated time required to address concerns regarding affected contractual arrangements.

D. Corporate Governance

Incorporation of IFRS into the financial reporting system for U.S. issuers may affect an issuer's compliance with corporate governance requirements. For example, in 2003, as required by the Sarbanes-Oxley Act, the SEC adopted rules that require a registrant to disclose whether it has at least one "audit committee financial expert" (as defined) serving on its audit committee and, if so, the name of the expert and whether the expert is independent of management.[119] Those rules also indicate the education and experience through which those attributes must have been acquired.

Listing rules for U.S. securities exchanges also have requirements regarding audit committee competence. One commenter explained:

> [R]ules of the NYSE, NASDAQ, and AMEX require members of the audit committee of each listed company to be financially literate and each listed company audit committee must have at least one member who has accounting or related financial management expertise. Many board members who currently meet the "financial expertise" qualifications are not likely to have had experience with IFRS or its adoption as they have been trained in U.S. GAAP. If a company adopts IFRS, its board is likely to need additional training in IFRS in order to meet the level of financial expertise necessary for them to carry out these functions and satisfy these requirements.[120]

Accordingly, incorporation of IFRS into the financial reporting system may result in challenges for U.S. issuers in identifying audit committee financial experts and in listing

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[118] See, e.g., AIA, CCMC, Hot Topic, JP Morgan, Psoras, and Tuesday Morning.

[119] See *Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002*, Release No. 33-8177 (January 23, 2003) [68 FR 5110 (January 31, 2003)].

[120] Metlife.

on securities exchanges, as well as, more broadly, compliance with other aspects of corporate governance. Further, similar to the potential effects on compliance with other regulatory requirements, changes in financial reporting could impact a company's compliance with certain quantitative listing standards. The Staff will analyze for the Commission's benefit the impact on compliance with corporate governance standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Determine the potential effects on corporate governance and related concerns of such incorporation.

- Determine possible approaches to address corporate governance concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

E. Accounting for Litigation Contingencies

Commenters expressed concerns regarding the treatment of litigation-related loss contingencies under IFRS. For example, the ABA Committee asserted that accounting for such contingencies under IFRS raises serious concerns by its use of a lower recognition threshold than U.S. GAAP and its requirements to make additional disclosures. Their concerns included "avoidance of prejudice to companies and their shareholders in our highly litigious society" and erosions of the protections of attorney-client privilege and work product. Other commenters expressed similar concerns, with one noting:

> [T]he loss contingency disclosures required under IFRS are similar to those proposed by the FASB in 2008. As these disclosures were rejected for use in the U.S. primarily due to objections from the legal community, it is likely that similar issues will arise if IFRS becomes mandatory.[121]

Incorporation of IFRS into the financial reporting system for U.S. issuers requires careful consideration of the impact of litigation contingency accounting and disclosure requirements under IFRS on issuers and investors. Accordingly, the Staff will analyze for the Commission's benefit the effects on accounting and disclosure requirements for litigation contingencies under IFRS in the U.S. legal environment, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Discuss with issuers, the legal profession, and investors concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS.

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[121] Dominion. See also, e.g., FPL and Pfizer. The Staff notes that the FASB is in the process of re-deliberating loss contingency disclosure requirements. See also section IV.E regarding concerns related to the auditing of loss contingencies accounted for under IFRS.

- Determine possible approaches to address concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS and the extent of, logistics for, and estimated time necessary to undertake these approaches.

F. Smaller Issuers versus Larger Issuers

Several commenters asserted that a move to IFRS would be particularly burdensome for smaller U.S. issuers. For example, one commenter included studies from two independent consultants indicating that, while recognizing potential cost savings for some large, multinational firms, a move to IFRS is likely to impose substantial transition costs, including disproportionate costs on smaller issuers.[122] Conversely, one commenter stated that "the impact is expected to be very small and the majority of the impact will occur in non-routine or one-off transactions which are typically subject to significant scrutiny in any case."[123]

In light of the above comments, the Staff will analyze for the Commission's benefit the extent to which incorporation of IFRS into the financial reporting system for U.S. issuers would affect smaller issuers differently than larger issuers and the extent of, logistics for, and estimated time necessary to undertake any changes, should the Commission determine in the future to do so. Specifically, the Staff will:

- Determine the manner in which the impact of such incorporation varies based on issuer size.

- Determine possible approaches to mitigate concerns regarding any disproportionate effects on smaller issuers of such incorporation and the extent of, logistics for, and estimated time necessary to undertake these approaches.

[122] FAF. See also, e.g., Biotechnology Industry Organization, Business Roundtable, CCMC, CRIFR, and IMA.

[123] Xenoport.

VI. Human Capital Readiness

A. Introduction

Should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to the readiness of all parties involved in the financial reporting process, including investors (see section III for further discussion), issuers, attorneys, auditors, regulators, and educators require evaluation to assess the magnitude and logistics of changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers. Accordingly, this section explores considerations related to:

- Education and training; and
- Auditor capacity.

B. Education and Training

In the Proposed Roadmap, the Commission noted that the education and ongoing training of most accountants in the United States are limited to or predominantly focused on the current provisions of U.S. GAAP. As a result, the Commission acknowledged that many parties likely would need comprehensive IFRS training, including:

- Investors, as discussed in section III;
- The personnel of issuers, including their accounting, internal audit, and investor relations departments, and their governing bodies, such as their audit committees and board of directors;
- Specialists, such as actuaries and valuation experts, as they often are engaged by management to assist in measuring certain assets and liabilities for financial reporting purposes;
- Attorneys, who will need to understand financial statements in order to, for example, advise on disclosures required under the securities laws and provide legal representations to external auditors;
- External auditors;
- Regulators, such as the Staff, PCAOB staff, and the staff of other regulatory bodies;[124]

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[124] See, e.g., BankReg (noted that they "collectively employ thousands of examination and policy support personnel that will need to be adequately trained in the use of IFRS if it is adopted before convergence is achieved").

- State licensing bodies, professional associations, and industry groups, who would need to integrate IFRS into their training materials, publications, testing, and certification programs (including the Uniform CPA Examination); and

- Colleges and universities that would need to include IFRS in their curricula.

In the Proposed Roadmap, the Commission observed that strategies taken by those participants in markets where issuers already report in accordance with IFRS might serve as examples of approaches to increasing education and awareness of IFRS.

The Commission also expressed that the private sector may respond to any increased demand for IFRS education by making educational materials available.[125] Since the Commission's issuance of the Concept Release in August 2007, several of the largest accounting firms in the United States have made more material available to the public about IFRS generally, as well as about the application of specific IFRS standards.[126]

Commenters expressed mixed views in terms of the importance of this issue, as well as timing for improvements in this area. Some commenters expressed concerns about the challenges faced in training and educating both existing and future practitioners.[127] For example, the nature of accounting education would require change, as professionals and students would not only need training in IFRS, but in utilizing judgment in the application of less prescriptive standards and in understanding the economic substance of transactions.[128] Accordingly, commenters expressed the view that a move to IFRS for U.S. issuers would be costly for educators,[129] particularly if a dual-reporting system (e.g., due to different systems for public versus private companies) evolved in the United States.[130] Commenters also asserted that educators would not be ready in the near term[131] and that work needs to begin immediately.[132] As such, some commenters recommended that the Commission address how sufficient resources and incentives for training would be achieved.[133]

Others, however, were of the view that educators, issuers, and other impacted parties

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[125] See Proposed Roadmap.

[126] These materials include publications (e.g., PwC's *IFRS and US GAAP: similarities and differences*; EY's *US GAAP vs. IFRS The basics: Oil and gas*) and other IFRS-related education initiatives (e.g., the KPMG IFRS Institute; Deloitte's IFRS University Consortium; EY's Academic Resource Center; PwC's IFRS Video Learning Center).

[127] See, e.g., CalPERS, CFA, Fund Stockowner Rights, ITAC, NASBA, NYCPAs, and Ohio CPAs.

[128] See, e.g., London Ctr Int'l Corp Gov Law and Shyam Sunder.

[129] See, e.g., AmerisourceBergen Corporation, Teresa P. Gordon, and Thomas N. Tyson.

[130] See, e.g., Travelers.

[131] See, e.g., American Accounting Association, Financial Accounting and Reporting Section, and Financial Reporting Policy Committee (pointed to surveys of educators indicating concerns over readiness).

[132] See, e.g., ING Insurance Americas.

[133] See, e.g., CalPERS and ICGN.

would be prepared in time, particularly once a date for moving to IFRS were established.[134] One commenter expressed that IFRS education and expertise will grow in the United States anyway – even if the United States does not move to IFRS – because of the ongoing increased foreign investment in the United States.[135]

The Staff recognizes that education and training efforts to facilitate incorporation of IFRS into the financial reporting system for U.S. issuers could be significant. Accordingly, the Staff will analyze for the Commission's benefit the sufficiency of the IFRS education and training infrastructure and the extent of, logistics for, and estimated time necessary to undertake changes, should the Commission determine in the future to do so. Specifically, the Staff will:

- Evaluate the current level of IFRS expertise and extent of IFRS education and training needs among constituents.

- Consider the extent of, logistics for, and estimated time to implement plans for future training among constituents.

C. Auditor Capacity

Incorporation of IFRS into the financial reporting system for U.S. issuers could strain audit firm resources if sufficient training and time are not provided. The Proposed Roadmap noted that "[a]udit firms would need to consider elements of their systems of quality control, such as their practices related to hiring, assigning personnel to engagements, professional development and advancement activities." An increase in the demand for IFRS expertise may affect the availability of audit services, with consequences on audit quality, cost, and audit firm concentration.

While some commenters expressed that moving to IFRS is likely to have little or no effect on the availability of audit services and audit quality,[136] others expressed concerns about a likely reduction in these areas, along with an increase in both internal and external audit costs, due to IFRS being less comprehensive and requiring more application of judgment.[137] For additional discussion regarding the impact of IFRS's comprehensiveness on its auditability, see section I.C.

Others commented that the consequences of a move to IFRS for U.S. issuers on audit firms may differ based on audit firm size. With respect to the large audit firms, commenters believed that a move to IFRS for U.S. issuers is likely to have little or no effect on the availability of audit services and audit quality.[138] Two large audit-firm

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[134] See, e.g., ACCA, Alcoa, CAQ, Dell Inc., EY, and PwC.

[135] See Pepsi.

[136] See, e.g., Deutsche Bank, UBS, and UTC.

[137] See, e.g., Davey Tree.

[138] See, e.g., BDO, Deloitte, EY, and PwC.

commenters noted that they currently audit foreign private issuers as well as subsidiaries of foreign multi-nationals that report under IFRS.[139] Further, they anticipated leveraging personnel from other member firms in countries that have already moved to IFRS.

On the other hand, opinions were mixed on the impact of moving to IFRS on "smaller" audit firms. The Proposed Roadmap stated that the potential use of IFRS by U.S. issuers:

> [M]ay be particularly challenging for less globally-oriented audit firms, which typically may have fewer resources available through affiliated or network firms located in jurisdictions in which issuers already report in accordance with IFRS. This could be a further factor affecting concentration in the auditing profession.

One commenter expressed concern that current IFRS expertise is concentrated within the "Big Four" public accounting firms, which could allow for opportunistic business behaviors when dealing with other competitors and regulators.[140] However, others commented that an SEC mandate to move to IFRS would not affect the competitive position of smaller firms.[141]

In light of these differing views, the Staff will analyze for the Commission's benefit potential auditor capacity constraints with respect to IFRS and their consequences, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze concerns regarding auditor capacity constraints, including the effect on audit quality, cost, and audit firm concentration and competitiveness.

- Determine possible approaches to mitigate these concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

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[139] See Deloitte and PwC.

[140] See ITAC.

[141] See, e.g., ACCA, Deloitte, EY, ICAEW (indicated that a move to IFRS did not have an identifiable impact on audit concentration in Europe), and PwC.

Commissioner Casey
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 270 and 274

[Release No. IC-29132; File Nos. S7-11-09, S7-20-09]

RIN 3235-AK33

Money Market Fund Reform

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting amendments to certain rules that govern money market funds under the Investment Company Act of 1940. The amendments will tighten the risk-limiting conditions of rule 2a-7 by, among other things, requiring funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reducing the maximum weighted average maturity of portfolio holdings, and improving the quality of portfolio securities; require money market funds to report their portfolio holdings monthly to the Commission; and permit a money market fund that has "broken the buck" (*i.e.*, re-priced its securities below $1.00 per share), or is at imminent risk of breaking the buck, to suspend redemptions to allow for the orderly liquidation of fund assets. The amendments are designed to make money market funds more resilient to certain short-term market risks, and to provide greater protections for investors in a money market fund that is unable to maintain a stable net asset value per share.

DATES: The rules, rule amendments, and form are effective May 5, 2010. The expiration date for 17 CFR 270.30b1-6T is extended from September 17, 2010 to December 1, 2010. Compliance dates are discussed in Section III of the Supplementary Information.

FOR FURTHER INFORMATION CONTACT: Office of Regulatory Policy, at (202)

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551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is adopting amendments to rules 2a-7 [17 CFR 270.2a-7], 17a-9 [17 CFR 270.17a-9] and 30b1-6T [17 CFR 270.30b1-6T], new rules 22e-3 [17 CFR 270.22e-3] and 30b1-7 [17 CFR 270.30b1-7], and new Form N-MFP [17 CFR 274.201] under the Investment Company Act of 1940 ("Investment Company Act" or "Act").[1]

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[1] 15 U.S.C. 80a. Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act, including rule 2a-7, are to Title 17, Part 270 of the Code of Federal Regulations [17 CFR 270]. References to "current" rules relate to rules in their current form [17 CFR Part 270 (2009 version)], and references to "amended" rules relate to rules as they will be amended by this Release.

I. BACKGROUND

On June 30, 2009, the Commission issued a release proposing new rules and rule amendments governing the operation of money market funds.[2] Money market funds are open-end management investment companies that are registered under the Investment Company Act. They invest in high-quality, short-term debt instruments such as commercial paper, Treasury bills and repurchase agreements. Money market funds pay dividends that reflect prevailing short-term interest rates and, unlike other investment companies, maintain a stable net asset value per share (or "NAV"), typically $1.00 per share. Money market funds have over $3.3 trillion dollars in assets under management, and comprise over 30 percent of the assets of registered investment companies.[3]

All money market funds are subject to rule 2a-7 under the Investment Company Act. Rule 2a-7, among other things, facilitates money market funds' ability to maintain a stable net asset value per share by permitting them to use the amortized cost method of valuation and the penny-rounding method of pricing.[4] But for rule 2a-7, the Investment Company Act and our

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[2] Money Market Fund Reform, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)] ("Proposing Release"). All references to "proposed" rules relate to rules as proposed in the Proposing Release.

[3] *See* Investment Company Institute, *Trends in Mutual Fund Investing*, Nov. 2009, *available at* http://www.ici.org/research/stats/trends/trends_11_09.

[4] Current rule 2a-7(a)(2) defines the amortized cost method as the method of calculating an investment company's net asset value per share (or "NAV") whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of

rules would require a money market fund to calculate its current net asset value per share by valuing portfolio securities at their current value ("mark-to-market").[5]

Under the amortized cost method, portfolio securities generally are valued at cost plus any amortization of premium or accumulation of discount. The basic premise underlying money market funds' use of the amortized cost method of valuation is that high-quality, short-term debt securities held until maturity will eventually return to their amortized cost value, regardless of any current disparity between the amortized cost value and market value, and would not ordinarily be expected to fluctuate significantly in value.[6] Therefore, the rule permits money market funds to value portfolio securities at their amortized cost so long as the deviation between the portfolio's amortized cost and current market value *remains* minimal and results in the computation of a share price that represents fairly the current net asset value per share of the fund.[7]

To reduce the likelihood of a material deviation occurring between the amortized cost value of a portfolio and its market-based value, the rule contains several conditions (which we

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discount rather than at their value based on current market factors. The penny-rounding method of pricing means the method of computing a fund's price per share for purposes of distribution, redemption, and repurchase whereby the current net asset value per share is rounded to the nearest one percent. *See* current rule 2a-7(a)(18).

5 *See* section 2(a)(41) of the Act (defining "value" of fund assets); rule 2a-4 (defining "current net asset value" for use in computing the current price of a redeemable security); and rule 22c-1 (generally requiring open-end funds to sell and redeem their shares at a price based on the funds' current net asset value as next computed after receipt of a redemption, purchase, or sale order).

6 *See* Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 13380 (July 11, 1983) [48 FR 32555 (July 18, 1983)] ("1983 Adopting Release") at nn.3-7 and accompanying text; Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 12206 (Feb. 1, 1982) [47 FR 5428 (Feb. 5, 1982)] at nn.3-4 and accompanying text.

7 *See* amended rule 2a-7(c)(1), (c)(8)(ii)(B) - (C) (requiring, among other things, that the fund's board of directors promptly consider what action, if any, should be taken if the deviation between the money market fund's current market value and the fund's amortized cost price per share exceeds ½ of 1%).

refer to as "risk-limiting conditions") that limit the fund's exposure to certain risks, such as credit, currency, and interest rate risks.[8] In addition, the rule includes certain procedural requirements overseen by the fund's board of directors. One of the most important is the requirement that the fund periodically "shadow price" the amortized cost net asset value of the fund's portfolio against the mark-to-market net asset value of the portfolio.[9] If there is a difference of more than one-half of one percent (or $0.005 per share), the fund's board of directors must consider promptly what action, if any, should be taken, including whether the fund should discontinue the use of the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share, an event colloquially known as "breaking the buck."[10]

As discussed in significant detail in the Proposing Release, during 2007-2008 money market funds were exposed to substantial losses, first as a result of exposure to debt securities issued by structured investment vehicles ("SIVs"), and then as a result of the default of debt securities issued by Lehman Brothers Holdings Inc. ("Lehman Brothers"). All but one of the funds that were exposed to losses from SIV and Lehman Brothers securities obtained support of

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[8] For example, the current rule requires, among other things, that a money market fund's portfolio securities meet certain credit quality requirements, such as being rated in the top one or two rating categories by nationally recognized statistical rating organizations ("NRSROs"). A fund, moreover, may only invest a limited portion of its portfolio in securities rated in the second highest rating category. *See* current rule 2a-7(c)(3). The current rule also places limits on the remaining maturity of securities in the fund's portfolio. A fund generally may not acquire, for example, any securities with a remaining maturity greater than 397 days, and the dollar-weighted average maturity of the securities owned by the fund may not exceed 90 days. *See* current rule 2a-7(c)(2).

[9] *See* current rule 2a-7(c)(7) (requiring that such shadow pricing be calculated at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions).

[10] *See* current rule 2a-7(c)(7)(ii)(B). Regardless of the extent of the deviation, rule 2a-7 imposes on the board of a money market fund a duty to take appropriate action whenever the board believes the extent of any deviation may result in material dilution or other unfair results to investors or current shareholders. Current rule 2a-7(c)(7)(ii)(C). *See* 1983 Adopting Release, *supra* note 6, at nn.51-52 and accompanying text.

some type from their advisers or other affiliated persons, which absorbed the losses or provided a guarantee covering a sufficient amount of losses to prevent the fund from breaking the buck. The Reserve Primary Fund, which held a $785 million position in Lehman Brothers debt, ultimately did not have a sponsor with sufficient resources to support it, and on September 16, 2008 the fund announced that it would re-price its securities at $0.97 per share.[11] It subsequently suspended redemptions as of September 17, 2008.[12]

The cumulative effect of these events, when combined with general turbulence in the financial markets, led to a run primarily on institutional taxable prime money market funds, which contributed to severe dislocations in short-term credit markets and strains on the businesses and institutions that obtain funding in those markets.[13] During the week of September 15, 2008, investors withdrew approximately $300 billion from taxable prime money market funds, or 14 percent of the assets held in those funds.[14] In the final two weeks of September

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11 *See* Proposing Release, *supra* note 2, at n.44 and accompanying text. The Reserve Primary Fund distributed the bulk of its assets, and investors have received more than $0.98 on the dollar. *See* Press Release, SEC, Reserve Primary Fund Distributes Assets to Investors (Jan. 29, 2010) *available at* http://www.sec.gov/news/press/2010/2010-16.htm.

12 In response to a request by The Reserve Fund, the Commission issued an order permitting the suspension of redemptions in certain Reserve funds, to permit their orderly liquidation. *See* In the Matter of The Reserve Fund, Investment Company Act Release No. 28386 (Sept. 22, 2008) [73 FR 55572 (Sept. 25, 2008)] (order). Several other Reserve funds also obtained an order from the Commission on October 24, 2008 permitting them to suspend redemptions to allow for their orderly liquidation. *See* Reserve Municipal Money-Market Trust, et al., Investment Company Act Release No. 28466 (Oct. 24, 2008) [73 FR 64993 (Oct. 31, 2008)] (order).

13 *See Minutes of the Federal Open Market Committee*, FEDERAL RESERVE BOARD, Oct. 28-29, 2008, at 5, *available at* http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081029.pdf ("*FRB Open Market Committee Oct. 28-29 Minutes*"). *See also* Press Release, Federal Reserve Board, Board Announces Creation of the Commercial Paper Funding Facility (CPFF) to Help Provide Liquidity to Term Funding Markets (Oct. 7, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081007c.htm.

14 *See* INVESTMENT COMPANY INSTITUTE, REPORT OF THE MONEY MARKET WORKING GROUP, at 62 (Mar. 17, 2009), *available at* http://www.ici.org/pdf/ppr_09_mmwg.pdf ("ICI REPORT") (analyzing data from iMoneyNet); *see also* Investment Company Institute, *Money Market Mutual Fund Assets Historical Data*, *available at* http://www.ici.org/pdf/mm_data_2010.pdf ("ICI

2008, money market funds reduced their holdings of top-rated commercial paper by $200.3 billion, or 29 percent.[15]

On September 19, 2008, the U.S. Department of the Treasury ("Treasury Department") and the Board of Governors of the Federal Reserve System ("Federal Reserve Board") announced an unprecedented intervention in the short-term markets. The Treasury Department announced its Temporary Guarantee Program for Money Market Funds ("Guarantee Program"), which temporarily guaranteed certain investments in money market funds that decided to participate in the program.[16] This program has now expired.[17] The Federal Reserve Board announced the creation of its Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF"), through which it extended credit to U.S. banks and bank holding companies to finance their purchases of high-quality asset backed commercial paper from money market funds.[18] These programs were effective in containing the run on institutional prime

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Mutual Fund Historical Data").

15 *See* Christopher Condon & Bryan Keogh, *Funds' Flight from Commercial Paper Forced Fed Move*, BLOOMBERG, Oct. 7, 2008, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a5hvnKFCC_pQ.

16 *See* Press Release, Treasury Department, Treasury Announces Guaranty Program for Money Market Funds (Sept. 19, 2008), *available at* http://www.treas.gov/press/releases/hp1147.htm. The Program insured investments in money market funds, to the extent of their shareholdings as of September 19, 2008, if the fund chose to participate in the Program. We adopted, on an interim final basis, a temporary rule, rule 22e-3T, to facilitate the ability of money market funds to participate in the Guarantee Program. The rule permitted a participating fund to suspend redemptions if it broke the buck and liquidated under the terms of the Program. *See* Temporary Exemption for Liquidation of Certain Money Market Funds, Investment Company Act Release No. 28487 (Nov. 20, 2008) [73 FR 71919 (Nov. 26, 2008)].

17 *See* Press Release, U.S. Department of the Treasury, Treasury Announces Expiration of Guarantee Program for Money Market Funds (Sept. 18, 2009), *available at* http://www.treas.gov/press/releases/tg293.htm. The Program expired on September 19, 2009, and rule 22e-3T expired on October 18, 2009.

18 *See* Press Release, Federal Reserve Board, Federal Reserve Board Announces Two Enhancements to its Programs to Provide Liquidity to Markets (Sept. 19, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20080919a.htm. The AMLF expired on February 1, 2010. *See* Press Release, Federal Reserve Board, FOMC Statement (Jan. 27, 2010), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20100127a.htm.

money market funds and providing additional liquidity to money market funds.[19]

The severity of the problems experienced by money market funds during 2007 and 2008 prompted us to review our regulation of money market funds. We sought to better understand how we might revise rule 2a-7 to reduce the susceptibility of money market funds to runs and reduce the consequences of a run on fund shareholders. Our staff consulted extensively with staff from other members of the President's Working Group on Financial Markets. We talked to many market participants, and reviewed a report from a "Money Market Fund Working Group" assembled by the Investment Company Institute ("ICI Report"), which recommended a number of changes.[20]

Our June 2009 proposals were the product of that review and were, we explained, a first step to addressing regulatory concerns we identified. They were designed to make money market funds more resilient and less likely to break a buck as a result of disruptions such as those that occurred in the fall of 2008. They would give us better tools to oversee money market funds. If a money market fund did break a buck, they would facilitate an orderly liquidation in order to protect fund shareholders and help contain adverse effects on the capital markets and other money market funds. In addition, throughout the Proposing Release we requested comment on additional regulatory changes aimed at further strengthening the stability of money market funds.

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19 During the week ending September 18, 2008, taxable institutional money market funds experienced net outflows of $165 billion. *See Money Fund Assets Fell to $3.4T in Latest Week*, ASSOCIATED PRESS, Sept. 18, 2008. Almost $80 billion was withdrawn from prime money market funds even after the announcement of the Guarantee Program on September 19, 2008. *See* Diana B. Henriques, *As Cash Leaves Money Funds, Financial Firms Sign Up for U.S. Protection*, N.Y. TIMES, Oct. 2, 2008, at C10. By the end of the week after the announcement, however, net outflows from taxable institutional money market funds had ceased. *See Money Fund Assets Fell to $3.398T in Latest Week*, ASSOCIATED PRESS, Sept. 25, 2008.

20 ICI Report, *supra* note 14.

We received approximately 120 comments on the rule, including approximately 45 comments from investment companies and their representatives, 22 from debt security issuers, and 30 from individuals, including investors and academics. The comment letters reflected a wide variety of views on most of the topics discussed in the Proposing Release. The investment companies generally supported those aspects of the proposal that were similar to those recommended in the ICI Report.[21] Most of them strongly objected to changes that would affect the stable net asset value that today is the principal characteristic of a money market fund.[22] Most debt security issuers who wrote to us objected to changes designed to increase the credit quality of money market fund portfolios by precluding funds from investing in second tier securities (as defined by the rule).[23] Many fund commenters pointed to the historical stability of funds and urged us to be modest in our changes to rule 2a-7.[24] Some others, however, pointed to the near-cataclysmic events of September 2008 in supporting more substantial changes.[25]

As we stated in the Proposing Release, we recognize that the events of 2007-2008 raise the question of whether further changes to the regulatory structure governing money market

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21 *See, e.g.*, Comment Letter of T. Rowe Price Associates, Inc. (Sept. 8, 2009) ("T. Rowe Price Comment Letter"); Comment Letter of UBS Global Asset Management (Americas) Inc. (Sept. 8, 2009); Comment Letter of The Vanguard Group, Inc. (Aug. 19, 2009) ("Vanguard Comment Letter").

22 *See, e.g.*, Comment Letter of BlackRock Inc. (Sept. 4, 2009) ("BlackRock Comment Letter"); Comment Letter of the Dreyfus Corporation (Sept. 8, 2009) ("Dreyfus Comment Letter"); Comment Letter of Goldman Sachs Asset Management, L.P. (Sept. 8, 2009) ("Goldman Sachs Comment Letter").

23 *See, e.g.*, Comment Letter of American Electric Power Company, Inc. (Sept. 8, 2009) ("Am. Elec. P. Comment Letter"); Comment Letters of the U.S. Chamber of Commerce and Joint Treasurer Signatories (Sept. 3 & Sept. 24, 2009) ("Chamber/Tier 2 Issuers Comment Letter"); Comment Letter of Dominion Resources Services, Inc. (Sept. 8, 2009) ("Dominion Res. Comment Letter").

24 *See, e.g.*, Comment Letter of Fidelity Investments (Aug. 24, 2009) ("Fidelity Comment Letter"); T. Rowe Price Comment Letter; Comment Letter of USAA Investment Management Company (Sept. 8, 2009) ("USAA Comment Letter").

25 *See, e.g.*, Comment Letter of Deutsche Investment Management Americas Inc. (Aug. 31, 2009) ("Deutsche Comment Letter"); Comment Letter of Jeffrey N. Gordon, Professor of Law, Columbia Law School (Sept. 9, 2009); Comment Letter of John R. Jay, CFA (Sept. 8, 2009).

funds may be warranted. Accordingly, in the Proposing Release we requested comment on additional, more fundamental regulatory changes, some of which we recognized could transform the business and regulatory model on which money market funds have been operating for more than 30 years.[26] For example, we requested comment on whether money market funds should move to the "floating net asset value" used by other open-end investment companies.[27] We received over 75 comment letters addressing this issue. We have continued to explore possible more significant changes to the regulation of money market funds in light of these comments and through the staff's work with members of the President's Working Group. We expect to issue a release addressing these issues and proposing further reform to money market fund regulation.

II. Discussion

Today we are adopting the amendments we proposed last June to the rules governing money market funds, with several changes made in response to the comments we received. As described below in more detail, we believe these amendments will make money market funds more resilient and less likely to break the buck. They will further limit the risks money market funds may assume by, among other things, requiring them to increase the credit quality of fund portfolios and to reduce the maximum weighted average maturity of their portfolios, and by requiring for the first time that all money market funds maintain liquidity buffers that will help them withstand sudden demands for redemptions. The rule amendments require fund managers to stress test their portfolios against potential economic shocks such as sudden increases in interest rates, heavy redemptions, and potential defaults. They provide investors with more timely, relevant information about fund portfolios to hold fund managers more accountable for the risks they take. They will improve our ability to oversee money market funds. And finally,

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26 *See* Proposing Release, *supra* note 2, at Section III.

27 *See id.* at Section III.A.

they provide a means to wind down the operations of a fund that does break the buck or suffers a run, in an orderly way that is fair to the fund's investors and reduces the risk of market losses that could spread to other funds. We believe that these reforms collectively will better protect money market fund investors in times of financial market turmoil and lessen the possibility that the money market fund industry will not be able to withstand stresses similar to those experienced in 2007-08. Thus, we believe that each of the rules and rule amendments we are adopting is necessary or appropriate in the public interest and consistent with the protection of investors and the policies and purposes of the Investment Company Act.[28]

A. Portfolio Quality

Rule 2a-7 limits a money market fund to investing in securities that are, at the time of their acquisition, "eligible securities," which means that securities must have been rated in either of the two highest short-term debt ratings categories from the relevant NRSROs or are comparable to securities that have been so rated in these categories.[29] Before a fund may invest in an "eligible security," a fund's board of directors (or its delegate) must also determine that the security presents minimal credit risks, which must be based on factors pertaining to credit quality in addition to any rating assigned to a security.[30]

We are amending rule 2a-7 to reduce the amount of credit risk a money market fund may assume by limiting the securities in which money market funds may invest. We are also amending provisions of rule 2a-7 that address how NRSRO ratings are used in the rule.

1. Second Tier Securities

We are amending rule 2a-7 to further limit money market funds' investments in "second

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[28] *See* section 6(c) of the Investment Company Act (under which rule 22e-3 and amendments to rules 2a-7 and 17a-9 are adopted).

[29] Amended rule 2a-7(a)(12) (eligible security).

[30] Amended rule 2a-7(c)(3)(i) (portfolio quality).

tier securities."[31] Under the amendments, we are reducing permissible money market fund investments in second tier securities by (i) lowering the permitted percentage of a fund's "total assets" that may be invested in second tier securities from five percent to three percent and (ii) lowering the permitted concentration of its total assets in second tier securities of a single issuer from the greater of one percent or $1 million to one-half of one percent.[32] In addition, money market funds will not be permitted to acquire any second tier security with a remaining maturity in excess of 45 days.[33]

Last June, we proposed to prohibit money market funds from acquiring second tier securities, based on our analysis of the risks that these securities can pose to money market funds. We noted that second tier securities trade in thinner markets, generally have a weaker credit quality profile, and exhibited credit spreads that widened more dramatically than those of first tier securities during the 2008 financial turmoil.[34] During times of financial market stress, we understand that these securities tend to become illiquid and sell in the secondary market, if at all, only at prices substantially discounted from their amortized cost value.[35] This additional risk

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31 Second tier securities are eligible securities that, if rated, have received other than the highest short-term term debt rating from the requisite NRSROs or, if unrated, have been determined by the fund's board of directors to be of comparable quality. *See* amended rule 2a-7(a)(24) (defining "second tier security"); amended rule 2a-7(a)(23) (defining "requisite NRSROs").

32 *See* amended rule 2a-7(c)(3)(ii) (portfolio quality – second tier securities); amended rule 2a-7(c)(4)(i)(C) (portfolio diversification – second tier securities); amended rule 2a-7(a)(27) (defining "total assets").

33 *See* amended rule 2a-7(c)(3)(ii) (portfolio quality – second tier securities).

34 *See* Proposing Release, *supra* note 2, at Section II.A.1. *See also* Thomas K. Hahn, *Commercial Paper* (Federal Reserve Bank of Richmond, Economic Quarterly Vol. 79/2, Spring 1993), at Fig. 4 (showing historical spreads between A-1/P-1 commercial paper and A-2/P-2 commercial paper between 1974 and 1992, including the tendency of such spreads to spike shortly before and during recessions); Comment Letter of the Investment Company Institute (Sept. 8, 2009) ("ICI Comment Letter") (noting that the market for Tier 2 commercial paper is less deep with fewer issuers than the Tier 1 market).

35 *See, e.g.*, Comment Letter of Invesco AIM Advisors, Inc. (Sept. 4, 2009) ("Invesco Aim Comment Letter") (noting that it has historically avoided the second tier market due to, among

created by the credit and liquidity profile of second tier securities increases the possibility that a fund holding these securities could break the buck in times of financial market turmoil, with a detrimental impact on fund investors.

Commenters were evenly divided between those supporting our proposed elimination of money market funds' ability to acquire second tier securities and those against our proposal. In general, most money market fund sponsors who commented supported elimination,[36] while most issuers of second tier securities who commented opposed elimination.[37] Those supporting elimination argued that it would be an effective way to increase the safety of money market funds and would reduce the likelihood that a fund would break the buck. Some commenters noted that the money market funds they manage have not acquired second tier securities historically[38] because of second tier issuers' weaker credit profiles, smaller issuer program sizes, and lower market liquidity.[39] A few commenters noted that eliminating money market funds' ability to acquire second tier securities should result in minimal market disruption because money market funds currently hold small amounts of such securities.[40]

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other factors, the less overall market liquidity of second tier securities); ICI Comment Letter. *See also* Proposing Release, *supra* note 2, at Section II.A.1 for a discussion of the wider credit spreads of second tier securities during the fall of 2008, indicating the extent to which such securities traded at a discounted price.

36 *See, e.g.*, Comment Letter of Bankers Trust Company, N.A. (Aug. 28, 2009) ("Bankers Trust Comment Letter"); BlackRock Comment Letter; Comment Letter of Charles Schwab Investment Management, Inc. (Sept. 4, 2009) ("Charles Schwab Comment Letter"); Dreyfus Comment Letter; Vanguard Comment Letter. *But see* Comment Letter of Federated Investors, Inc. (Sept. 8, 2009) ("Federated Comment Letter"); Fidelity Comment Letter (opposing elimination).

37 *See, e.g.*, Comment Letter of the American Securitization Forum (Sept. 8, 2009) ("Am. Securit. Forum Comment Letter"); Comment Letter of the U.S. Chamber of Commerce, Center for Capital Markets Competitiveness (Sept. 8, 2009) ("Chamber Comment Letter"); Dominion Res. Comment Letter; Comment Letter of XTO Energy Inc. (Sept. 3, 2009) ("XTO Energy Comment Letter").

38 *See, e.g.*, Dreyfus Comment Letter; Invesco Aim Comment Letter.

39 *See, e.g.*, Invesco Aim Comment Letter.

40 *See, e.g.*, ICI Comment Letter; Comment Letter of TD Asset Management (Sept. 8, 2009)

Commenters that opposed the proposal disagreed that second tier securities significantly increase risk at money market funds,[41] argued that a complete ban would not be justified on a cost-benefit basis,[42] and stated that a ban would have a material adverse impact on second tier security issuers.[43] Some commenters noted that in a report of default rates through 2006, second tier securities have default rates substantially similar to those of first tier securities.[44] These commenters also noted that rating agencies require that second tier security issuers establish backup liquidity lines of credit providing 100 percent coverage for any issuance.[45] Several

("TDAM Comment Letter").

41 *See, e.g.*, Comment Letter of the Association for Financial Professionals (Sept. 8, 2009) ("Assoc. Fin. Professionals Comment Letter"); Chamber/Tier 2 Issuers Comment Letter; Dominion Res. Comment Letter.

42 *See, e.g.*, Comment Letter of Fund Democracy and the Consumer Federation of America (Sept. 8, 2009) ("CFA/Fund Democracy Comment Letter"); Chamber Comment Letter; Dominion Res. Comment Letter. *But see* TDAM Comment Letter (stating that the benefits of eliminating second tier securities will far outweigh any disadvantages).

43 *See, e.g.*, Chamber Comment Letter; Dominion Res. Comment Letter; Comment Letter of Treasury Strategies, Inc. (Sept. 8, 2009) ("Treasury Strategies Comment Letter").

44 Chamber Comment Letter; Chamber/Tier 2 Issuers Comment Letter. These commenters were citing the following study: Moody's Investors Service, *Short-Term Corporate and Structured Finance Rating Transition Rates, 1972-2006* (June 2007), *available at* http://www.moodys.com/cust/content/content.ashx?source=staticcontent/free%20pages/regulatory%20affairs/documents/st_corp_and_struc_transition_rates_06_07.pdf (showing, for example, a default rate for P-1 rated commercial paper over a 365 day time horizon of 0.02% versus a default rate for P-2 rated commercial paper of 0.10% over the same time horizon).

45 We note, however, that commenters did not discuss conditions under which those issuers would not be permitted to draw on those backup liquidity facilities. It is our understanding that such backup liquidity facilities typically do not provide a full backstop of liquidity support because they contain conditions limiting an issuer's ability to draw on the facility if the issuer has experienced a "material adverse change," which would often occur if the financial situation of the issuer had declined due to financial market or other economic turmoil. *See also* Hahn, *supra* note 34 (stating that backup lines of credit generally will not be useful for a firm whose operating and financial condition has deteriorated to the point where it is about to default on its short-term liabilities because credit agreements often contain "material adverse change" clauses that allow banks to cancel credit lines if the financial condition of the firm changes significantly); Pu Shen, *Why Has the Nonfinancial Commercial Paper Market Shrunk Recently?*, FEDERAL RESERVE BANK OF KANSAS CITY ECONOMIC REVIEW, at 69 (First Quarter 2003) (stating that commercial paper backup facilities are only meant to provide emergency assistance for short-term liquidity difficulties and not to enhance the credit quality of issues); Standard & Poor's, *2008 Corporate Criteria: Commercial Paper*, at 3 (Apr. 15, 2008) ("Given the size of the CP market, backup

commenters agreed with our statement in the Proposing Release that second tier securities were not the direct cause of strains on money market funds during the 2007-2008 period.[46] A few stated that banning the acquisition of second tier securities would reduce diversification of money market fund portfolio holdings and thus increase risk, noting in particular that a greater percentage of second tier security issuers are not financial institutions, compared to first tier security issuers.[47]

Commenters also asserted that prohibiting the acquisition of second tier securities would have unintended consequences for the capital markets. They stated that it might discourage investors other than money market funds from investing in second tier securities, causing a more

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facilities could not be relied on with a high degree of confidence in the event of widespread disruption.").

46 *See, e.g.*, Chamber/Tier 2 Issuers Comment Letter; Federated Comment Letter; Fidelity Comment Letter.

47 *See, e.g.*, Treasury Strategies Comment Letter; USAA Comment Letter; XTO Energy Comment Letter. We note that while a greater *percentage* of second tier security issuers do appear to be non-financial companies, there are a much greater *number* of non-financial first tier issuers and thus it is not clear that money market funds would not be able to achieve sufficient diversification in their portfolio holdings even if limited to acquiring first tier securities. The Chamber/Tier 2 Issuers Comment Letter also states that prohibiting money market funds from acquiring second tier securities would "cut the pool of *potential issuers* by 43%" (emphasis added). Any diversification is not driven only by the *number* of *potential* issuers, however. It is also determined by the amount of money market fund *assets* that can be *actually* allocated to different issuers. For example, while there are over 200 P-2 rated commercial paper programs, only approximately half of these programs are active in issuing *any* commercial paper and only 16 programs have an average quarterly outstanding issuance in excess of $500 million. *See* American Securit. Forum Comment Letter. In addition, during the market turmoil of 2007 and 2008, second tier securities did not exhibit less risky or countervailing economic metrics relevant to money market funds maintaining a stable net asset value compared to first tier securities. *See* Proposing Release, *supra* note 2, at Section II.A.1, at n.98 and accompanying text and chart. In fact, AA-rated non-financial commercial paper did exhibit significantly greater price stability than A2/P2-rated non-financial commercial paper during the fall of 2008. *See* Federal Reserve Board, Commercial Paper Data, *available at* http://www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP ("Federal Reserve Commercial Paper Data"). *See also* V.V. Chari, L. Christiano & P. Kehoe, *Facts and Myths about the Financial Crisis of 2008*, Federal Reserve Bank of Minneapolis Working Paper 666, at Fig. 7B (Oct. 2008).

substantial reduction in the issuance of second tier securities.[48] Some argued that if second tier issuers are not able to issue sufficient commercial paper, they will be forced to borrow more from banks, which is a less flexible and more costly alternative that will increase borrowing costs.[49] Finally, two commenters stated that a complete ban on the acquisition of second tier securities by money market funds might have a negative effect on those issuers of first tier securities that are viewed as presenting a higher risk of being downgraded, because money market funds may elect not to invest in those securities out of concern that the securities might soon become second tier securities.[50]

The focus of our concerns is and must be on the risk to money market funds and their

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48 *See, e.g.*, Chamber Comment Letter; Dominion Res. Comment Letter; Treasury Strategies Comment Letter. Commenters asserted that eliminating money market funds' ability to acquire second tier securities might have a substantially greater adverse impact on second tier issuers, and thus potentially on capital formation because other investors in second tier securities or lesser quality first tier securities might avoid investment in those securities as a result of our rule amendments. Investor behavior in this regard is difficult to predict. It is equally likely that investors in second tier paper would demand higher yields, increasing issuers' financing costs. As discussed below, however, we are not precluding money market funds from investing in second tier securities. Accordingly, we do not need to reach a conclusion on this matter.

49 *See, e.g.*, Am. Elec. P. Comment Letter; Chamber/Tier 2 Issuers Comment Letter; Dominion Res. Comment Letter; XTO Energy Comment Letter. We note that money market funds hold a relatively low percentage of outstanding second tier commercial paper. *See* Bank of America Merrill Lynch, Tier-2 US Commercial Paper Market Update (Oct. 15, 2009) (attached to the Am. Securit. Forum Comment Letter) (indicating that over 75% of Tier-2 commercial paper is held by insurance firms, corporations and banks, and that only 11% is held by the asset management industry, which would include money market funds as well as other mutual funds and asset managers).

50 Fidelity Comment Letter; USAA Comment Letter. Two other commenters suggested that the Commission should consider the effect of banning the acquisition of second tier securities on tax-exempt money market funds, and in particular single-state funds. *See* Dreyfus Comment Letter; Federated Comment Letter. As discussed further in the cost benefit analysis section of this Release, based on our review of money market fund portfolios in September 2008, very few money market funds, including tax-exempt funds, will be impacted by our amendments relating to second tier securities. The greatest potential impact on tax-exempt funds will be the 45-day maturity limitation for acquisition of second tier securities. Given the prevalence of variable rate demand notes among municipal securities, however, we believe that tax-exempt funds should be able to effectively manage the 45-day maturity limit without a substantial impact. Accordingly, we do not believe that a special accommodation for tax-exempt money market funds is required with respect to second tier securities.

shareholders from their investments in second tier securities. While, as commenters noted,[51] second tier securities do not appear to be subject to substantially greater default risk than first tier securities they present greater credit spread risk and trade in thinner markets,[52] all of which can lead to greater price volatility and illiquidity in times of market stress.[53] While these characteristics may not pose the same degree of risk to money market funds as the likelihood that a security could default and become worthless, they can adversely affect money market funds' ability to maintain a stable net asset value. This is particularly the case given money market funds' narrow margin for deviation between the mark-to-market value of their assets and the amortized cost value of those assets, and the significant negative impact on money market funds and their investors if a fund breaks the buck.

Several commenters asserted that there are high-quality second tier securities available and that money market funds conducting a thorough credit risk analysis may conclude that

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[51] *See supra* note 44 and accompanying text.

[52] A few commenters argued that the increase in spreads of Tier 2 commercial paper over Tier 1 commercial paper during the fall of 2008 was due to the Federal Reserve Board's announcement of its creation of the Commercial Paper Funding Facility (CPFF) on October 7, 2008, which only supported issuance of 90-day Tier 1 commercial paper. *See* Chamber Comment Letter; Chamber/Tier 2 Issuers Comment Letter; Dominion Res. Comment Letter. We note, however, that spreads between Tier 1 and Tier 2 commercial paper widened significantly (by well over 300 basis points) immediately after the bankruptcy of Lehman Brothers was announced on September 14, 2008—well before the CPFF was announced on October 7. *See* Federal Reserve Commercial Paper Data, *supra* note 47 (comparing AA and A2/P2 rated 30-day and 60-day nonfinancial commercial paper rates).

[53] We note that second tier securities are also more likely to be downgraded than first tier securities. *See* Moody's Investors Service, *Short-Term Corporate and Structured Finance Rating Transition Rates*, *supra* note 44, cited in Chamber/Tier 2 Issuers Comment Letter (showing that for each time period, commercial paper with a P-2 rating had a greater percentage chance of being downgraded than commercial paper with a P-1 rating, and that this gap widened over time—for example, P-2 rated commercial paper had a 1.09% chance of being downgraded over a 60-day period compared to a 0.72% chance of P-1 commercial paper being downgraded (a 0.37% difference); P-2 rated commercial paper had a 2.07% chance of being downgraded over a 120-day period compared to a 1.46% chance of P-1 commercial paper being downgraded (a 0.61% difference); and P-2 rated commercial paper had a 4% chance of being downgraded over a 270-day period compared to a 3.18% chance of P-1 commercial paper being downgraded (a 0.82% difference)).

certain second tier securities provide a higher yield than first tier securities while still maintaining a risk profile consistent with investment objectives for money market fund investment.[54] In these circumstances, investment in higher yielding second tier securities may benefit fund investors. These commenters suggested that, given these benefits, it may be more appropriate for us to preserve money market funds' ability to invest in second tier securities, but to a reduced degree.[55]

In light of these considerations, we believe that it is not necessary to prohibit money market funds from acquiring second tier securities. Instead, we believe that a better approach is to further limit money market funds' exposure to the risks presented by second tier securities. We expect that this treatment will both satisfy our policy objectives, as further discussed below, while mitigating some of the possible negative consequences noted by commenters that could result from eliminating money market funds' ability to acquire second tier securities. This approach is reflected in three amendments we are adopting to rule 2a-7.

First, as suggested by some commenters,[56] we are reducing the amount of second tier securities that money market funds can acquire from five to three percent of their total assets, in order to reduce money market funds' aggregate exposure to the risks posed by second tier

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54 *See, e.g.*, Fidelity Comment Letter; Comment Letter of Thrivent Mutual Funds (Sept. 8, 2009) ("Thrivent Comment Letter").

55 *See, e.g.*, Federated Comment Letter (suggesting, as an alternative to eliminating money market funds' ability to acquire second tier securities, further limitations including reducing the percentage of fund assets permitted to be invested in second tier securities and limiting the final maturity of permissible second tier securities). *See also, e.g.*, Am. Elec. P. Comment Letter; Fidelity Comment Letter; USAA Comment Letter (each suggesting, as an alternative to eliminating money market funds' ability to acquire second tier securities, limiting the final maturity of permissible second tier securities to 90 days).

56 *See* Federated Comment Letter; Comment Letter of the Sargent Shriver National Center on Poverty Law (Jul. 13, 2009) ("Shriver Poverty Law Ctr. Comment Letter"). These commenters did not suggest a particular percentage level to which the permissible aggregate amount of second tier securities that could be acquired should be reduced.

securities.[57] We are concerned that a limit of less than three percent could be equivalent to eliminating money market funds' ability to acquire second tier securities because we understand that investing in second tier securities requires an additional amount of credit analysis.[58] Accordingly, money market funds may not be willing to incur the costs of this additional credit analysis if they could only acquire second tier securities in amounts unlikely to make a meaningful contribution to fund yields.

Second, we are reducing the amount of second tier securities of any one issuer that a money market fund can acquire from one percent of the fund's total assets or $1 million (whichever is greater), to one-half of one percent of the fund's total assets.[59] We requested

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[57] The amendments apply the new limit on second tier securities holdings to all money market funds, including tax-exempt funds. *See* amended rule 2a-7(c)(3). Current rule 2a-7 limits tax-exempt funds' holdings of second tier securities only with respect to conduit securities (*i.e.*, securities issued by a municipal issuer involving an arrangement or agreement entered into with a person other than the issuer that provides for or secures repayment of the security). *See* current rule 2a-7(c)(3)(ii)(B).

[58] In light of our decision not to prohibit the acquisition of second tier securities and after review of comments we received, we are persuaded that the current requirements regarding the rating standards in rule 2a-7 for certain long-term securities with remaining maturities of less than 397 days ("stub securities") are sufficient. We proposed to permit money market funds to acquire only those stub securities that had received a long-term rating in the highest two categories rather than the highest three categories, as permitted under the current rule. *See* current rule 2a-7(a)(10(ii)A). Commenters largely opposed our proposal asserting that standards associated with long-term ratings referenced in the current rule generally are correlated with the standards associated with the highest categories of short-term ratings. *See* BlackRock Comment Letter; Charles Schwab Comment Letter; ICI Comment Letter.

[59] Amended rule 2a-7(c)(4)(i)(C). The limitation also applies to tax-exempt funds, which under the current rule are only subject to the issuer diversification requirement with respect to conduit securities that are second tier. We also are amending rule 2a-7(c)(4)(i)(B) to prohibit each "single state fund" from acquiring more than ½ of 1% of its total assets in second tier securities. We also discussed modification to the guarantor and demand feature diversification provisions under rule 2a-7 in Section II.D of the Proposing Release. In addition to the reduction in the ability of money market funds to acquire second tier securities of any particular issuer, we are proportionately reducing by half the ability of a money market fund to acquire "demand features" or "guarantees" of a single issuer that are second tier securities from 5% to 2.5% of the money market fund's total assets. *See* amended rule 2a-7(c)(4)(iii)(B). We believe that this reduction will provide appropriate protection to money market funds against exposure to any particular guarantor or demand feature provider. We do not believe that we need to reduce this limitation to ½ of 1%, as we are doing with other individual second tier issuer exposures, because in these cases a security

comment in the Proposing Release on whether the issuer diversification limitations under rule 2a-7 should be further reduced and, if so, to what level.[60] Most commenters focused their response on whether there should be a general increase in the diversification limits under rule 2a-7 for all eligible securities. Many argued against an increase because it would require funds to invest in securities of lower credit quality in order to increase the number of issuers of portfolio securities and satisfy the greater diversification requirement.[61] One commenter, however, recommended that funds not be able to acquire more than one-half of one percent of their assets in *second tier securities* of any particular issuer as a method of limiting money market funds' exposure to the risks of second tier securities.[62]

We are adopting this commenter's suggestion because we believe the limitation will enhance the resilience of money market funds. It should decrease the likelihood that the default of, or significant distress experienced by, any particular second tier issuer alone will cause a money market fund to break the buck. While a money market fund can break the buck due to simultaneous stresses across its portfolio, it also can break the buck due to a sudden decline in the market-based price of a particular security in its portfolio, as was the case with respect to securities of Lehman Brothers during September 2008.[63] In addition, unlike in the case of imposing a one-half of one percent diversification limitation on *all* issuers held in a money

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holder has recourse to both the security issuer and the issuer of the demand feature or guarantee, and thus there is a lesser chance that an individual company's default or distress will adversely impact the security. We received no comments on this aspect of the Proposing Release.

60 *See* Proposing Release, *supra* note 2, at Section II.D.

61 *See*, *e.g.*, Charles Schwab Comment Letter; Invesco Aim Comment Letter.

62 *See* Comment Letter of James J. Angel, Professor of Finance, Georgetown University (Sept. 8, 2009). Two other commenters also generally supported greater restrictions on money market funds' ability to acquire securities of any particular issuer. *See* Shriver Poverty Law Ctr. Comment Letter; Comment Letter of C. Stephen Wesselkamper (Sept. 3, 2009) ("C. Wesselkamper Comment Letter").

63 *See supra* text accompanying note 11.

market fund's portfolio, given the other limitations on holdings of second tier securities that we are adopting today, a diversification limitation of one-half of one percent that applies only to second tier securities should not require money market funds to invest in a substantially greater number of issuers, and thus should not expose the fund to investing in securities of lower credit quality.[64] In sum, we believe this tightened limitation on exposure to any particular second tier security issuer will provide additional protection to the stability of money market funds.

Third, we are limiting money market funds to acquiring second tier securities with remaining maturities of 45 days or less.[65] Several commenters urged us to adopt this approach to limiting money market funds' exposure to risk from second tier securities.[66] The risks of second tier securities discussed above can be substantially limited by restricting the length of time that a money market fund is exposed to the risks of that particular security. Securities of shorter maturity will pose less credit spread risk and liquidity risk to the fund because there is a shorter period of credit exposure and a shorter period until the security will mature and pay cash. Moreover, second tier securities with shorter maturities are less likely to be downgraded.[67] In

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64 Under the current rule, a taxable money market fund could invest the greater of 1% or $1 million of its assets in second tier securities of a single issuer. Under the amendments we are adopting today, a money market fund maximizing its investment ability in second tier securities and trying to concentrate its holdings in as few issuers as possible would hold securities of six different second tier security issuers, rather than five second tier issuers under the current rule.

65 Amended rule 2a-7(c)(3)(ii). We requested comment on this approach in the Proposing Release. *See* Proposing Release, *supra* note 2, at Section II.A.1.

66 *See, e.g.*, Am. Elec. P. Comment Letter; Fidelity Comment Letter; USAA Comment Letter (all suggesting that permissible second tier security maturities be limited to a 90-day maximum); Thrivent Comment Letter (suggesting that permissible second tier security maturities be limited to a 45-day maximum). Given the need for money market funds to adjust quickly to changes in market risk to avoid breaking the buck (and given that based on historical experience second tier securities are unlikely to be issued with a 90-day maturity limit), we believe that a 45-day maturity limit is more prudent than a 90-day maturity limit.

67 *See* Moody's Investors Service, *Short-Term Corporate and Structured Finance Rating Transition Rates*, *supra* note 44 (showing that P-2 rated commercial paper had a 98.79% chance of being rated P-2 or higher over a 30-day period, but a 96.31% chance of being rated P-2 or higher over a 90-day period, and a 92.75% chance of maintaining this rating level over a 180-day period).

recognition of the role that a shorter maturity can play in reducing second tier securities' risk, the market typically has demanded that such securities be issued at shorter maturities than first tier securities.[68] We believe that limiting the risk arising out of second tier securities through limiting their permissible maturity is appropriate and that a 45-day maturity limit will provide additional protection to investors without causing undue market disruption.[69]

We believe that the above combination of limitations on money market funds' ability to acquire second tier securities will achieve an appropriate balance between reducing the risk that money market funds will not be able to maintain a stable price per share and allowing fund investors to benefit from the higher returns that limited exposure to second tier securities can provide.

2. Eligible Securities

We are amending rule 2a-7 to require that the board of directors of each money market fund (i) designate four or more NRSROs, any one or more of whose short-term credit ratings the

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68 For example, the average maturity of outstanding non-asset backed second tier commercial paper as of November 20, 2009 was 25.6 days compared to 52.2 days for non-asset backed first tier commercial paper. *See* Federal Reserve Board, Average Maturity by Category for Outstanding Commercial Paper, *available at* http://www.federalreserve.gov/releases/cp/maturity.htm (last visited Dec. 2009). The Federal Reserve Board also has reported that during each of 2007, 2008, and 2009, on average over 96% of non-financial A2/P2 commercial paper had a maturity of 40 days or less at issuance. *See* Federal Reserve Board, Volume Statistics for Commercial Paper, A2/P2 Nonfinancial, *available at* http://www.federalreserve.gov/releases/cp/volumestats.htm (last visited Dec. 2009).

69 One commenter asserted that because so little of second tier commercial paper currently is issued with a maturity of greater than 45 days, imposing a maturity limitation of 45 days on second tier securities eligible for money market fund investment would have little effect on a fund's overall exposure to credit risk. *See* ICI Comment Letter. We disagree. It is true that in recent years, second tier commercial paper has been issued largely at maturities of less than 45 days. *See supra* note 68. This fact may mean that there will be less cost impact from our amendments limiting money market funds to acquiring second tier securities with maturities of 45 days or less. It does not mean, however, that this historical maturity distribution will hold true in the future, and that money market funds will not seek in the future to invest in longer term second tier securities to achieve a higher yield, which would expose money market funds to the higher risks associated with longer term second tier securities.

fund would look to under the rule in determining whether a security is an eligible security, and (ii) determine at least once each calendar year that the designated NRSROs issue credit ratings that are sufficiently reliable for that use.[70] In addition, funds must identify the designated NRSROs in the fund's statement of additional information ("SAI").[71] Under the amendments, funds may, but are not required to, consider (or monitor) the ratings of other NRSROs under other provisions of the rule.[72]

As we have stated on several occasions, we are concerned with the authority that references to NRSRO ratings in our rules have given certain rating agencies, and whether such references have inadvertently placed an "official seal of approval" on ratings that could adversely affect the quality of due diligence and investment analysis.[73] The debt crisis of 2007-2008 also has given us concern about the reliability of these ratings.[74] Accordingly, we asked in the Proposing Release and in 2008 in a separate release whether we should eliminate or alter our use of ratings by NRSROs in rule 2a-7.[75]

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70 Amended rule 2a-7(a)(11)(i). As under the definition of "NRSRO" in current rule 2a-7, a designated NRSRO may not be an affiliated person of the issuer of, or any insurer or provider of credit support for, the security. Amended rule 2a-7(a)(11)(ii). The definition of "designated NRSRO" incorporates the definition of NRSRO in section 3(a)(62) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78c(a)(62)]. Amended rule 2a-7(a)(11).

71 Amended rule 2a-7(a)(11)(iii) (requiring the fund to disclose in its SAI its designated NRSROs and any limitations with respect to the fund's use of such designation). *See* Part B of Form N-1A. In addition, funds must identify designated NRSROs in Form N-MFP with respect to each of the fund's portfolio securities. *See infra* Section II.E.2.

72 *See infra* notes 116-118, 121 and accompanying text.

73 *See*, *e.g.*, References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327 (July 1, 2008) [73 FR 40124 (July 11, 2008)] ("NRSRO References Proposing Release"); References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28939 (Oct. 5, 2009) [74 FR 52358 (Oct. 9, 2009)] ("NRSRO References Adopting Release").

74 *See* NRSRO References Proposing Release, *supra* note 73, at text following n.6.

75 *See* Proposing Release, *supra* note 2, at text following n.110; NRSRO References Proposing Release, *supra* note 73, at Section III.A.

The Proposing Release requested comment on alternative approaches. One approach would have eliminated any references to ratings in rule 2a-7, the effect of which would be to eliminate the floor established by the "eligible security" requirement and rely entirely on fund boards (and their delegates) to determine whether investment in a security involved minimal credit risks. An alternative approach would have maintained references to credit ratings in the rule, but shifted responsibility to fund boards to determine at least annually which NRSROs were sufficiently reliable for the fund to use to determine whether a security is an eligible security that could be considered for investment. Among other things, we requested comment on the minimum number of credit rating agencies we should require that a board designate for this purpose.

Each time we have solicited comments, a substantial majority of commenters has strongly supported retaining the references to NRSRO ratings in the rule.[76] Among other reasons, commenters argued that using credit ratings as a floor for credit quality limits money market fund advisers from taking greater risks that could weaken the rule's risk limiting conditions and thus the protection of investors.[77] Many urged us instead to address the "root causes" of ratings failures rather than remove the safety net provided by the credit ratings requirements of the rule.[78] Some disputed suggestions that inclusion of ratings in rule 2a-7

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76 *See, e.g.*, Comment Letter of Calvert Group, Ltd. (Sept. 8, 2009) ("Calvert Comment Letter"); Federated Comment Letter; ICI Comment Letter. *See also* Comment Letter of the American Bar Association (Committee on Federal Regulation of Securities and Committee on Securitization and Structured Finance) (Sept. 12, 2008) (available in File No. S7-19-08); Comment Letter of the Institutional Money Market Funds Association (Sept. 5, 2008) (available in File No. S7-19-08); Comment Letter of the Securities Industry and Financial Markets Association (Dec. 8, 2009) (available in File No. S7-19-08). Comment letters submitted in File No. S7-19-08 are available on the Commission's web site at: http://www.sec.gov/comments/s7-19-08/s71908.shtml.

77 *See, e.g.*, Dreyfus Comment Letter; ICI Comment Letter; Comment Letter of J.P. Morgan Asset Management (Sept. 8, 2009) ("J.P Morgan Asset Mgt. Comment Letter"). *See also* Proposing Release, *supra* note 2, at nn.108-110 and accompanying text.

78 *See, e.g.*, Comment Letter of the Northern Funds and Northern Institutional Funds – Independent

encourages fund managers to over-rely on the ratings, pointing to provisions in the rule that specifically require independent analysis by fund managers.[79] One commenter argued that NRSRO ratings provide "an additional, independent check on the investment manager's judgment."[80] By acting as a floor, the commenter argued, these ratings keep all money market funds operating at or above the same level,[81] and they restrain any particular money market fund from taking (and exposing investors to) greater risks than other competing money market funds in order to gain a competitive advantage in a highly yield-sensitive market.[82]

Only a few commenters have supported removing references to NRSRO ratings.[83] These

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Trustees (Sept. 8, 2009) ("Northern Funds Indep. Trustees Comment Letter"); Comment Letter of the Tamarack Funds Trust (Sept. 8, 2009) ("Tamarack Funds Comment Letter"). *See also* Comment Letter of Charles Schwab & Co., Inc. (Sept. 5, 2008) (available in File No. S7-19-08); Comment Letter of Dechert LLP (Sept. 5, 2008) (available in File No. S7-19-08); Comment Letter of Realpoint (Aug. 14, 2008) (available in File No. S7-19-08). We have recently adopted rule amendments designed to improve our regulation and oversight of NRSROs, which help address the integrity of their rating procedures and methodologies. *See* Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009) [74 FR 63832 (Dec. 4, 2009)]; Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (Feb. 2, 2009) [74 FR 6456 (Feb. 9, 2009)]; 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)].

79 *See* ICI Comment Letter; TDAM Comment Letter.

80 *See* ICI Comment Letter.

81 *See, e.g.*, Comment Letter of State Street Global Advisors (Sept. 8, 2009) ("State Street Comment Letter"); Vanguard Comment Letter.

82 *See* ICI Comment Letter. *See also* J.P Morgan Asset Mgt. Comment Letter; Comment Letter of Stradley Ronon Stevens & Young, LLP (Sept. 8, 2009) ("Stradley Ronon Comment Letter").

83 *See* Comment Letter of James B. Burnham, Business School Professor, Duquesne University (Aug. 27, 2009) ("J. Burnham Comment Letter"); Comment Letter of Moody's Investors Service (Sept. 8, 2009) ("Moody's Comment Letter"); Comment Letter of James L. Nesfield (Jul. 4, 2009) ("J. Nesfield Comment Letter"); Comment Letter of the Shadow Financial Regulatory Committee (Sept. 14, 2009) ("Shadow FRC Comment Letter"); Comment Letter of John M. Winters, CFA (Jul. 23, 2009). *See also* Comment Letter of Professor Lawrence J. White (Sept. 5, 2008) (available in File No. S7-19-08); Comment Letter of Professor Frank Partnoy (Sept. 5, 2008) (available in File No. S7-19-08); Comment Letter of the Government Finance Officers Association (Sept. 5, 2008) (available in File No. S7-19-08); Comment Letter of the Financial Economists Roundtable (Dec. 1, 2008) (available in File No. S7-19-08).

commenters principally asserted that removing credit ratings references would prevent fund boards and advisers from overreliance on NRSRO ratings and encourage advisers to make independent decisions about whether a security presents a credit risk.[84] Other commenters, however, countered that eliminating NRSRO ratings from the rule would do nothing to prevent a fund manager from being highly dependent upon NRSRO ratings in making its minimal credit risk determination.[85]

Commenters did, however, largely support the approach of allowing funds to designate a minimum number of NRSROs that the fund would look to under rule 2a-7 in determining whether a security is an eligible security. They asserted that NRSRO designation would encourage competition among NRSROs to achieve designation and reduce the cost of subscribing to all NRSROs' ratings.[86] They also noted that this approach would permit funds to focus better on standards, methods, and current ratings levels developed by designated NRSROs.[87] Several commenters expressed concern, however, that requiring designation of only three NRSROs would result in funds designating the three largest NRSROs, which could further entrench their market dominance.[88] Other commenters stated that designating NRSROs could

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84 *See* J. Burnham Comment Letter; Moody's Comment Letter; J. Nesfield Comment Letter; Shadow FRC Comment Letter. One commenter asserted that transparency of portfolio holdings was a better approach than using references to NRSRO ratings. J. Nesfield Comment Letter. We note that we are amending rule 2a-7 to require money market funds to disclose information about their portfolio holdings each month on their websites. *See infra* Section II.E.1.

85 Stradley Ronon Comment Letter (removing the references would not prevent advisers from relying too heavily on NRSRO ratings under their own internal credit risk analysis).

86 *See, e.g.*, Federated Comment Letter; Fidelity Comment Letter; ICI Comment Letter.

87 *See* Am. Securit. Forum Comment Letter.

88 *See, e.g.*, Comment Letter of DBRS Limited (Sept. 8, 2009) ("DBRS Comment Letter"); Comment Letter of Wells Fargo Funds Management, LLC (Sept. 8, 2009) ("Wells Fargo Comment Letter"). Three of the 10 NRSROs registered with the Commission issued approximately 97% of all outstanding ratings across all categories reported to the Commission for 2008. *See* SEC, ANNUAL REPORT ON NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS (Sept. 2008) at 10.

disadvantage small NRSROs with well-developed capabilities regarding certain investments and suggested that the fund should have flexibility to rely on the particular NRSROs it determines have the best expertise to evaluate a particular security.[89] Some commenters, while supporting designation of NRSROs, asserted that fund boards are unprepared to make such determinations and urged that fund advisers be given the responsibility.[90]

The Commission is committed to reevaluating the use of NRSRO ratings in our rules. Recently we eliminated references to NRSRO ratings in several rules where we concluded that they were no longer warranted as serving their intended purposes and where the elimination was consistent with the protection of investors.[91] Today, as discussed in more detail below, we are eliminating the only provision in rule 2a-7 that limits money market funds to investing in a type of security *only* if it is rated.[92] We continue to work to further the goals of the Credit Rating Agency Reform Act in order to improve the quality and reliability of securities ratings.[93]

We have found no evidence that suggests that over-reliance on NRSRO ratings contributed to the problems that money market funds faced during the debt crisis. Our staff closely examined, for example, why some money market funds held securities issued by certain

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[89] *See* Tamarack Funds Comment Letter; TDAM Comment Letter.

[90] *See* Comment Letter of the American Bar Association (Committee on Federal Regulation of Securities) (Sept. 9, 2009) ("ABA Comment Letter"); Comment Letter of the Mutual Fund Directors Forum (Sept. 8, 2009) ("MFDF Comment Letter"); Comment Letter of Northern Funds and Northern Institutional Funds (Sept. 8, 2009) ("Northern Funds Comment Letter").

[91] *See* NRSRO References Adopting Release, *supra* note 73.

[92] *Compare* amended rule 2a-7(a)(12) *with* current rule 2a-7(a)(10)(i)(B).

[93] *See, e.g.*, Proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61051 (Nov. 23, 2009) [74 FR 63866 (Dec. 4, 2009)] (proposing rule amendments and a new rule requiring each NRSRO to: (1) furnish an annual report describing the steps taken by the firm's designated compliance officer during the fiscal year with respect to certain compliance matters; (2) disclose additional information about sources of revenues on Form NRSRO; and (3) make publicly available information about revenues of the NRSRO attributable to persons paying the NRSRO for the issuance or maintenance of a credit rating).

SIVs that became distressed in 2007. The staff exams appear to indicate that the minimal creditworthiness evaluations of SIVs made by advisers to funds that held those SIVs differed from the evaluations made by advisers to funds that did not invest in those SIVs in the emphasis the advisers gave to particular elements of the analysis.[94] Had fund managers relied too heavily on credit rating agencies, we would have expected to see far more funds holding Lehman Brothers commercial paper when it defaulted than we did.[95]

The current provisions of rule 2a-7 were designed to prevent excess reliance on credit rating agencies.[96] Under rule 2a-7, adequate ratings alone do not provide a basis for eligibility. As we have noted before, a determination that a security is an eligible security is a necessary but not sufficient finding in order for a fund to acquire the security.[97] The rule also requires fund boards (which typically rely on the fund's adviser) to determine that the security presents minimal credit risks, and specifically requires that determination "be based on factors pertaining to credit quality in addition to any ratings assigned to such securities by an NRSRO."[98] Thus, credit ratings provide an important *but not exclusive* input into the investment decision-making

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94 *See* Proposing Release, *supra* note 2, at note 135.

95 *See Fitch: Market Challenges Offer 'Lessons' for Rated Money Market Funds*, Business Wire (Oct. 1, 2008) ("Most funds were able to eliminate or minimize their exposure to securities issued by SIVs and Lehman Brothers by limiting their absolute exposures and/or taking measures to scale back their risk as the credit picture deteriorated."). *See* Bloomberg Terminal Database, LEH <Equity> CRPR (historical short-term credit ratings for credit rating agencies, including Moody's and Fitch, indicate that these agencies did not downgrade their ratings of Lehman Brothers debt before the company filed for bankruptcy); Bob Ivry, Mark Pittman & Christine Harper, *Sleep-At-Night-Money Lost in Lehman Lesson Missing $63 Billion*, BLOOMBERG (Sept. 8, 2009), *available at* http://www.bloomberg.com/apps/news?pid=email_en&sid=aLhi.S5xkemY (historical short-term credit ratings for Moody's and Fitch indicate that these credit rating agencies did not downgrade their ratings of Lehman Brothers debt before the company filed for bankruptcy); David Segal, *The Silence of the Oracle*, NEW YORK TIMES (Mar. 18, 2009) (noting Moody's rated Lehman Brothers' debt A2 before the firm's bankruptcy).

96 *See* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 18005 (Feb. 20, 1991) [56 FR 8113 (Feb. 27, 1991)] ("1991 Adopting Release") at Section II.A.

97 *See*, *e.g.*, *id.* at text accompanying n.18.

98 Current rule 2a-7(c)(3)(i).

process, [99] and the unreliability or low quality of ratings issued by one or more NRSROs can (and should) be addressed by an investment adviser providing a thorough analysis of the security to determine if it involves minimal credit risks. The use of these ratings provides an independent perspective on the creditworthiness of short-term securities that we have considered, in part, when determining whether to exercise our exemptive authority to permit money market funds to use the amortized cost method of valuation.[100]

This is not to say, however, that we are content with the current approach of rule 2a-7. Any one of the growing number of NRSROs, regardless of its expertise in rating short-term securities of the type held by money market funds, could have deemed a security unfit for a money market fund to acquire or, conversely, deemed a security to be eligible for investment by a money market fund. To address this concern, we are adopting amendments to rule 2a-7 that shift responsibility to money market fund boards for deciding which NRSROs they will use in determining whether a security is an eligible security for purposes of the rule.

The amendments are designed, among other things, to foster greater competition among NRSROs to produce the most reliable ratings in order to obtain designation by money market fund boards. Accordingly, we believe this approach will improve the utility of the rule's use of NRSRO ratings as threshold investment criteria, and is consistent with the goals of Congress in passing the Credit Rating Agency Reform Act.[101]

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99 *See* 1991 Adopting Release, *supra* note 96, at Section II.A.

100 *See* 1983 Adopting Release, *supra* note 6, at paragraphs following n.31.

101 *See* Senate Committee on Banking, Housing, and Urban Affairs, Credit Rating Agency Reform Act of 2006, S. Rep. 109-326, at 1 (2006) ("Senate Report No. 109-326") ("The purpose of the 'Credit Rating Agency Reform Act' … is 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."). In 2007, pursuant to the Credit Rating Agency Reform Act, we adopted rules to implement a program for registration and Commission oversight of NRSROs ("NRSRO Rules"). Oversight of Credit Rating Agencies Registered as Nationally Recognized

a. Number of Designated NRSROs

Under amended rule 2a-7, each money market fund must designate in its registration statement[102] at least four NRSROs that the fund will use to determine, among other things, whether a security is an eligible security.[103] Several commenters expressed concern that permitting funds to designate only three NRSROs (which was recommended by the ICI Report) would simply embrace the current market for ratings, which is dominated by three rating

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Statistical Rating Organizations, Exchange Act Release No. 55857 (June 5, 2007) [72 FR 33564 (June 18, 2007)] ("NRSRO Rules Adopting Release"). Our rule amendments regarding NRSROs have been designed, among other things, to foster greater competition among NRSROs and to encourage more of them to enter the market. *See, e.g.*, Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009) [74 FR 63832 (Dec. 4, 2009)], at nn.1-3 and accompanying text (*citing* Senate Report No. 109-326, at 1).

[102] The fund must disclose the designated NRSROs, including any limitations with respect to the fund's use of such designation, in the fund's SAI. Amended rule 2a-7(a)(11)(iii). In response to our request for comment on whether to require disclosure of designated NRSROs in money market funds' SAI, *see* Proposing Release, *supra* note 2, at text accompanying n.115, several commenters suggested we require disclosure of designated NRSROs in the fund's registration statement. *See, e.g.*, Fidelity Comment Letter (recommending disclosure in the fund's SAI); Invesco Aim Comment Letter (same); ICI Comment Letter (recommending disclosure in the fund's prospectus or website). In contrast, one commenter objected to disclosure of designated NRSROs in the fund's registration statement on the grounds that investors do not consider this information to be material and stickering the fund's prospectus for each change in designation would be too costly. *See* Federated Comment Letter. We believe that the identity of each designated NRSRO is not essential information for investors, but that some investors may find it useful, and therefore are requiring it in the SAI. *See generally* Form N-1A at General Instruction C.2(b) (noting that the purpose of the SAI is to provide additional information about a fund that is not necessary to be in the prospectus but that some investors may find useful).

[103] Amended rule 2a-7(a)(11). A fund may designate only credit rating agencies that are registered as NRSROs with the Commission under the Exchange Act and the rules adopted under those provisions. *See* section 15E of the Exchange Act [15 U.S.C. 78o-7]; 17 CFR 240.17g-1. In response to our request for comment, one commenter recommended permitting designation of unregistered credit rating agencies on the grounds that this could promote competition. *See* Moody's Comment Letter. Two commenters opposed designation of an unregistered credit rating agency, and one of these commenters argued that the potential for introducing under-researched data into the marketplace could disrupt the orderly functioning of markets. *See* DBRS Comment Letter; Invesco Aim Comment Letter. In light of the enhanced disclosure obligations and ongoing rulemaking initiatives designed to improve the quality and reliability of ratings issued by registered NRSROs, we are maintaining the requirement that only credit rating agencies registered as NRSROs with the Commission may be designated under the rule. *See, e.g.*, *supra* note 93.

agencies.[104] We share these commenters' concerns and thus are requiring funds to designate at least four NRSROs, an approach recommended by commenters as a way to foster competition among NRSROs to develop a specialized service of providing short-term ratings to money market funds and improve independent credit ratings for purposes of the rule.[105] We also believe that the designation of at least four NRSROs will allow funds to designate smaller NRSROs that specialize in rating particular investments.

Under the amendments, a fund could designate an NRSRO with respect to short-term credit ratings for only certain types of issuers or securities.[106] This would allow a fund, for example, to designate an NRSRO that specializes in securities issued by insurance companies or banks.[107] This approach, which was supported by several of the commenters,[108] may further encourage new entrants among NRSROs that fund managers might not otherwise consider designating due to lack of confidence in ratings outside the NRSROs' areas of expertise.

b. Board Designation and Annual Determination

The amendments require each money market fund's board of directors to designate the

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104 *See, e.g.*, DBRS Comment Letter; Wells Fargo Comment Letter; C. Wesselkamper Comment Letter.

105 *See* DBRS Comment Letter; Fidelity Comment Letter. In response to our request for comment on the appropriate number of NRSROs a board should designate, another commenter requested we require funds to designate at least five NRSROs as a way to encourage new entrants to the market. *See* Federated Comment Letter. *See also* Proposing Release, *supra* note 2, at text following n.113 and at n.117 and accompanying text (requesting comment).

106 Amended rule 2a-7(a)(11)(i)(A) (providing that a money market fund's board of directors may designate an NRSRO whose short-term credit ratings with respect to any obligor or security or particular obligors or securities will be used by the fund to determine whether a security is an eligible security).

107 A fund that has designated an NRSRO to use in determining the eligibility of insurance company-issued securities need not review or monitor any class of ratings that the NRSRO issued with respect to other securities or their issuers in which the fund may invest. A fund adviser (under delegated authority) would be free (but not required) to consider these ratings in determining whether the non-insurance company-issued security (or its issuer) presents minimal credit risks. Amended rule 2a-7(c)(3)(i).

108 *See* DBRS Comment Letter; Moody's Comment Letter; Wells Fargo Comment Letter.

NRSROs on which the fund will rely for purposes of the rule. In addition, the board must determine at least once each calendar year that each designated NRSRO issues credit ratings that are sufficiently reliable for such use.[109] Before designating an NRSRO and before making its annual determination, a board should have the benefit of the adviser's evaluation regarding the quality of the NRSRO's short-term ratings.[110] We would anticipate that the board's designations and annual determinations would be based on recommendations of the fund adviser and its credit analysts, who would have evaluated each NRSRO based on their experiences in addition to any information provided by the NRSRO. We would expect the adviser's annual evaluation to be based, among other things, on an examination of the methodology an NRSRO uses to rate securities, including the risks they measure, and the NRSRO's record with respect to the types of securities in which the fund invests, including asset backed securities.[111] The reliability of a newly registered NRSRO could be evaluated based upon the quality and relevant experience of

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109 Amended rule 2a-7(a)(11)(i). We are requiring funds to perform the annual determination once each calendar year to simplify compliance so that a fund is not in violation of the rule if the board's determination occurs soon after the year anniversary of the previous determination.

110 Fund boards may, however, also find an NRSRO's record with respect to long-term securities to be helpful in evaluating the overall quality of the organization.

111 *See* Moody's Comment Letter (advocating that any board designation be "based on the board's assessment of ratings' attributes, such as quality, comparability and historical performance."). We have recently adopted rule amendments relating to NRSROs that should help fund advisers and their credit analysts in performing their evaluations. Our amendments require NRSROs, among other things, to disclose information about their ratings methodology, experience and performance. For example, NRSROs must disclose in their applications their ratings experience, performance in assessing the creditworthiness of securities and obligors, procedures and methodologies used in determining credit ratings, the types of conflicts NRSROs face and how they manage those conflicts, and the qualifications of the NRSRO's credit analysts. *See* Items 6, 7 and Exhibits 1, 2, 6, 7, 8 of Form NRSRO. In addition, NRSROs currently are required to disclose on a public web site a random sample of 10% of the ratings histories of issuer paid ratings in each class of credit ratings for which the NRSRO is registered and has issued 500 or more issuer paid credit ratings. Rule 17g-2(a)(8) and (d) [17 CFR 240.17g-2(a)(8) and (d)]. In June of this year, these public disclosures will have to include ratings action histories for *all* credit ratings initially determined on or after June 26, 2007. *See* Amendments to Rules for Nationally Recognized Statistical Ratings Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009) [74 Fed. Reg. 63832 (Dec. 4, 2009)] at text following n.19 and compliance date.

the personnel conducting the rating. Even with the recommendations of the fund adviser, we recognize that ultimately, a board's determination whether an NRSRO's ratings are "sufficiently reliable" for use in determining whether a security is an eligible security will be a matter of judgment.

Many commenters expressed concern that a money market fund's board of directors does not have the necessary expertise to designate NRSROs, and urged that we delegate the authority to fund advisers to make the designation.[112] A number of these commenters seem to assume that we would require fund boards to engage in the type of analysis that we expect the adviser will provide the board for its consideration. We believe that it will be useful for boards to consider the designation of NRSROs, a role not unlike the role that many boards play in approving other matters of substantial significance to the operation of the fund.[113] Board designation and determination (at least once a calendar year) will serve as a check on fund managers that may have conflicts of interest in selecting an NRSRO from which the manager seeks a rating for the fund (in order to facilitate marketing the fund),[114] or an NRSRO that may accommodate the fund's investment in higher yielding, riskier securities.[115]

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112 *See, e.g.*, ABA Comment Letter; MFDF Comment Letter; Northern Funds Comment Letter. These commenters responded to our discussion of this approach in the Proposing Release. *See* Proposing Release, *supra* note 2, at text following n.118.

113 *See, e.g.*, amended rule 2a-7(c)(8) (requiring the fund's board of directors to establish procedures to stabilize the fund's NAV, including procedures providing for, among other things, the board's periodic review of the fund's shadow price, the methods used for calculating shadow price, and what action, if any, the board should initiate if the fund's shadow price exceeds amortized cost by more than ½ of 1%).

114 *See* Wells Fargo Comment Letter.

115 *See* Moody's Comment Letter (noting that the more narrowly defined the categories of ratings for which a designation can be obtained, the "easier it could be for mutual funds to game the system, *e.g.*, by dropping an NRSRO from its list of designated NRSROs for a particular class of ratings because the NRSRO has introduced a more conservative ratings methodology.").

c. *Operation of the Rule*

Once a board has designated the NRSROs, the fund could look to the designated NRSROs whenever it has to consider credit ratings under rule 2a-7 unless and until the board changes the designation.[116] A fund must look to only the designated NRSROs to determine whether the security is an eligible security, a rated security,[117] and whether it is a first tier or a second tier security.[118] Under the amendments, a security is an unrated security if neither the security nor its issuer has received a short-term rating from any of the designated NRSROs.[119]

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[116] We have changed the term from "NRSRO" to "designated NRSRO" throughout the rule each time it is used. As a consequence, changes in the fund's designated NRSROs may affect the ability of the fund to purchase a new security or rollover a current holding, and may require the fund to reassess promptly whether the security continues to present minimal creditworthiness and dispose of a current holding. This is because a new designation of an NRSRO (or a removal of a designated NRSRO) is now treated under the rule as the equivalent of a credit event requiring the fund board or adviser to consider the rating of the newly designated NRSRO (or preclude the consideration of a formerly designated NRSRO). For example, if a fund acquires an unrated security (*i.e.,* a security (or its issuer) that does not have a short-term rating from a designated NRSRO) that the fund considered to be equivalent to a first tier security and the fund thereafter designates a new NRSRO that has rated the security as a second tier security, the fund must then treat the security as a second tier security. The fund would not be required to dispose of the security (although it would be required to perform a credit assessment, which might prompt it to dispose of the security) even if the position in the security exceeds the fund's limits on second tier securities, because compliance with the limits on second tier securities is determined immediately after the fund acquires the security. *See* amended rule 2a-7(c)(3)(ii); 2a-7(c)(4)(i)(C). The fund could only roll over the position to the extent that immediately after the rollover the fund would meet the rule's limits on second tier securities. *See* amended rule 2a-7(a)(1) (defining "acquisition" to include a rollover of a position in security).

[117] Amended rule 2a-7(a)(23) (defining the term "requisite NRSROs"). For purposes of determining whether a rated security is an eligible security and a first tier security, rule 2a-7 requires the fund to determine whether the security (or its issuer) has received a short-term rating from the requisite NRSROs. Amended rule 2a-7(a)(12)(i). Under the amended rule, the requisite NRSROs must be drawn from the designated NRSROs. Amended rule 2a-7(a)(23). Thus, for example, a security that is rated as a first tier security by two NRSROs, only one of which is a designated NRSRO, and as a second tier security by another designated NRSRO, is a split-rated security and thus a second tier security. *Id.*

[118] Amended rule 2a-7(a)(12) (defining "eligible security"); amended rule 2a-7(a)(14) (defining "first tier security"); and amended rule 2a-7(a)(24) (defining "second tier security").

[119] Amended rule 2a-7(a)(30) (defining "unrated security" by reference to amended rule 2a-7(a)(21), which defines a "rated security" as, among other things, a security that has received or been issued by an issuer that has received a short-term rating by a designated NRSRO).

Accordingly, before investing in the security, the fund adviser must make a determination that the security is of comparable quality to a rated security.[120] After a money market fund acquires a security, the fund manager must monitor only the ratings of designated NRSROs to determine whether a change in those ratings requires the board to reassess promptly whether the security continues to present minimal credit risks or to dispose of a portfolio security that is no longer an eligible security.[121]

3. Asset Backed Securities

We are amending rule 2a-7 to eliminate a requirement that an asset backed security ("ABS") be rated by at least one NRSRO in order to be an eligible security that a money market fund may acquire.[122] As a consequence, funds may acquire an unrated asset backed security that otherwise meets the requirements of rule 2a-7, including those requirements that apply to unrated securities.[123]

In 1996, we limited funds to investing in rated ABSs because we thought that NRSROs played a beneficial role in assuring that assets underlying an ABS were properly valued and

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[120] Amended rule 2a-7(a)(12) (defining "eligible security").

[121] Amended rule 2a-7(c)(7)(i)(A) (requiring a fund's board of directors to reassess promptly whether the security continues to present minimal credit risks and cause the fund to take action if: (i) the security ceases to be a first tier security because it no longer has the highest rating from the requisite NRSROs or, in the case of an unrated security, the board determines it is no longer of comparable quality to a first tier security, or (ii) the security is an unrated security or second tier security and the fund's investment adviser (or portfolio manager) becomes aware since acquisition of the security that any designated NRSRO has given it a rating below the designated NRSRO's second highest short-term rating); amended rule 2a-7(c)(7)(ii)(B) (requiring a fund to dispose of a security that ceases to be an eligible security as soon as practicable consistent with achieving an orderly disposition of the security, absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund).

[122] We are thus amending current rule 2a-7(a)(10)(ii) to eliminate paragraph (B) and renumber paragraph 2a-7(a)(10)(ii)(A) as 2a-7(a)(12)(ii).

[123] *See, e.g.*, amended rule 2a-7(a)(12)(ii); (c)(3)(iv)(C); (c)(7)(i)(A)(*1*). As under the current rule, if an asset backed security is a rated security, it will be required to satisfy the rule's ratings criteria. Amended rule 2a-7(a)(12)(i).

would support the cash flows required to fund the ABS, and we were concerned that fund advisers may not be in as good a position to perform the legal, structural, and credit analysis that the rating agencies performed.[124] As discussed in the Proposing Release, NRSROs rapidly downgraded ABSs from their status as first tier securities over a short time period during 2007-2008.[125] The NRSROs thus did not seem to play a role in buttressing the minimal credit risk analysis of fund management sufficient to warrant a requirement that *all* ABSs be rated to be eligible for money market fund investment. We would otherwise have expected a slower, more orderly downgrading process for these ABSs, which would have permitted money market funds to gradually roll off the paper.

We received only a few comments on this approach.[126] One NRSRO commenter supported removing this requirement.[127] Two urged us to keep the ratings requirement for ABSs,[128] and one of those asserted that ratings "under appropriate criteria" enhance the liquidity of ABSs and provide credit and structural expertise and research that benefit investors.[129] As

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124 Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (Mar. 21, 1996) [61 FR 13956 (Mar. 28, 1996)] at Section II.E.4; Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 19959 (Dec. 17, 1993) [58 FR 68585 (Dec. 28, 1993)] ("1993 Proposing Release") at nn.110-112 and accompanying text.

125 *See* Proposing Release, *supra* note 2, at Section II.A.4. *See also* Standard & Poor's, *Global Structured Finance Default and Transition Study—1978-2008: Credit Quality of Global Structured Securities Fell Sharply in 2008 Amid Capital Market Turmoil* (Feb. 25, 2009), *available at* http://www2.standardandpoors.com/portal/site/sp/en/ca/page.article/3,3,3,0,1204847668460.html (showing greater default rate and significantly greater downgrades in structured finance securities).

126 We also solicited comment generally on whether, and if so how, we should amend rule 2a-7 to generally address the risks presented by ABSs. We received a number of comments in response to this request, and will consider them in developing further amendments to rule 2a-7.

127 *See* Moody's Comment Letter.

128 *See* Am. Securit. Forum Comment Letter; Shriver Poverty Law Ctr. Comment Letter.

129 *See* Am. Securit. Forum Comment Letter.

noted above, we do not believe that NRSRO ratings of ABSs served this function during the 2007-2008 turmoil in the ABS marketplace, and we no longer believe that the provision of rule 2a-7 that has required such ratings for *all* ABSs is warranted as serving its intended purpose, and thus we are eliminating this requirement.[130]

We do note, however, that as part of the minimal credit risk analysis that any money market fund must conduct before investing in an ABS, the board of directors (or its delegate) should: (i) analyze the underlying ABS assets to ensure that they are properly valued and provide adequate asset coverage for the cash flows required to fund the ABS under various market conditions; (ii) analyze the terms of any liquidity or other support provided by the sponsor of the ABS; and (iii) otherwise perform the legal, structural, and credit analyses required to determine that the particular ABS involves appropriate risks for the money market fund.[131]

B. Portfolio Maturity

We are adopting amendments to rule 2a-7 to further restrict the maturity limitations on a money market fund's portfolio in order to reduce the exposure of money market fund investors to certain risks, including interest rate risk, spread risk, and liquidity risk. First, we are reducing the maximum weighted average portfolio maturity permitted by the rule from 90 days to 60 days. Second, we are adopting a 120-day limit on the weighted average life of a money market fund's portfolio, which will limit the portion of a fund's portfolio that could be held in longer term adjustable-rate securities. Finally, we are deleting a provision in the rule that permitted certain money market funds to acquire Government securities with extended maturities of up to 762

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130 *See* Statement of Lawrence J. White, SEC Roundtable to Examine Oversight of Credit Rating Agencies at 2 (Apr. 15, 2009) (initial ratings on bonds securitized from subprime residential mortgages "proved to be excessively optimistic" – especially for the bonds based on mortgages originated in 2005 and 2006).

131 *See* 1993 Proposing Release, *supra* note 124, at nn.108-111 and preceding and accompanying text.

calendar days.

1. Weighted Average Maturity

We are amending rule 2a-7 to require that each money market fund maintain a dollar-weighted average portfolio maturity (WAM) appropriate to its objective of maintaining a stable net asset value or price per share, but in no case greater than 60 days.[132] We believe that such a limit on the maximum WAM will result in money market funds that are more resilient to changes in interest rates that may be accompanied by other market shocks, and thus reduce the likelihood of a run and better protect money market fund investors. As we explained in the Proposing Release, a portfolio weighted towards securities with longer maturities increases the fund's exposure to interest rate risk, amplifies spread risk, and decreases the ability of a fund to pay redeeming shareholders.[133]

Most commenters that addressed this proposal supported further reducing the maximum WAM of fund portfolios in order to reduce the funds' exposure to related risk. Those commenters were divided between those supporting the 60-day maximum WAM that we proposed[134] and those supporting a reduction to 75 days.[135] Other commenters argued for no reduction at all (*i.e.*, leaving the limit at 90 days).[136] Commenters supporting a maximum WAM limitation of 60 days believed that such a reduction would be appropriate to increase the stability

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132 *See* amended rule 2a-7(c)(2).

133 *See* Proposing Release, *supra* note 2, at Section II.B.1.

134 *See, e.g.*, Goldman Sachs Comment Letter; Comment Letter of the Institutional Money Market Funds Association (Sept.8, 2009) ("IMMFA Comment Letter"); Northern Funds Indep. Trustees Comment Letter.

135 *See, e.g.*, Charles Schwab Comment Letter; Comment Letter of GE Asset Management Incorporated (Sept. 8, 2009) ("GE Asset Mgt. Comment Letter"); T. Rowe Price Comment Letter.

136 *See, e.g.*, State Street Comment Letter; Comment Letter of Victory Capital Management (Sept. 8, 2009) ("Victory Cap. Mgt. Comment Letter"); Wells Fargo Comment Letter.

and liquidity of money market funds[137] and would reduce funds' exposure to interest rate risk.[138] One asserted that a 60-day limitation is appropriate as it prioritizes a money market fund's safety and liquidity over yield.[139]

Commenters supporting a maximum WAM of 75 days argued that such a limitation would achieve the Commission's goal of reducing funds' exposure to interest rate risk while providing funds with sufficient flexibility to invest in high quality securities when shorter term investments are scarce.[140] Some expressed concern about whether a 60-day WAM would reduce a money market fund's ability to generate sufficient yield.[141] Still others argued that a shorter WAM could make some money market funds more risky because of the alternative investment strategies they might employ as a result.[142] Finally, two commenters opposing any change in the maximum WAM permitted by rule 2a-7 argued that liquidity risk to funds is more appropriately limited by other aspects of our amendments to rule 2a-7, and that the resulting reduction in yield would "homogenize" money market funds to such an extent that investors may be driven to

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137 *See* Tamarack Funds Comment Letter.

138 *See* TDAM Comment Letter.

139 *See* Invesco Aim Comment Letter.

140 *See, e.g.*, Charles Schwab Comment Letter; GE Asset Mgt. Comment Letter; ICI Comment Letter.

141 *See, e.g.*, Charles Schwab Comment Letter; Comment Letter of Crane Data LLC and Money Fund Intelligence (Aug. 31, 2009) ("Crane Data Comment Letter"); T. Rowe Price Comment Letter.

142 One commenter noted that a WAM limitation longer than 60 days would allow a fund to improve the credit profile of its portfolio by substituting longer term Government securities for shorter term corporate securities. *See* BlackRock Comment Letter. Another commenter argued that a reduction would lead to fund portfolios with a "barbelled" maturity structure in which the fund balanced the low yield offered by the large amount of very short-term securities it would be required to hold with an offsetting amount of riskier longer term securities, which could increase the riskiness of fund portfolios. *See* Comment Letter of Waddell & Reed/Ivy Fund Portfolio Managers (Sept. 8, 2009) ("Waddell & Reed Comment Letter"). Another stated that higher risk issuers tend to be limited to issuing shorter maturity securities, so a shorter WAM limitation could increase a fund's credit risk profile. *See* Wells Fargo Comment Letter.

invest in unregulated funds, thus increasing systemic risk.[143]

We believe that the maximum WAM permissible for money market funds should be reduced to 60 days in order to reduce the likelihood of funds breaking the buck. The increased resilience to simultaneous stresses from interest rate and other risks that a money market fund would achieve through a maximum WAM of 60 days is significant. A fund with a 90-day WAM could withstand an instantaneous change in interest rates of 200 basis points before breaking the buck.[144] In contrast, a fund with a WAM of 60 days could withstand an interest rate change of 300 basis points without breaking the buck.[145] Although an interest rate change of such a magnitude may be unlikely to occur,[146] funds must also be able to withstand multiple shocks occurring simultaneously, such as those that occurred in September 2008 when there was a simultaneous increase in LIBOR rates and widening spreads due to credit deterioration and liquidity pressures, together with extraordinary redemptions.[147]

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143 *See* Fidelity Comment Letter; State Street Comment Letter. Several commenters also asserted that any reduction in WAM would increase issuers' reliance on short-term funding, also increasing systemic risk. *See, e.g.*, Am. Securit. Forum Comment Letter; State Street Comment Letter; Wells Fargo Comment Letter.

144 *See* Fidelity Comment Letter.

145 Our staff supplemented stress test analysis conducted by commenters with more data points and stress scenarios to illustrate the impact on a money market fund's net asset value per share from multiple stresses on that fund's portfolio. A fund with a 75-day WAM could withstand an interest rate change of less than 250 basis points without breaking the buck. We note that these scenarios also represent the most conservative scenarios because they assume that the money market fund started with a market-based net asset value of $1.00. It is our understanding that at any point in time, a large number of money market funds will not start from a market-based net asset value of $1.00—many will start with a market-based net asset value of less than a dollar and thus a smaller interest rate change will cause the funds to break the buck.

146 Interest rate shocks of a 300 basis point magnitude over a relatively short period of time have occurred, although not since the late 1970s. *See* Federal Reserve Bank of New York, Historical Changes of the Target Federal Funds and Discount Rates, 1971 to present, *available at* http://www.newyorkfed.org/markets/statistics/dlyrates/fedrate.html. In low interest rate environments (such as today), a shock in interest rates could occur if the Federal Reserve determines to raise interest rates quickly, for example, to stave off inflation as the economy recovers or to strengthen the U.S. dollar.

147 *See* Proposing Release, *supra* note 2, at nn.47-48, 53, 63, 66-67 and accompanying text. *See also*

A fund with a lower WAM has significantly greater protection in the circumstances described above. For example, a fund with a 90-day WAM facing a change in credit spreads of 50 basis points and redemptions of 10 percent would break the buck with an interest rate change of a little more than 100 basis points.[148] Greater shocks from an even larger increase in spreads or redemptions would only lessen that interest rate cushion – last fall increases in spreads and redemptions were considerably above this level.[149] A fund with a 60-day WAM would be in a better position to withstand multiple shocks without breaking the buck than if it maintained a 90-day or 75-day WAM.[150]

We disagree with those commenters that asserted that a reduction of maximum permissible WAM would have a significant adverse effect on money market funds' investment strategies or yield. We have not observed such adverse effect in funds with WAMs below 60 days or a greater tendency to invest in riskier short-term securities or to follow riskier portfolio strategies to increase yield. These funds do not appear to have had great difficulties in creating

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infra note 178 (discussing the increase in LIBOR during the financial crisis). Many money market fund portfolio holdings at the time were tied to LIBOR.

148 This assumes a weighted average life limitation of 120 days. A fund with a 75-day WAM could withstand a 50 basis point increase in credit spreads across its portfolio, 10% redemptions, and an increase in interest rates of 125 basis points before breaking the buck, assuming a 120-day weighted average life.

149 In addition, we note that spreads have widened to significant degrees in the past. *See, e.g.*, Benjamin N. Friedman & Kenneth N. Kuttner, *Why Does the Paper-Bill Spread Predict Real Economic Activity?*, NBER Working Paper No. 3879, at Fig.1 (Oct. 1991) (showing historical spreads for 6-month commercial paper over 6-month Treasury bill rates from 1959 to 1990).

150 Based on staff review of various stress test scenarios, a fund with a 60-day WAM could withstand a 50 basis point increase in credit spreads across its portfolio, 10% redemptions, and an increase in interest rates of over 150 basis points before breaking the buck, again assuming a weighted average life limitation of 120 days. Others have recognized that exposure to multiple stresses may call for a lower WAM. *See, e.g.*, Standard & Poor's, *Fund Ratings Criteria: Market Price Exposure*, at 3 (2007), *available at* http://www2.standardandpoors.com/spf/pdf/events/MMX709.pdf (stating that money market funds with a greater liquidity risk due to a smaller asset size or shareholder composition may need to maintain a lower WAM than 60 days).

portfolios that generated competitive yields and attracted investors.[151] Indeed, many domestic money market funds currently limit their WAM to a maximum of 60 days voluntarily, a limit they likely would have discontinued if they had experienced the management or competitive difficulties suggested by commenters.[152] No commenter reported to us that any of these funds were doing so. We acknowledge that one consequence of our amendments may be to further "homogenize" fund portfolios as managers have fewer avenues to acquire yield by exposing the funds to risk, but we believe that the level of potential homogenization is justified to reduce the risk to investors that a money market fund will break the buck. In addition, we are not persuaded by comments that a likely consequence of a shortened maximum WAM will be riskier portfolios. Accordingly, we are adopting the 60-day WAM limitation as proposed.

2. *Weighted Average Life*

We are adopting, as proposed, a requirement that limits the dollar-weighted average life

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151 Similarly, European stable value money market funds do not appear to have had these difficulties. As the Institutional Money Market Fund Association (IMMFA) notes in its comment letter, IMMFA funds (which manage a significant amount of stable value money market fund assets in Europe) have been required to maintain a maximum WAM of 60 days since 2002. The recent proposals by the European Union's Committee of European Securities Regulators to create common requirements for European money market funds would impose a maximum 60-day WAM for short-term money market funds. *See* Committee of European Securities Regulators Consultation Paper, *A Common Definition of European Money Market Funds*, CESR/09-850 (Oct. 20, 2009), *available at* http://www.cesr.eu/index.php?page=consultation_details&id=151.

152 For some time and through various interest rate and market environments a large portion of domestic money market funds have maintained a maximum WAM of less than 60 days. According to data provided by the ICI, from January 1998 through April 2009, even the 75th percentile of prime money market funds has maintained an average WAM of 53 days and the 90th percentile of prime money market funds has maintained an average WAM of 65 days. Investment Company Institute, Average Maturity of Taxable Prime Money Market Funds, 1998-2009, *available at* http://www.sec.gov/comments/s7-11-09/s71109-14.htm. The 75th percentile of these funds only reported a WAM in excess of 60 days on 8 monthly occasions out of the 136 monthly time periods reported. We also note that to obtain a top rating from an NRSRO, money market funds must maintain a WAM of no greater than 60 days. According to the iMoneyNet Money Market Fund Analyzer Database, as of November17, 2009, 61% of money market fund assets were held in funds that were top rated by at least one NRSRO and 34% of money market funds had a top rating from at least one NRSRO.

to maturity of a money market fund's portfolio to 120 calendar days.[153] Unlike weighted average maturity, the weighted average life (or "WAL") of a portfolio is measured without reference to any rule 2a-7 provision that otherwise permits a fund to shorten the maturity of an adjustable-rate security by reference to its interest rate reset dates.[154] The WAL limitation thus restricts the extent to which a fund can invest in longer term securities that may expose a fund to spread risk.[155]

We proposed the WAL limitation because we were concerned that the traditional WAM limitation of rule 2a-7 does not require that a manager of a money market fund limit the spread risk associated with longer term adjustable-rate securities.[156] These securities are more sensitive

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153 *See* amended rule 2a-7(c)(2)(iii). This limitation will apply to all money market funds (including taxable and tax-exempt funds).

154 The Fidelity Comment Letter, the Comment Letter of HighMark Capital Management, Inc. (Sept. 8, 2009) ("HighMark Capital Comment Letter"), and the ICI Comment Letter requested that the Commission amend rule 2a-7 to specify how cash balances held by money market funds would be treated under the WAM and WAL limitations. For purposes of the WAM and WAL limitations, cash balances have a maturity of one day. The Tamarack Funds Comment Letter also suggested that the Commission address extendible notes. For purposes of the WAM and WAL limitations, in calculating the final legal maturity of a security extendible at the option of the issuer the security should be deemed fully extended. *See* amended rule 2a-7(d) (final maturity is determined with reference to the time at which a fund will unconditionally receive payment); *see also* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (Mar. 21, 1996) [61 FR 13956 (Mar. 28, 1996)] at n.151 and accompanying text (discussing the unconditional right to receive payment with respect to demand features).

155 *See* Morgan Stanley, Weighted Average Life: Enhancing Money Market Fund Transparency (2009), *available at* http://www.morganstanley.com/msamg/msimintl/docs/en_US/common/comm/200907_mm_update.pdf ("[Morgan Stanley Investment Management is] introducing WAL to supplement our WAM reporting. The WAL calculation is based on a security's stated final maturity date or, when relevant, the date of the next demand feature when the fund may receive payment of principal and interest (such as a put feature). Accordingly, WAL reflects how a portfolio would react to deteriorating credit (widening spreads) or tightening liquidity conditions. We believe that when viewed alongside WAM, the supplemental WAL disclosure will provide investors with a further degree of insight into our portfolios' structure.").

156 For example, if the market perceived an issuer's credit risk as deteriorating, the spreads on that issuer's 30-day floating-rate securities would likely widen to a lesser extent than the spreads on that issuer's 397-day floating-rate securities because the longer term securities have a much longer exposure to the issuer's credit risk (assuming neither security had a Demand Feature). Because the WAM limitation allows the use of interest rate reset dates to shorten the maturity of a

to credit spreads than short-term securities with final maturities equal to the reset date of the longer term security.[157] The WAL limitation will provide an extra layer of protection for funds and their shareholders against spread risk, particularly in volatile markets. We proposed a 120-day limit as a prudent limit recommended to us in the ICI Report and one that we understand is currently used by some money market fund managers.[158] We requested comment on whether a higher or lower WAL limitation would be more appropriate.

Twenty-one commenters supported adding a WAL limit to the rule.[159] One large money market fund manager, for example, described the WAL as "a very prudent addition to the rule that, combined with the minimum liquidity requirements . . . represents an important and substantive risk reduction in the permissible construction of a money fund portfolio."[160] Another acknowledged that "the risk that such a security will begin to deviate significantly from its Amortized Cost increases with its maturity," and agreed that "the new 120-day WAL limit should control this risk."[161]

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security, each of the 397-day floating-rate securities and the 30-day floating-rate securities would be considered to have a maturity of one day. In contrast, under the WAL limitation we are today adopting each adjustable-rate security without a Demand Feature would have a maturity equal to its final legal maturity. As a result, if spreads on these securities widen to different degrees due to changing market perceptions of credit risk or liquidity, the WAL limitation will capture these different risk exposures.

157 *See* Proposing Release, *supra* note 2, at Section II.B.2.

158 *See, e.g.*, HighMark Capital Comment Letter ("We have been calculating a WAL for years and believe it will more appropriately reflect the total interest rate and spread risk of a portfolio."). *See also* JPMorgan Prime Money Market Fund Quarterly Fact Sheet (Dec. 31, 2009), *available at* https://www.jpmorganfunds.com/cm/BlobServer/FS-PMM-P.PDF?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1158572105887&blobheader=application%2FPDF&blobheadername1=Content-Disposition&ssbinary=true&blobheadervalue1=inline;filename=FS-PMM-P.PDF (showing the fund's WAL over the previous year).

159 *See, e.g.*, Bankers Trust Comment Letter; Goldman Sachs Comment Letter; Northern Funds Trustees Comment Letter.

160 *See* BlackRock Comment Letter.

161 *See* Federated Comment Letter.

Two commenters generally opposed a WAL limitation.[162] One urged us to consider, instead, revising the maturity-shortening provisions of rule 2a-7 to require money market funds to measure the maturity of adjustable-rate securities by reference to their final legal maturity date rather than the date at which the interest rate resets.[163] Such a change would dramatically reduce the ability of money market funds to invest in floating rate securities, and as we discuss below, such a reduction may be unnecessary.[164] Another commenter asserted that the WAL limitation was unnecessarily restrictive of prime retail funds and disagreed with our assessment of the spread risk posed by floating-rate Government securities.[165] The commenter, however, offered no explanation of why the exposure to spread risk would have less harmful consequences for a prime retail fund than for other types of funds and thus be of less concern.

Most commenters supported the proposed WAL limit of 120 days,[166] which the ICI comment letter described as "flexible enough even during 'normal' market conditions to not unduly restrict a fund's ability to offer a diversified portfolio of short-term, high quality debt securities."[167] Four commenters supported a WAL with a longer term, with two of these commenters suggesting a longer WAL for government money market funds than for other

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162 *See* Thrivent Comment Letter; USAA Comment Letter.

163 *See* USAA Comment Letter. Amended rule 2a-7(d) allows money market funds to shorten the maturity of an adjustable-rate portfolio security for purposes of the WAM limitation by referring to the security's interest rate reset date, rather than the final legal maturity of the security, if the security has a final maturity of 397 days or less (for corporate securities) or an interest rate that adjusts no less frequently than every 397 days for Government securities.

164 This comment also implies that rule 2a-7 should only have a WAL limitation (and not a separate WAM limitation). We believe that the WAM and WAL limitations address different risks (with the WAM primarily aimed at limiting interest rate risk and the WAL primarily aimed at limiting spread risk) and thus believe having both limitations in rule 2a-7 protects money market funds and their investors.

165 *See* Thrivent Comment Letter.

166 *See*, *e.g.*, BlackRock Comment Letter; Invesco Aim Comment Letter; Comment Letter of Ridge Worth Capital Management, Inc. ("RidgeWorth Comment Letter").

167 ICI Comment Letter.

money market funds.[168] One of these commenters argued that the spread risk associated with Government floating-rate securities is different from the spread risk associated with non-Government securities.[169] Another commenter only supported a WAL limitation applicable to Government securities with maturities of more than two years, arguing that applying a 120-day WAL to all adjustable-rate Government securities would disrupt the short-term debt markets and hinder the ability of Government security issuers to meet internal funding needs.[170]

On balance, we conclude that 120 days is an appropriate length of time for the WAL limitation. A WAL limitation of, for example, 90 days appears to be unnecessarily restrictive to money market funds because it could significantly constrain the range of high-quality, short-term debt securities in which money market funds may invest, particularly when combined with our new minimum liquidity requirements.[171] Such a short WAL limitation also may provide spread risk protection beyond what is reasonably necessary to enhance the stability of money market funds. For a money market fund to break the buck while maintaining a WAL of 90 days, average spreads on *all* securities in the fund's portfolio would have to widen beyond 200 basis points.[172] Other securities held by money market funds may not simultaneously face such spread

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168 *See* Fidelity Comment Letter (supporting a 150-day WAL for government money market funds and a 120-day WAL for all other money market funds); Victory Cap. Mgt. Comment Letter (supporting a 150-day WAL); C. Wesselkamper Comment Letter (supporting a 180-day WAL for government money market funds and a 150-day WAL for all other money market funds); Wells Fargo Comment Letter (supporting a 180-day WAL).

169 *See* Fidelity Comment Letter.

170 *See* Comment Letter of Fannie Mae (Sept. 3, 2009) ("Fannie Mae Comment Letter"). One commenter also argued that a 120-day WAL would limit Government security issuers' ability to meet their funding needs. *See* Fidelity Comment Letter.

171 One commenter stated that the Commission should not impose a WAL shorter than 120 days, asserting that a shorter limitation would be unnecessarily restrictive and limit a fund's ability to maintain a diversified portfolio of high quality short-term debt securities. *See* Charles Schwab Comment Letter. No commenters supported a shorter WAL than 120 days.

172 This assumes that there are no other simultaneous shocks to the fund's portfolio from redemption pressures or otherwise. In order to evaluate commenters' discussion about the appropriate length

widening even if the commercial paper market is under stress.[173] Accordingly, protection across an *entire* money market fund portfolio against spread widening of the magnitude experienced in the commercial paper market during the fall of 2008 may be unnecessary.

On the other hand, we are not convinced that a WAL significantly longer than 120 days would be appropriate for a money market fund that is seeking to maintain a stable net asset value. For example, with a 150-day WAL, a money market fund would break the buck with a spread widening of just over 120 basis points (assuming no other simultaneous stresses on the fund's portfolio).[174] Historically, commercial paper spreads, for example, have widened to that extent fairly frequently.[175] Given this limited resilience to spread widening, and given that a money market fund would break the buck even earlier if any other shocks to the fund's portfolio occurred simultaneously, we have determined not to adopt a longer WAL, such as a 150- or 180-day WAL. We note that the European Union's Committee of European Securities Regulators has also recently proposed requiring that short-term money market funds adhere to a maximum 120-day WAL.[176]

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of time for a WAL limitation in the context of the shocks a money market fund might face, we again referred to stress test scenarios.

173 Such spread widening even in commercial paper has been rare and commercial paper typically only comprises a portion of money market funds' portfolios. Spreads between 3-month commercial paper and the 3-month Treasury bill widened to approximately 300 basis points at the height of the financial crisis in the fall of 2008 and widened similarly in the mid-1970s, but otherwise have rarely widened by 200 basis points in the last 50 years. This analysis is based on commercial paper spread data contained in Bradley T. Ewing, Gerald J. Lynch & James E. Payne, *Monetary Volatility and the Paper-Bill Spread*, in PROGRESS IN ECONOMICS RESEARCH (2006), at p. 58, supplemented with data from Bloomberg on spreads between yields of 3-month commercial paper and the 3-month Treasury bill.

174 This is based on our staff's analysis of stress test scenarios.

175 *See* Ewing *et al.*, *supra* note 173, at 58.

176 *See* Committee of European Securities Regulators Consultation Paper, *A Common Definition of European Money Market Funds*, CESR/09-850 (Oct. 20, 2009), *available at* http://www.cesr.eu/index.php?page=consultation_details&id=151. In addition, Europe's Institutional Money Market Fund Association (IMMFA) recently has adopted changes to its code

Finally, we are not providing for a longer WAL for money market funds that primarily invest in Government securities. While some commenters asserted that adjustable-rate Government securities have a more benign credit risk profile,[177] they are still exposed to widening interest rate spreads to the same extent as non-Government securities and, as we noted in the Proposing Release, spreads on certain adjustable-rate Government securities did widen during the fall of 2008.[178] In addition, many prime money market funds also hold a sizeable portion of Government securities (and may hold even more Government securities after the adoption of rule 2a-7's new liquidity requirements). Given this fact, allowing government money market funds to have a longer WAL solely because they hold more Government securities than prime funds do, does not appear to us to be an approach that treats the risks attendant to longer term, adjustable-rate Government securities equally, and thus appears

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of conduct that will require IMMFA money market funds to adhere to a maximum 120-day WAL. *See* IMMFA Code of Practice, at Section 40, *available at* http://www.immfa.org/About/Codefinal.pdf.

We also note that the rating agencies have taken varied approaches to limiting the WAL of rated money market funds. Fitch has adopted revised ratings requirements limiting top-rated money market funds to a WAL of 120 days, but allowing longer WALs for lesser rated money market funds. *See* Fitch Ratings, *Global Money Market Fund Rating Criteria* (Oct. 5, 2009), *available at* http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=470368. Standard & Poor's has proposed more restrictive requirements that would limit top-rated money market funds to a WAL of 90 days, subject to upward adjustment to no more than 120 days depending on the extent of Government securities in the money market fund's portfolio. *See* Standard & Poor's, *Principal Stability Fund Rating Criteria* (Jan. 5, 2010), *available at* http://www2.standardandpoors.com/spf/pdf/events/FITcon11410RFC.pdf.

177 *See, e.g.*, Fidelity Comment Letter. *But see* BlackRock Comment Letter (recent events have shown that spread relationships can be variable for agency securities); Wells Fargo Comment Letter (credit spreads on Government securities widened to a significant degree in 2008).

178 *See* Proposing Release, *supra* note 2, at Section II.B.2. We understand that many floating-rate securities issued by federal agencies and outstanding during the financial crisis had rates tied to LIBOR. As noted in the Proposing Release, the "TED" spread (the difference between the U.S. Treasury Bill rate and LIBOR) reached a high of 463 basis points on October 10, 2008. *See id.*, at n.67. We understand that most adjustable-rate Government securities held by money market funds had a final maturity of two years or less and thus limiting the WAL limitation to adjustable-rate Government securities with final maturities greater than two years would not address these securities' spread risk.

inappropriate.

3. Maturity Limit for Government Securities

The Commission is deleting a provision of rule 2a-7 that has permitted a fund that relied exclusively on the penny-rounding method of pricing to acquire Government securities with remaining maturities of up to 762 days, rather than the 397-day limit otherwise provided by the rule.[179] As we noted in the Proposing Release,[180] we are unaware of any money market fund that currently relies solely on the penny-rounding method of pricing, and none that holds *fixed-rate* Government securities with remaining maturities of two years, which would involve the assumption of a substantial amount of interest rate risk. We received one comment on this topic, which supported the change.[181] Accordingly, we are adopting this change as proposed.[182]

C. Portfolio Liquidity

We are amending rule 2a-7 to require that money market funds maintain a sufficient degree of liquidity necessary to meet reasonably foreseeable redemption requests and reduce the

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179 *See* current rule 2a-7(c)(2)(ii). In a conforming change, we also are amending as proposed the maturity-shortening provision of the rule for variable-rate Government securities to require that the variable rate of interest is readjusted no less frequently than every 397 days, instead of 762 days as the rule has permitted. *See* amended rule 2a-7(d)(1).

180 *See* Proposing Release, *supra* note 2, at Section II.B.3.

181 *See* BlackRock Comment Letter.

182 We also requested comment in the Proposing Release on whether we should impose a limitation on the maximum final legal maturity of adjustable-rate Government securities that money market funds are permitted to acquire. We received only two comments on this proposal. One commenter encouraged us to constrain any limitation on adjustable-rate Government securities with a final legal maturity in excess of two years. *See* Fannie Mae Comment Letter. Another asserted that the WAL limitation provided a sufficient limitation on the risks posed by long-term adjustable-rate Government securities. *See* Federated Comment Letter. We are aware that WAL creates some limitation of this risk, but that even with a 120-day WAL limitation, a fund would still have some ability to acquire longer term adjustable-rate Government securities. No commenters provided us with any data on the extent of adjustable-rate Government securities outstanding from time to time. Two commenters indicated that these securities experienced variable spreads during the financial crisis. *See* BlackRock Comment Letter; Wells Fargo Comment Letter. In the future, we may reconsider whether to limit the maximum maturity of adjustable-rate Government securities that can be held by money market funds after obtaining additional data.

likelihood that a fund will have to meet redemptions by selling portfolio securities into a declining market. As discussed in the Proposing Release, money market funds generally have a higher and less predictable volume of redemptions than other open-end investment companies.[183] Their ability to maintain a stable net asset value will depend, in part, on their ability to convert portfolio holdings to cash to pay redeeming shareholders without having to sell them at a loss. The liquidity of fund portfolios became a critical factor in permitting them to absorb very heavy redemption demands in the fall of 2008 when the secondary markets for many short-term securities seized up.

Commenters generally agreed with our analysis of the liquidity needs of money market funds. They emphasized the importance of liquidity for money market funds and their ability to meet shareholder redemptions.[184] Several also acknowledged the need to place outside limits on the risks money market funds may take.[185] Most commenters supported amending the rule to impose more robust liquidity requirements, but many disagreed with our specific proposals.[186] Some asserted that the proposed requirements might negatively affect funds' ability to manage their portfolios, place excessive burdens on the board of directors, and affect the markets of some portfolio securities.[187] Others argued that the proposals are not sufficient to meet money market funds' liquidity concerns.[188]

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183 *See* Proposing Release, *supra* note 2, at n.172 and accompanying text.

184 *See, e.g.*, Comment Letter of the Securities Industry and Financial Markets Association (Sept. 8, 2009) ("SIFMA Comment Letter"); State Street Comment Letter.

185 *See, e.g.*, Federated Comment Letter; Comment Letter of the Independent Directors Council (Sept. 8, 2009) ("IDC Comment Letter").

186 *See, e.g.*, State Street Comment Letter (opposing a general liquidity standard and different minimum liquidity thresholds for retail and institutional funds); Invesco Aim Comment Letter (same).

187 *See, e.g.*, Fidelity Comment Letter; ICI Comment Letter; Shadow FRC Comment Letter.

188 *See, e.g.*, Fund Democracy/CFA Comment Letter (requesting that the Commission mandate

After reviewing the comments, and based on our analysis of redemption activity during the 2008 run on money market funds, we are amending rule 2a-7 to add three new provisions, substantially as proposed, which address different aspects of portfolio liquidity.[189] Together, we believe they will result in money market funds that are better able to absorb large amounts of redemptions.

1. General Liquidity Requirement

We are amending rule 2a-7, as proposed, to require that each money market fund hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders (the "general liquidity requirement").[190] Depending upon the volatility of its cash flows (particularly shareholder redemptions), this new provision may require a fund to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements set forth in the rule and discussed below.

Most commenters who addressed this proposal supported the addition of a general liquidity requirement.[191] They agreed that funds should be required to assess appropriate levels of liquidity above the minimums set forth in the rule.[192] Some commenters, however, expressed

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private liquidity insurance for money market funds); HighMark Capital Comment Letter (suggesting a private liquidity bank or that Treasury continue to provide emergency liquidity as possible solutions to address liquidity concerns); Vanguard Comment Letter (asserting that the proposed rule does not address liquidity risk arising from factors other than size of accounts, such as geographical concentration of the shareholders); Waddell & Reed Comment Letter (recommending some type of permanent backstop be available to money market funds); Wells Fargo Comment Letter (suggesting the Federal Reserve set up a secured lending facility to serve as a lender of last resort).

189 *See* Proposing Release, *supra* note 2, at Section II.C.1-2.

190 Amended rule 2a-7(c)(5).

191 *See, e.g.*, ICI Comment Letter; Northern Funds Indep. Trustees Comment Letter; Tamarack Funds Comment Letter.

192 *See, e.g.*, Federated Comment Letter; ICI Comment Letter;.

concerns that the proposed requirement was too vague,[193] or was unnecessary in light of the minimum daily and weekly liquidity requirements.[194] We disagree. Funds will have different liquidity needs that we cannot sufficiently anticipate and codify in a rule beyond the minimums we are adopting today.[195] Therefore, we believe it is incumbent upon the management of each fund and its board of directors to evaluate the fund's liquidity needs and to protect the fund and its shareholders from the harm that can occur from failure to properly anticipate and provide for those needs.

To comply with this general liquidity requirement, we would expect money market fund managers to consider factors that could affect the fund's liquidity needs, including characteristics of a money market fund's investors and their likely redemptions.[196] For example, some shareholders may have regularly recurring liquidity needs, such as to meet monthly or more frequent payroll requirements. Others may have liquidity needs that are associated with particular annual events, such as holidays or tax payment deadlines. A fund also would need to consider the extent to which it may require greater liquidity at certain times when investors' liquidity needs may coincide. In addition, a volatile or more concentrated shareholder base

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193 *See, e.g.*, Charles Schwab Comment Letter; Dreyfus Comment Letter. We note, however, that similar general requirements in rule 2a-7 have not hampered fund managers. *See, e.g.*, current rule 2a-7(c)(2) (requiring a money market fund to maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share). Thus, we do not share commenters' concerns that the general liquidity standard could expose a money market fund to liability based on hindsight review of the fund's subjective determinations and market events.

194 *See, e.g.*, TDAM Comment Letter. Another commenter asserted that money market funds are already subject to this requirement under section 22(e) of the Act. *See* State Street Comment Letter. The general liquidity requirement, together with rule 2a-7's specific obligations related to illiquid securities and daily and weekly liquid assets, identifies the liquidity obligations that are specific to money market funds.

195 For example, suggestions that we require each fund to maintain sufficient liquidity to meet redemptions by the largest shareholders seem inadequate because they assume that only those shareholders will redeem. *See* Stradley Ronon Comment Letter; SIFMA Comment Letter.

196 *See* Proposing Release, *supra* note 2, at text following n.205.

would require a fund to maintain greater liquidity than a stable shareholder base consisting of thousands of retail investors.[197]

Thus, to comply with rule 2a-7, as amended, money market funds should adopt policies and procedures designed to assure that appropriate efforts are undertaken to identify risk characteristics of shareholders.[198] In other words, fund boards should make sure that the adviser is monitoring and planning for "hot money." In their consideration of these procedures and in the oversight of their implementation, fund boards should appreciate that, in some cases, fund managers' interests in attracting additional fund assets may be in conflict with their overall duty to manage the fund in a manner consistent with maintaining a stable net asset value.[199] We urge directors to consider the need for establishing guidelines that address this conflict.

As some commenters noted, identification of these risks may be more challenging when

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197 *See* Thrivent Comment Letter (suggesting that we approach portfolio liquidity on the basis of concentration among a fund's shareholders). In determining the amount of liquidity available to meet the requirements of rule 2a-7, funds should not consider the fund's ability to access overdraft protection, lines of credit, and inter-fund borrowing arrangements. *See* Federated Comment Letter (suggesting that we adopt the opposite approach). A fund that borrowed to satisfy redemptions would leverage its holdings, thus amplifying the risk of shareholder losses if the fund eventually broke the buck.

198 Upon adoption of these amendments, such policies and procedures are, we believe, required under rule 38a-1 under the Investment Company Act (the "compliance rule"). Although two commenters suggested that the requirement to adopt the policies and procedures should be incorporated in rule 2a-7, we do not see a reason to duplicate the requirements for policies and procedures encompassed in the compliance rule. *See* Dreyfus Comment Letter; Comment Letter of Fifth Third Asset Management, Inc. (Sept. 8, 2009) ("Fifth Third Comment Letter"). One commenter recommended that "know your customer" policies apply only to shareholders whose redemptions (in their entirety) would have a material impact on the fund's ability to satisfy redemptions. Stradley Ronon Comment Letter. *See also* SIFMA Comment Letter. Another commenter argued that the relevant shareholder characteristics should be limited to clearly defined parameters such as historical net flows. *See* RidgeWorth Comment Letter. We are not identifying specific characteristics that should be addressed in a fund's policies and procedures because we believe that money market funds are in a better position to do so. For example, concurrent redemptions of several shareholders may have a material effect on a fund's ability to satisfy redemptions even if the shareholders' individual redemptions alone would not have such an effect. Nor are we setting limits as to the scope of the policies and procedures because different money market funds may have different needs in this regard.

199 *See* Proposing Release, *supra* note 2, at n.180 and accompanying text.

share ownership is less transparent because the shares are held in omnibus accounts.[200] Funds may seek access to information about the investors who hold their interests through omnibus accounts in addition to considering information about the omnibus accounts, including their aggregate historical redemption patterns and the account recordholder's ability to redeem the entire account.[201]

2. *Limitation on Acquisition of Illiquid Securities*

We are amending rule 2a-7 to further limit a money market fund's investments in illiquid securities (*i.e.*, securities that cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to them by the money market fund).[202] Under the amended rule, a money market fund cannot acquire illiquid securities if, immediately after the acquisition, the fund would have invested more than five percent of its total assets in illiquid securities.[203]

In light of the risk that liquid assets would become illiquid thereby impairing the ability of a money market fund to meet redemption demands, we proposed to prohibit funds from acquiring securities that were, at the time of their acquisition, already illiquid. Many fund commenters objected, arguing such a limitation could preclude them from investing in certain

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200 *See, e.g.*, Comment Letter of the Coalition of Mutual Fund Investors (Sept. 10, 2009) ("CMFI Comment Letter"); HighMark Capital Comment Letter.

201 Some commenters argued that we should require greater transparency of investments held through financial intermediaries to allow funds to better monitor client profiles. *See, e.g.*, BlackRock Comment Letter; CMFI Comment Letter. Funds may seek to access this information in contractual arrangements with their financial intermediaries.

202 We have construed section 22(e) of the Investment Company Act, which requires registered investment companies to satisfy redemption requests within seven days, to restrict a money market fund from investing more than 10% of its assets in illiquid securities. *See* 1983 Adopting Release, *supra* note 6, at nn.37-38 and accompanying text; Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies (Mar. 12, 1986) [51 FR 9773 (Mar. 21, 1986)], at n.21 and accompanying text; Proposing Release, *supra* note 2, at n.171 and accompanying text.

203 Amended rule 2a-7(c)(5)(i).

high quality illiquid securities in which money market funds have historically invested,[204] make it more difficult for tax-exempt funds to construct a well-diversified, high quality portfolio,[205] and prevent funds from investing in new types of securities that are illiquid until a market for them has been established.[206] Others asserted that a ban may be unnecessary in light of the new daily and weekly liquidity standards.[207]

These comments persuaded us that prohibiting funds from acquiring *any* illiquid securities may have undesirable consequences for money market funds. Instead, we are further limiting the circumstances under which a money market fund may acquire illiquid securities. Under the amended rule, a fund cannot acquire an illiquid security if, after the purchase, more than five percent of the fund's total assets would consist of illiquid securities.[208] Several commenters suggested that we lower the existing 10 percent limit as an alternative to our proposal.[209] We are reducing by half the existing limit in order to strike a balance between our concern regarding liquidity risk, *i.e.*, a fund's ability to satisfy redemption demands if it is holding illiquid securities, and funds' concerns that they retain some ability to make investments in high quality illiquid securities.

We are also amending the rule to define the term "illiquid security" as a security that

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204 These include, among other securities, term repurchase agreements, some time deposits, and insurance company funding agreements. *See, e.g.*, Am. Bankers Assoc. Comment Letter; Comment Letter of New York Life Investments (Sept. 14, 2009); Comment Letter of Promontory Interfinancial Network, LLC (Sept. 8, 2009); Wells Fargo Comment Letter.

205 *See* Stradley Ronon Comment Letter; Wells Fargo Comment Letter.

206 *See, e.g.*, Deutsche Comment Letter; Stradley Ronon Comment Letter; USAA Comment Letter.

207 *See, e.g.*, Charles Schwab Comment Letter; TDAM Comment Letter.

208 Amended rule 2a-7(c)(5)(i).

209 *See* Federated Comment Letter; J.P. Morgan Asset Mgt. Comment Letter; Vanguard Comment Letter; Wells Fargo Comment Letter (all recommending a 5% percent limit). *See also* TDAM Comment Letter (recommending that we reduce the existing limit). Other commenters argued that we should maintain the 10% limit. *See, e.g.*, Charles Schwab Comment Letter; Deutsche Comment Letter.

cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the money market fund. At the suggestion of commenters, we would not treat as illiquid a security that could not be sold at amortized cost.[210]

3. *Minimum Daily and Weekly Liquidity Requirements*

The Commission is adopting new liquidity requirements that mandate each money market fund maintain a portion of its portfolio in cash and securities that can readily be converted into cash. More specifically, we are amending rule 2a-7 to require all *taxable* money market funds to hold at least 10 percent of their total assets in "daily liquid assets" and *all* money market funds to hold at least 30 percent of their total assets in "weekly liquid assets."[211] A money market fund must comply with the daily and weekly liquidity standards at the time each security is acquired.[212]

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210 *See* amended rule 2a-7(a)(19). *See, e.g.*, Charles Schwab Comment Letter; Wells Fargo Comment Letter. The proposed rule defined "liquid security" with reference to the security's "amortized cost value." *See* proposed rule 2a-7(a)(18). Under the amended rule, a money market fund using the amortized cost method will be able to treat as liquid a security that the fund can sell at a price that deviates from the security's amortized cost value, as long as the price approximates the market-based value that the fund has ascribed to the security for purposes of determining its shadow price. Because the market-based value assigned by a money market fund to its securities is the measure that ultimately justifies the fund's use of a stable net asset value, a money market fund should treat as illiquid any security that cannot be sold at a price approximating such market-based value. *See* 1983 Adopting Release, *supra* note 6, at n.37 and paragraphs following n.39.

211 *See* amended rule 2a-7(c)(5)(ii)-(iii). *See also* amended rule 2a-7(a)(8) (defining "daily liquid assets"); 2a-7(a)(32) (defining "weekly liquid assets"); *infra* notes 229-243 and accompanying text. "Total assets" means with respect to a money market fund using the amortized cost method, the total amortized cost of its assets and, with respect to any other money market fund, the total market-based value of its assets. *See* amended rule 2a-7(a)(27).

212 *See* amended rule 2a-7(a)(8); 2a-7(a)(32). One commenter recommended that the minimum liquidity standards apply on an ongoing basis, which could require money market funds with holdings that fall below the requirements to sell securities in order to meet the requisite daily and weekly liquid asset thresholds. *See* Fund Democracy/CFA Comment Letter. We do not agree with such an approach. A money market fund whose portfolio does not meet the minimum daily or weekly liquidity standards is not in violation of the rule, but may not acquire any assets other than daily or weekly liquid assets. *See* Dreyfus Comment Letter (requesting that the standards incorporate some flexibility to allow funds not to comply with them under unforeseeable circumstances).

As we explained in the Proposing Release, current liquidity standards applicable to money market funds presume that a fund is able to find a buyer of its securities.[213] Our new approach would include as a "daily liquid asset" or "weekly liquid asset" only cash or securities that can readily be converted to cash (as discussed below). Thus, a fund should be able to use those assets to pay redeeming shareholders even in market conditions (such as those that occurred in September and October 2008) in which money market funds cannot rely on a secondary or dealer market to provide immediate liquidity.

Commenters who addressed the issue largely supported the introduction of daily and weekly liquidity standards.[214] One large sponsor of money market funds asserted that it "recognize[d] that a meaningful and sustained level of liquidity has the potential to ease concerns of investors and may be useful for unforeseen events."[215] Another agreed that "mandating liquidity requirements will bolster investor confidence in the ability of money market funds to sustain prolonged redemption pressures with increased levels of immediate cash on hand, both on a daily and weekly basis."[216] One commenter, however, urged us to rely solely on the general liquidity requirement, arguing that requiring a minimum requirement would require unnecessary levels of liquidity at times that will not be sufficient during a severe market crisis.[217]

Markets can become illiquid very rapidly in response to events that money market fund managers may not anticipate. The failure of a single fund to anticipate such conditions may lead to a run of the sort we saw in September 2008 affecting all or many funds. We think it would be

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213 *See* Proposing Release, *supra* note 2, at Section II.C.2.

214 *See*, *e.g.*, Calvert Comment Letter; Vanguard Comment Letter.

215 J.P. Morgan Asset Mgmt. Comment Letter.

216 Invesco Aim Comment Letter.

217 *See* Wells Fargo Comment Letter. *See also* T. Rowe Price Comment Letter (the weekly liquidity standard is overly restrictive in light of the daily liquidity standard and other proposed changes to rule 2a-7).

ill-advised to rely solely on the ability of managers to anticipate liquidity needs, which may arise from events the money market fund manager cannot anticipate or control. We acknowledge our minimum standards alone may not establish sufficient liquidity to allow funds to meet every liquidity crisis, which is why we also are adopting a general liquidity requirement (discussed above) to supplement the minimum requirements.

Distinguishing between Retail and Institutional Funds. In the Proposing Release, we observed that institutional money market funds need (and typically maintain) greater portfolio liquidity. These funds had substantially greater redemption pressure on them in the fall of 2008. During the four-week period ending October 8, 2008, prime institutional funds (or share classes) experienced 30 percent net outflows compared to only 4.6 percent outflows of prime retail funds, according to data compiled by the ICI.[218] Consequently, we proposed to impose substantially lower liquidity requirements on retail funds because the higher thresholds appeared unnecessary and would have resulted in higher costs on them in terms of lower yields. For example, instead of 30 percent "weekly liquid assets," we proposed to require that retail prime money market funds maintain 15 percent "weekly liquid assets." We proposed to require that each money market fund's board make an annual determination whether a fund was an institutional fund (and thus subject to the higher liquidity requirements) based on the nature of record owners of shares, minimum initial investment requirements, and cash flows from purchases and redemptions.[219]

[218] *See* ICI, *Money Market Mutual Fund Assets Historical Data, available at* http://www.ici.org/pdf/mm_data_2010.pdf. *See also* Proposing Release, *supra* note 2, at n.63 and accompanying text. The Proposing Release also noted that on September 17, 2008, approximately 4% of prime retail money market funds (or share classes) and 25% of prime institutional money market funds had outflows greater than 5%; on September 18, 2008, approximately 5% of prime retail funds and 30% of prime institutional funds had outflows greater than 5%; and on September 19, 2008, approximately 5% of prime retail funds and 22% of prime institutional funds had outflows greater than 5%. Proposing Release, *supra* note 2, at n.185.

[219] *See* proposed rule 2a-7(a)(17) (defining "institutional fund"); Proposing Release, *supra* note 2, at Section II.C.2.a-b.

Most commenters representing money market funds argued against drawing such a regulatory distinction, asserting that there are inherent difficulties in determining the difference between the two types of funds within a generally applicable definition.[220] Commenters asserted that many money market funds include both types of shareholders, and even if one could distinguish a fund with an institutional rather than a retail shareholder base, not all shareholders behave in the same manner and present the same liquidity challenges as their peers.[221] Others expressed concern that the fund's board is not in the best position to make these determinations.[222] The difficulty in drawing bright lines led some commenters to express concern with the competitive consequences that might result when fund boards of directors come to different conclusions.[223]

We anticipated these concerns and requested comment on alternative approaches. One

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220 *See, e.g.*, BlackRock Comment Letter; Goldman Sachs Comment Letter; ICI Comment Letter; Comment Letter of TCW Investment Management Company (Sept. 4, 2009); Vanguard Comment Letter. A few commenters expressed support for the distinction. *See, e.g.*, Dreyfus Comment Letter; Fidelity Comment Letter; USAA Comment Letter.

221 *See, e.g.*, GE Asset Mgt. Comment Letter; SIFMA Comment Letter; State Street Comment Letter. Many also argued that the nature of the financial intermediary record owner does not always correspond to the behavior of the ultimate investor. *See, e.g.*, T. Rowe Price Comment Letter; Vanguard Comment Letter. A few commenters objected for other reasons. *See* Comment Letter of the Committee of Annuity Insurers (Sept. 8, 2009) ("Committee Ann. Insur. Comment Letter") (the characterization as retail or institutional would be confusing for investors); J.P. Morgan Asset Mgt. Comment Letter (retail investors would suffer if they invested in an institutional fund through an omnibus account or a money market fund lost its retail status because of institutional investments in the fund); Comment Letter of Russell Investment Management Company (Sept. 8, 2009) ("Russell Inv. Comment Letter") (money market funds would incur substantial costs to monitor and enforce the distinction); Waddell & Reed Comment Letter (the distinction is punitive for retail money market funds, which have a less concentrated shareholder base).

222 *See, e.g.*, IDC Comment Letter; Comment Letter of the New York City Bar Association (Sept. 8, 2009) ("NYC Bar Assoc. Comment Letter").

223 *See, e.g.*, Comment Letter of FAF Advisors (Sept. 9, 2009) ("FAF Advisors Comment Letter") (in the absence of clear guidelines, boards would likely characterize funds with largely the same shareholder base differently); Goldman Sachs Comment Letter (the distinction would create an incentive to characterize a fund as retail so that the fund would be subject to the lower standard); IDC Comment Letter (a board might take a conservative approach and identify more funds as institutional at the expense of the funds' shareholders).

commenter suggested that we treat as institutional a fund that has any class which offers same day liquidity to shareholders.[224] We are uncertain, however, whether institutional investors will be willing to migrate to funds that offer next day liquidity in order to obtain additional yield, and if they did our purpose in drawing the distinction would be defeated. We have similar concerns that institutional investors might invest in retail funds that are defined with respect to minimum initial account sizes or maximum expense ratios, as suggested by other commenters.[225] The suggestion that the distinction be based on average account size raises different concerns, including the appropriate size for this measure and whether it should be based on total assets in omnibus accounts or in the accounts of the underlying shareholders.[226]

Taking into account the comments and after further consideration, we have not identified an effective way at this time to distinguish between types of money market funds to achieve our purpose. Therefore, we have determined to apply the same minimum liquidity standards to both institutional and retail money market funds.[227] We believe the compelling need to limit the liquidity risk of money market funds before another run occurs is reason not to further distinguish retail from institutional money market funds. We intend, however, to consider revisiting our determination to apply the same minimum liquidity standards to all money market funds and reevaluate whether there is a workable objective definition that would accurately identify funds with lower liquidity needs and thus justify applying lower minimum standards to

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224 *See* Fidelity Comment Letter. *See also* Charles Schwab Comment Letter; Waddell & Reed Comment Letter.

225 *See* HighMark Capital Comment Letter; T. Rowe Price Comment Letter.

226 *See* Waddell & Reed Comment Letter. Similar concerns would arise if we used the definition the ICI uses for its analysis of retail money market share classes, *i.e.,* those "offered primarily to individuals with moderate-sized accounts." *See* http://www.ici.org/my_ici/mmf_developments/faqs_money_funds.

227 *See* amended rule 2a-7(c)(5)(ii)- (iii).

them.[228]

New Daily and Weekly Minimum Liquidity Requirements. We are adopting the higher minimum liquidity thresholds we proposed for all money market funds. Under the final rule, (i) no *taxable* money market fund can acquire any security other than a daily liquid asset if, immediately after the acquisition, the fund would have invested less than 10 percent of its total assets in daily liquid assets, and (ii) no money market fund can acquire any security other than a weekly liquid asset if, immediately after the acquisition, the fund would have invested less than 30 percent of its total assets in weekly liquid assets.[229] We proposed these liquidity levels based on the levels of cash and overnight repurchase agreements that we believe reflect the liquidity needs of money market funds with institutional investors or other investors with similar liquidity needs.[230]

A few commenters supported our proposed levels for daily and weekly liquid assets, but most supported the lower levels recommended in the ICI Report of five percent of portfolios in daily liquid assets and 20 percent of portfolios in weekly liquid assets.[231] Commenters argued that when combined with our other proposals, these thresholds would provide sufficient

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[228] One commenter suggested that we impose different minimum liquidity standards for government and non-government money market funds. *See* C. Wesselkamper Comment Letter. We believe this is unnecessary, however, given that most Government money market funds have sufficient holdings of Treasury securities and Government agency discount notes to satisfy the rule's requirements for daily and weekly liquid assets. *See* amended rule 2a-7(a)(8) (defining "daily liquid assets"); 2a-7(a)(32) (defining "weekly liquid assets").

[229] Amended rule 2a-7(c)(5)(ii)-(iii).

[230] *See* Proposing Release, *supra* note 2, at n.191 and accompanying and following text.

[231] *See, e.g.*, FAF Advisors Comment Letter; Invesco Aim Comment Letter. Others recommended different standards. *See* Crane Data Comment Letter (5% daily and 15% weekly liquidity for all money market funds); Fifth Third Comment Letter (10% daily liquidity and 25% weekly liquidity for all money market funds); J.P. Morgan Asset Mgt. Comment Letter (5% daily liquidity for taxable money market funds and 20% weekly liquidity for all money market funds); Vanguard Comment Letter (weekly liquidity requirement for institutional funds should not exceed 25%).

protection to investors.[232] They also suggested that the lower levels strike an appropriate balance of improving funds' liquidity while providing sufficient flexibility to allow portfolio managers to meet the challenges of different market conditions.[233]

We are concerned that the lower minimum liquidity levels suggested by commenters would be insufficient to establish an adequate liquidity floor for money market funds in the event of a crisis such as we experienced in September 2008. The five percent daily liquidity level would have been insufficient to satisfy redemptions in one-fifth of prime institutional funds (or share classes) on each of three days during the week of September 15, and the 20 percent weekly liquidity level would have been insufficient to address outflows in more than a quarter of those funds during that week.[234] We would be concerned if such a large portion of money market funds had to increase their liquidity quickly in response to sudden market turmoil at the same time the overall market experiences a flight to liquidity.[235] As we noted above, one fund's inability to satisfy redemption requests may lead to a run on other money market funds.[236] Accordingly, we believe that the floor we establish for minimum liquidity requirements must be

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232 *See* Dreyfus Comment Letter ($119 billion redeemed in institutional funds during the week of September 17, 2008 represented 5% of institutional fund assets as reported by iMoneyNet on August 5, 2009); FAF Advisors Comment Letter; Goldman Sachs Comment Letter.

233 *See* Invesco Aim Comment Letter.

234 On September 17, 2008, approximately 25% of prime institutional money market funds experienced outflows greater than 5% of total assets; on September 18, 2008, approximately 30% of prime institutional money market funds experienced outflows greater than 5%; and on September 19, 2008, approximately 22% of prime institutional money market funds experienced outflows greater than 5%. As noted in the Proposing Release, during that week, approximately 27% of prime institutional money market funds experienced redemptions of more than 20% of assets, and 22% had outflows greater than 25%. This is based on analysis of data from the iMoneyNet Money Fund Analyzer Database. Proposing Release, *supra* note 2, at n.185.

235 As of January 20, 2010, assets in taxable institutional share classes represented approximately 63% of the total assets of money market funds, and assets in prime institutional share classes represented approximately 37% of the total assets of money market assets. *See* ICI, *Money Market Mutual Fund Assets*, *available at* http://www.ici.org/research/stats/mmf/mm_01_21_10.

236 *See supra* text following note 217.

sufficiently high to allow most money market funds to manage their liquidity risk in a crisis, particularly when they may experience significant redemption requests on successive days.[237] For this reason, we have adopted the higher liquidity thresholds, under which we estimate that approximately 90 percent of retail and institutional funds would have been able to satisfy the level of redemption demands during individual days as well as the week of greatest redemption pressure in the fall of 2008 (September 15-19).[238] At the same time, we appreciate commenters' concerns that the proposed liquidity thresholds would limit funds' flexibility to meet the challenges of different market conditions. In order to address those concerns as well as our concerns regarding liquidity risk, the amendments preserve funds' ability to invest in a limited amount of illiquid securities, which is designed to permit funds some flexibility in dealing with varying market conditions.[239]

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[237] In support of its proposed lower liquidity levels, the ICI stated that the 5% daily and 20% weekly thresholds "would have met the demands of a large majority of the prime funds with at least one institutional share class" and noted that between September 10 through 24, 52% of these funds had outflows of less than 5 percent, and 22 percent experienced outflows of between 5% and 20% of assets, which would have been covered by the thresholds recommended by the ICI Report. Under the ICI's analysis, however, one quarter of prime money market funds would *not* have been covered by the thresholds recommended by the ICI Report, which as discussed above, we believe is too large a proportion that might have to increase liquidity quickly in response to sudden severe economic stress. We are not considering the redemption levels of the week following September 19, when the Treasury Department adopted the Guarantee Program, because we have no basis to estimate what the redemptions would have been had the Treasury not adopted the Program. We also note that another commenter that provided specific information on redemption flows, a large sponsor of money market funds, reported in its comment letter that on September 17, redemptions in its money market funds exceeded 5% and during the week of September 15, redemptions in the funds exceeded 20%. Federated Comment Letter.

[238] *See* Proposing Release, *supra* note 2, at n.201 and accompanying text. The 9% of institutional money market funds that had redemptions exceeding 30% of assets in the week after The Reserve Fund broke the buck accounted for 10.9% of all institutional funds' total assets as of September 15, 2008. We estimate that under the minimum liquidity standards we are adopting more retail funds would have been able to satisfy the level of redemption demands than would have institutional funds. During the week ending September 19, 2008, 3% of retail funds experienced outflows greater than 30%. This is based on analysis of data from the iMoneyNet Money Fund Analyzer Database

[239] *See supra* Section II.C.2 (limitations on illiquid securities).

Tax-Exempt Money Market Funds. As proposed, the final rule excludes tax-exempt money market funds from the daily liquidity requirements.[240] Several commenters supported the proposal, noting that these funds cannot engage in repurchase agreements and the supply of tax-exempt securities with daily demand features is extremely limited.[241] One commenter, however, argued that tax-exempt funds are subject to daily redemptions and should be subject to the required minimum.[242] Based on the comments we received, we continue to believe that the different nature of the markets for tax-exempt securities justifies exempting tax-exempt money market funds from the daily liquidity requirements.[243]

Definition of Daily and Weekly Liquid Assets. As discussed above, the new daily and weekly liquidity requirements are designed to ensure that a money market fund has the legal right to receive cash within one or five business days so that a fund may more easily satisfy redemption requests during times of market stress.[244] Like our proposal, the final definition of "daily liquid assets" includes cash (including demand deposits), Treasury securities, and securities (including repurchase agreements) for which a money market fund has a legal right to receive cash in one business day.[245] Our proposed definition of "weekly liquid assets" included the same assets (except that the fund would have had to have the right to receive cash in five

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240 *See* Proposing Release, *supra* note 2, at nn.198-99 and accompanying text.

241 *See, e.g.*, Federated Comment Letter; ICI Comment Letter.

242 *See* Fidelity Comment Letter.

243 We understand that most of the portfolios consist of longer term floating and variable-rate securities with seven-day demand features from which the fund obtains much of its liquidity, and that they are unlikely to have investment alternatives that would permit them to meet a daily liquidity requirement.. *See* Proposing Release, *supra* note 2, at n.199 and accompanying text.

244 *See supra* note 213 and accompanying and following text.

245 Amended rule 2a-7(a)(8) (defining "daily liquid asset" to mean (i) cash; (ii) direct obligations of the U.S. Government; and (iii) securities that will mature or are subject to a demand feature that is exercisable and payable within one business day).

business days rather than one).[246] We proposed to include Treasury securities regardless of their maturity in the liquidity baskets because they have been the most liquid assets during times of market stress.[247] Indeed, we understand that the "flight to liquidity" that happens during times of uncertainty makes it easy to sell Treasury securities in even large quantities.[248]

Commenters supported our inclusion of Treasury securities, but many argued that we should include additional securities.[249] In particular, a number of commenters argued that we should also include agency notes (*i.e.,* direct obligations of federal government agencies and government-sponsored enterprises) as daily or weekly liquid assets or in both liquid asset baskets.[250] We are persuaded, based on the comments we received, that the market for very short-term agency notes is likely to be sufficiently liquid under stressful market conditions to

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[246] Proposed rule 2a-7(a)(32).

[247] U.S. Treasury securities were highly liquid during the market turmoil in 2008. *See, e.g., FRB Open Market Committee Oct. 28-29 Minutes, supra* note 13, at 5; *Minutes of the Federal Open Market Committee*, FEDERAL RESERVE BOARD, Dec. 15-16, 2008, at 4, *available at* http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081216.pdf.

[248] *See, e.g.*, Francis A. Longstaff, *The Flight-to-Liquidity Premium in U.S. Treasury Bond Prices*, 77 J. BUS. 511 (July 2004).

[249] *See, e.g.*, Comment Letter of the Federal Home Loan Banks (Sept. 8, 2009) ("FHLB Comment Letter") (include Federal Home Loan Bank discount notes); RidgeWorth Comment Letter (include fixed-rate agency discount notes with maturities of 95 days or less); Victory Cap. Mgmt. Comment Letter (include fixed-rate agency discount notes with maturities of 397 days or less). *See also* Dreyfus Comment Letter (include bank time deposits); Fidelity Comment Letter (include shares of other money market funds). Both shares of money market funds and bank time deposits, which some commenters advocated we specifically include in the rule text, fall within the definitions of daily and weekly liquid assets if they satisfy the applicable maturity terms.

[250] *See, e.g.*, Comment Letter of the Capital Management of the Carolinas (Sept. 4, 2009) ("Cap. Mgt. Carolinas Comment Letter") (include discount notes with maturity of 397 days or less as daily liquid assets); Fidelity Comment Letter (include discount notes with maturity of 397 days or less as both daily and weekly liquid assets); ICI Comment Letter (include fixed-rate agency discount notes with maturity of 397 days or less as weekly liquid assets); C. Wesselkamper Comment Letter (include in daily and weekly liquid assets Government securities with fixed rates or fixed rate Government securities maturing in no more than 60 days). One commenter also expressed concern about the supply of assets that would qualify as daily or weekly liquid assets. *See* Fidelity Comment Letter.

treat them as weekly liquid assets. Therefore, amended rule 2a-7 includes agency discount notes with remaining maturities of 60 days or less in the definition of weekly liquid assets.[251]

Our decision to include these securities is based on our consideration of the relative liquidity of agency discount notes during times of extreme market stress.[252] We compared average daily yields for the two weeks before and the two weeks after the Lehman Brothers bankruptcy on September 15, 2008. Between these periods, the yields for 30-day Treasury bills fell 75 percent while yields for 30-day and 60-day agency discount notes remained essentially the same.[253] The yields for other money market assets increased over the same periods. For example, the average daily yield for 90-day agency discount notes increased four percent; while the yield for 30-day first tier financial securities increased 23 percent.[254] Transaction volume in

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251 Amended rule 2a-7(a)(32) (defining "weekly liquid assets" to mean (i) cash; (ii) direct obligations of the U.S. Government; (iii) Government securities issued by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States, that are issued at a discount to the principal amount to be repaid at maturity and have a remaining maturity of 60 days or less; and (iv) securities that will mature or are subject to a demand feature that is exercisable and payable within five business days).

252 Commenters who advocated including agency discount notes in the liquid asset baskets stressed the depth of liquidity in the secondary markets for these securities. *See*, *e.g.*, Charles Schwab Comment Letter; ICI Comment Letter; SIFMA Comment Letter; FHLB Comment Letter (comment limited to Federal Home Loan Bank discount notes).

253 Between these periods, 30-day Treasury bill average daily yields fell from 1.53% to 0.39%; 30-day agency discount note average daily yields held constant at 2.14%; and 60-day agency discount note average daily yields increased from 2.25% to 2.27%. *See* Bloomberg Terminal Database, US 30-Day T-Bill USGB030Y <Index>; Agency Discount Note 30 Day Yield AGDN030Y <Index>; Agency Discount Note 60 Day Yield AGDN060Y <Index>. We note that in September 2008, the Federal Reserve's Open Market Trading Desk purchased discount notes issued by Fannie Mae, Freddie Mac, and the Federal Home Loan Banks in order to support market functioning. *See* Press Release, Federal Reserve Bank of New York, Statement Regarding Planned Purchases of Agency Debt (Sept. 19, 2008), *available at* http://www.newyorkfed.org/markets/operating_policy_080919.html. Data concerning the purchases are available at the Federal Reserve Bank of New York's Permanent Open Market Operations Historical Search webpage, *available at* http://www.newyorkfed.org/markets/pomo/display/index.cfm?fuseaction=showSearchForm.

254 Average daily yields on 90-day agency discount notes increased from 2.35% to 2.45%. *See* Bloomberg, Agency Discount Note 90 Day Yield AGDN090Y <Index>. In addition, average

agency discount notes increased over this time period,[255] which suggests to us that money market funds were able to sell their shorter maturity agency discount notes at amortized cost or higher prices.

4. *Stress Testing*

We are adopting amendments to rule 2a-7 to require the board of directors of each money market fund to adopt procedures providing for periodic stress testing of the money market fund's portfolio.[256] Almost all of the commenters who addressed this matter supported requiring stress testing of fund portfolios,[257] although several suggested changes from our proposal.[258]

Under the amended rule, a fund must adopt procedures that provide for the periodic testing of the fund's ability to maintain a stable net asset value per share based upon certain hypothetical events. These include an increase in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund.[259]

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daily yields on 30-day first tier financial securities increased from 2.40% to 2.96% and average daily yields on 30-day first tier non-financial securities increased from 2.03% to 2.16%. *See* Federal Reserve Commercial Paper Data, *supra* note 47 (select rates from the preformatted data package menu and follow the instructions to reformat the date range and download). Average daily yields on 60-day first tier financial securities increased from 2.57% to 2.99% and average daily yields on 60-day first tier non-financial securities increased from 2.03% to 2.19%. *See id.*

255 *See* Federal Reserve Bank of New York, Primary Dealer Statistics, *available at* http://www.newyorkfed.org/markets/gsds/search.cfm.

256 *See* amended rule 2a-7(c)(10)(v).

257 *See*, *e.g.*, J.P. Morgan Asset Mgt. Comment Letter; Tamarack Funds Comment Letter. *But see* C. Wesselkamper Comment Letter (stress testing should be an adviser's best practice).

258 At the suggestions of some commenters, we have made the stress testing requirement applicable to all money market funds that employ either the amortized cost method of valuing portfolio securities or the penny-rounding method of pricing fund shares. *See* Federated Comment Letter; TDAM Comment Letter. We believe that few, if any, money market funds will be affected by this change.

259 Amended rule 2a-7(c)(10)(v)(A).

Commenters differed on whether we should specify details for stress testing in addition to these hypothetical events.[260] Because different tests may be appropriate for different market conditions and different money market funds, we believe that the funds are better positioned to design and modify their stress testing systems and have not included more specific criteria in the rule.[261]

The amendment requires the testing to be done at such intervals as the fund board of directors determines appropriate and reasonable in light of current market conditions.[262] This is the same approach that rule 2a-7 takes with respect to the frequency of shadow pricing.[263] The rule does not, however, specifically require the board to design the portfolio stress testing, as may have been suggested by our proposing release.[264] We agree with the many commenters that asserted that the board may not have sufficient expertise to construct appropriate stress tests for a

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260 *See, e.g.*, Charles Schwab Comment Letter (opposing more specific tests in the rule); State Street Comment Letter (same); RidgeWorth Comment Letter (requesting that the Commission more clearly define feasible stress testing requirements); TDAM Comment Letter (same).

261 *See* Federated Comment Letter (different types of money market funds should have different stress testing procedures); Invesco Aim Comment Letter ("each investment adviser should have the discretion to determine the appropriate assumptions and hypothetical events for which to test."). As discussed above, amended rule 2a-7's new liquidity requirements require money market funds to evaluate their liquidity needs based on their shareholder base. *See supra* note 195 and preceding and accompanying text. Money market funds should also incorporate this element in their stress testing procedures as appropriate. *See* Thrivent Comment Letter.

262 Amended rule 2a-7(c)(10)(v)(A). Commenters differed in their views on the appropriate intervals for testing. *See, e.g.*, J.P. Morgan Asset Mgt. Comment Letter (monthly or even more frequently); HighMark Comment Letter (quarterly under normal market conditions); Shriver Poverty Law Ctr. Comment Letter (same). We believe that a fund's board of directors is best positioned to choose the appropriate frequency under different conditions. We urge funds to adopt thresholds for testing frequency based, in part, on the amount of the deviation of the funds market-based net asset value per share from its amortized cost value per share similar to many funds' thresholds for more frequent shadow pricing. Thus, we would expect that if a fund's shadow net asset value per share decreased to less than $0.9975, the fund would conduct stress tests at least every week, even if the fund stress tests less frequently under normal conditions. More frequent testing would likely allow the fund to better understand and manage the risks to which the fund and its shareholders are exposed.

263 Amended rule 2a-7(c)(8)(ii)(A)(*1*).

264 *See* Proposing Release, *supra* note 2, at text following n.209.

fund.[265] Each board may, of course, consider the extent to which it wishes to become involved in design of the stress tests.

The rule also requires that the board receive a report of the results of the stress testing at its next regularly scheduled meeting, as proposed, and more frequently, if appropriate, in light of the results.[266] We have added the requirement for more frequent reporting in light of results because we believe that the board should be apprised of test results when they indicate that the magnitude of hypothetical events required to cause the fund to break a buck (such as changes in interest rates or shareholder redemptions or a combination of factors) is slight when compared with actual conditions.

As proposed, the report must include: (i) the date(s) on which the fund portfolio was tested; and (ii) the magnitude of each hypothetical event that would cause the money market fund to break the buck.[267] The report also must include an assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.[268] Finally, as proposed, funds are required

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265 *See, e.g.*, ABA Comment Letter; HighMark Capital Comment Letter; IDC Comment Letter.

266 Amended rule 2a-7(c)(10)(v)(B). We disagree with commenters that recommended that the adviser report to the board only annually and on an exception basis. *See, e.g.*, Stradley Ronon Comment Letter; Tamarack Funds Comment Letter; T. Rowe Price Comment Letter. We believe that regular reports will allow the board more effectively to monitor the fund's ability to withstand hypothetical events that alone or in combination would cause the fund to break the buck. In the Proposing Release, we asked whether we should impose minimum liquidity requirements based on the results of a particular stress test. *See* Proposing Release, *supra* note 2, at text following n.216. Commenters were divided on this issue. *See* Fidelity Comment Letter (against); Bankers Trust Comment Letter (in favor); Shriver Poverty Law Ctr. (same). As discussed above, we expect that money market funds take into consideration the results of their stress testing in assessing their liquidity needs under the general liquidity requirement of rule 2a-7(c)(5). *See supra* note 261.

267 Amended rule 2a-7(c)(10)(v)(B)(*1*).

268 Amended rule 2a-7(c)(10)(v)(B)(*2*). We do not agree with commenters who argued that advisers should not be required to provide an assessment of a fund's ability to withstand events that are reasonably likely to occur within the following year. *See* Charles Schwab Comment Letter;

to maintain records of the stress testing for six years, the first two years in an easily accessible place.[269]

D. Repurchase Agreements

Money market funds typically invest a significant portion of their assets in repurchase agreements, many of which mature the following day and provide an immediate source of liquidity. We are adopting, as proposed, two amendments to rule 2a-7 that affect fund investments in repurchase agreements for purposes of rule 2a-7's diversification provisions.[270]

First, we are limiting money market funds to investing in repurchase agreements collateralized by cash items or Government securities in order to obtain special treatment of those investments under the diversification provisions of rule 2a-7.[271] This change is designed to reduce the risk that a money market fund would experience losses upon the sale of collateral in the event of a counterparty's default.[272] Most commenters who addressed our proposal supported it.[273] Commenters also confirmed our understanding that many managers of money market funds

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Federated Comment Letter; Stradley Ronon Comment Letter; Vanguard Comment Letter. The rule does not require advisers to predict the future in order to determine which hypothetical events to use in stress testing (and we recognize that advisers will not always be correct in their assessments of which events are reasonably likely to occur within the following year). Instead, the provision is designed to provide to the board some context within which to evaluate the assessment on the magnitude of each hypothetical event that would cause the fund to break the buck. *See* Proposing Release, *supra* note 2, at text following n.211.

269 Amended rule 2a-7(c)(11)(vii).

270 Amended rule 2a-7(c)(4)(ii)(A); Proposing Release, *supra* note 2, at Section II.E.

271 Amended rule 2a-7(a)(5) (defining the term "collateralized fully"). The special treatment allows money market funds to consider the acquisition of the repurchase agreement as an acquisition of the underlying collateral for diversification purposes. *See* Proposing Release, *supra* note 2, at n.228 and accompanying text. Under the new rule, securities with the highest rating, or unrated securities of comparable credit quality, will no longer be acceptable collateral. *Compare* amended rule 2a-7(a)(5) *with* current rule 2a-7(a)(5).

272 *See* Proposing Release, *supra* note 2, at n.229 and accompanying text.

273 *See* Bankers Trust Comment Letter; BlackRock Comment Letter; HighMark Capital Comment Letter; RidgeWorth Comment Letter. Two commenters opposed the proposal. Wells Fargo made a number of arguments based on the premise that the change will prevent money market funds

already look through only those repurchase agreements that are collateralized by Government securities or cash instruments.[274]

Second, we are reinstating the requirement that the money market fund's board of directors or its delegate evaluate the creditworthiness of the repurchase agreement's counterparty in order for the fund to take advantage of the special look-through treatment under rule 2a-7's diversification provisions.[275] The effect of this amendment is to require a fund adviser to determine that the counterparty is a creditworthy institution, separate and apart from the value of the collateral supporting the counterparty's obligation under the repurchase agreement.[276]

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from investing in repurchase agreements collateralized by non-government securities. The rule, however, does not restrict funds from investing in repurchase agreements. Instead, it limits the circumstances under which a fund may look through the repurchase agreement to the underlying collateral for diversification purposes. A money market fund will continue to be able to invest in repurchase agreements collateralized by other types of assets, although the securities will not be eligible for special treatment under the diversification provisions. Another commenter asserted that the limitation is unnecessary if a fund evaluates the creditworthiness of the counterparty *or* if it adequately values the collateral in light of rule 2a-7(c)'s minimal credit risk determination. *See* Am. Securit. Forum Comment Letter. As discussed above and in the Proposing Release, we are adopting this provision to protect against circumstances in which the fund may be unable to obtain its collateral or the full value of that collateral.

[274] *See* Federated Comment Letter (Federated has never relied on the diversification look-through approach for repurchase agreements collateralized by non-government securities); ICI Comment Letter (ICI members typically adopt the look-through approach only for repurchase agreements collateralized by cash items and government securities). *See also* FITCH RATINGS, MONEY MARKET FUNDS SPECIAL REPORT, U.S. PRIME MONEY MARKET FUNDS: MANAGING PORTFOLIO COMPOSITION TO ADDRESS CREDIT AND LIQUIDITY RISKS (Aug. 14, 2009) ("Fitch Report"), at 6 *available at* http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=462366 (reporting that after the end of 2008 "a number of advisors to Fitch-rated U.S. prime money market funds … significantly amended their investment policies with respect to repurchase agreements counterparties and collateral schedules"; the amendments include, among others, "[r]educed acceptance of repurchase agreement collateral other than U.S. Treasury and agency securities").

[275] *See* amended rule 2a-7(c)(4)(ii)(A). We eliminated the requirement in 2001. *See* Proposing Release, *supra* note 2, at nn.230-33 and accompanying text. Three commenters specifically supported the change. *See* BlackRock Comment Letter; HighMark Capital Comment Letter; Shriver Poverty Law Ctr. Comment Letter.

[276] A number of commenters argued that the evaluation should not be the board's responsibility. *See, e.g.*, IDC Comment Letter; Comment Letter of the North Carolina Capital Management Trust – Independent Trustees (Sept. 8, 2009). We note that rule 2a-7(e) allows a board to delegate the creditworthiness evaluation to the fund's investment adviser or officers, under

We are not adopting an approach suggested by some of the commenters that the evaluation of a repurchase agreement should be limited to the credit risk determination already required by rule 2a-7(c)(3) with regard to the purchase of any security.[277] That approach would not require a fund to evaluate separately the creditworthiness of the counterparty in order to take advantage of the special look-through treatment for diversification purposes. Under that approach, the fund's evaluation of a repurchase agreement could be based primarily or exclusively on the quality of the *collateral*. As we explained in the Proposing Release, in the midst of a market disruption caused by the default of a *counterparty*, a money market fund may find it difficult to protect fully its collateral without incurring losses.[278] The amendment is designed to avoid such losses by requiring money market funds to evaluate the creditworthiness of the counterparty in order to limit exposure to less creditworthy institutions.

E. Disclosure of Portfolio Information

1. Public Website Posting

We are amending rule 2a-7 to require money market funds to disclose information about their portfolio holdings each month on their websites. The disclosure will provide greater transparency of portfolio information in a manner convenient for most investors. The amendment is designed to give investors a better understanding of the current risks to which the fund is exposed, strengthening their ability to exert influence on risk-taking by fund advisers.

Commenters generally supported requiring money market funds to post portfolio

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guidelines and procedures that the board establishes and reviews.

277 Three commenters argued that the proposed creditworthiness evaluation is unnecessary because it is already an element of the minimal credit risk determination that a fund makes pursuant to rule 2a-7(c)(3). *See* Federated Comment Letter; ICI Comment Letter; IDC Comment Letter. Two other commenters recommended that the applicable standard be the minimal credit risk evaluation. *See* Fidelity Comment Letter; Stradley Ronon Comment Letter.

278 Proposing Release, *supra* note 2, at n.233 and accompanying text.

information monthly, although several urged us to revise the amendments in certain ways.[279] The amendments we are today adopting are substantially similar to those we proposed, with modifications to (i) the information required to be disclosed, (ii) the time within which a fund must post its portfolio holdings information, and (iii) the length of time a fund must maintain the information on its website. We discuss each of these modifications below.

Information Required to be Disclosed. As proposed, the amendments to rule 2a-7 would have required a fund to disclose the fund's schedule of investments, as prescribed by rules 12-12 through 12-14 of Regulation S-X,[280] identifying, among other things, the issuer, the title of the issue, the principal amount, the interest rate, the maturity date, and the current amortized cost of the security.[281] Several commenters asserted that requiring the information specified in rules 12-12 through 12-14 of Regulation S-X would include information that would not be helpful to investors. They urged us instead to require information about money market fund portfolios that would better fit the needs of investors seeking information relevant to their investment decisions.[282] For example, some commenters noted that under the proposed amendments a fund would be required to classify and subtotal securities by industry, provide detailed restricted securities disclosures, and provide detailed information regarding repurchase agreement counterparties and collateral. One also noted that under the proposal funds may be required to provide certain notes required by generally accepted accounting principles ("GAAP"), as many

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279 *See, e.g.*, Assoc. for Fin. Professionals Comment Letter; SIFMA Comment Letter; Vanguard Comment Letter.

280 17 CFR 210.12-12 – 12-14.

281 Proposed rule 2a-7(c)(12). As discussed below, all of these enumerated items are required under amended rule 2a-7(c)(12).

282 *See, e.g.*, BlackRock Comment Letter; GE Asset Mgt. Comment Letter; Invesco Aim Comment Letter.

funds do for filings on Form N-Q.[283] Commenters asserted that these requirements would unnecessarily complicate the disclosure, be of little interest or benefit to investors, be difficult to comply with, and would impose a significant additional burden on money market funds. They suggested modifying the disclosure requirements to exclude some of the detail.[284]

We are revising the information about portfolio holdings that funds must disclose on their websites. Instead of referring to Regulation S-X as we proposed, we are listing in rule 2a-7(c)(12) the information that funds must disclose.[285] These revisions more closely tailor the required information to the needs of money market fund investors and others who seek information about fund holdings through internet websites. For example, rule 12-12 of Regulation S-X requires funds to disclose the *subtotal* of each category of investments, *subdivided* by business grouping or investment type. We agree with commenters who argued that this level of detail, although appropriate for financial statements, is unnecessary in a fund's

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283 *See* ICI Comment Letter.

284 *See, e.g.*, BlackRock Comment Letter; Fidelity Comment Letter; ICI Comment Letter.

285 Rules 12-12 through 12-14 of Regulation S-X require, and the proposed rule amendments would have required, in addition to the information required by rule 2a -7(c)(12), the following information, which we believe is not critical to be made available to investors on money market fund websites: (i) the subtotals for each category of investments, subdivided by business grouping or investment type, with their percentage value compared to net assets; (ii) for repurchase agreements, showing for each, among other things, the date of the agreement, the total amount to be received upon repurchase, the repurchase date, and a description of the securities that are subject to the repurchase agreement; (iii) for restricted securities (1) as to each such issue (a) the acquisition date, (b) the carrying value per unit of investment at date of related balance sheet, and (c) the cost of such securities, (2) as to each issue acquired during the year preceding the date of the related balance sheet, the carrying value per unit of investment of unrestricted securities of the same issuer at (a) the day the purchase price was agreed to, (b) the day on which an enforceable right to acquire such securities was obtained, and (c) the aggregate value of all restricted securities and the percentage which the aggregate value bears to net assets; (iv) the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost; (v) the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value; (vi) the net unrealized appreciation or depreciation; (vii) the aggregate cost of securities for federal income tax purposes; (viii) disclosure of investments in non-securities; (ix) the amount of equity in net profit and loss for the period; and (x) the dollar amount of dividends or interest in investments in affiliates.

website disclosures to investors.[286] For investors who may prefer to obtain the more detailed information, it will continue to be available in money market funds' quarterly Form N-CSR and Form N-Q filings.[287] As discussed below, detailed information also will be available on a fund's filings on Form N-MFP.[288]

As amended, rule 2a-7(c)(12) will require funds to disclose monthly with respect to each security held: (i) the name of the issuer; (ii) the category of investment (*e.g.*, Treasury debt, government agency debt, asset backed commercial paper, structured investment vehicle note); (iii) the CUSIP number (if any); (iv) the principal amount; (v) the maturity date as determined under rule 2a-7 for purposes of calculating weighted average maturity; (vi) the final maturity date, if different from the maturity date previously described; (vii) coupon or yield; and (viii) the amortized cost value.[289] In addition, the amendments require funds to disclose their overall weighted average maturity and weighted average life maturity of their portfolios.[290] The information required is substantially the same as was proposed but eliminates some of the details required by Regulation S-X, to which investors will continue to have access in the fund's

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286 *See supra* note 282.

287 Money market funds must provide a full schedule of their portfolio holdings in quarterly filings to the Commission, within 60 days after the end of the quarter. *See* Form N-CSR [17 CFR 274.128] (form used by registered management investment companies to file shareholder reports); Form N-Q [17 CFR 274.130] (form used by registered management investment companies to file quarterly reports of portfolio holdings after the first and third quarters).

288 *See infra* Section II.E.2.

289 Amended rule 2a-7(c)(12)(ii). We have added disclosure of the security's CUSIP number as an item of the web disclosure, which is designed to help users identify the securities in the fund's portfolio. We proposed and are adopting CUSIP number reporting on Form N-MFP, and commenters did not object to this reporting. *See infra* note 306 and accompanying text.

290 Amended rule 2a-7(c)(12)(i). We proposed to require that funds disclose this information on Form N-MFP, which we indicated we intended to make public. Some commenters also recommended we include these disclosure items in funds' website disclosures. *See* Assoc. Fin. Professionals Comment Letter; BlackRock Comment Letter; Fidelity Comment Letter.

quarterly filings.[291]

Time of Posting Information on Website. The amended rule requires funds to post the portfolio information, current as of the last business day of the previous month, no later than the *fifth* business day of the month.[292] Under the proposed amendments, a fund would have been required to post the portfolio information on its website no later than the *second* business day of the month.[293] We have extended the time in response to commenters that asserted that the second business day deadline would not provide funds with enough time to compile, review, and post the required portfolio information accurately.[294]

Maintenance of Information on the Website. Portfolio information must be maintained on the fund's website for no less than six months after posting.[295] We have reduced the

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291 As discussed above, the proposed amendments to rule 2a-7 would have required money market funds to disclose on their websites their monthly schedule of investments in accordance with rules 12-12 to 12-14 of Regulation S-X. To avoid unnecessarily duplicative disclosure obligations, we also proposed to amend rule 30b1-5 to exempt money market funds from Item 1 of Form N-Q, which similarly requires funds to disclose their schedule of investments in accordance with rules 12-12 to 12-14 of Regulation S-X in quarterly filings with the Commission. Because we have revised the website disclosure requirement not to include certain items in rules 12-12 to 12-14 of Regulation S-X, the disclosure requirements of rule 2a-7 and Item 1 of Form N-Q are no longer duplicative. As a result, we are not adopting the proposed amendments to rule 30b1-5.

292 Amended rule 2a-7(c)(12).

293 Proposed rule 2a-7(c)(12).

294 *See, e.g.*, BlackRock Comment Letter; Charles Schwab Comment Letter; T. Rowe Price Comment Letter; Vanguard Comment Letter. One commenter estimated that compliance with the proposed second business day deadline would cost $1.5 million initially and $220,000 annually. *See* Fidelity Comment Letter. The recommended deadlines submitted by commenters ranged from 5 business days to 15 or 30 business days after the end of each month. In light of the modifications we are making to the information that must be posted on the fund's website, as discussed above, we believe that lengthening the deadline to five business days should provide funds sufficient time to compile, review, and post the portfolio holding information accurately. We also note that a five business day deadline will typically mean seven calendar days and, when holidays intervene, eight calendar days.

295 Amended rule 2a-7(c)(12). The amended rule also requires funds to provide a link to a Securities and Exchange Commission webpage where a user may obtain access to the fund's most recent 12 months of publicly available filings on Form N-MFP. Amended rule 2a-7(c)(12)(iii).

maintenance period from the proposed twelve months in response to commenters.[296] Many commenters stated that the proposed twelve-month maintenance period was too long.[297] Half of these commenters recommended a six-month period, asserting that historical portfolio holdings information could be obtained from publicly available semi-annual filings with the Commission.[298] Other commenters recommended that no historical data be maintained on a fund's website at all.[299] We believe that it is important for investors to be able to compare current holdings information with previous holdings information from which they (or others analyzing the data) may discern trends. However, because historical portfolio holdings information is available to investors in semi-annual filings to the Commission, we have determined to reduce the maintenance period to six months.[300]

2. *Reporting to the Commission*

We are adopting a new rule requiring money market funds to provide the Commission a monthly electronic filing of more detailed portfolio holdings information. The information will permit us to create a central database of money market fund portfolio holdings, which will enhance our oversight of money market funds and our ability to respond to market events.[301] As

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296 Proposed rule 2a-7(c)(12).

297 *See* Comment Letter of Clearwater Analytics, LLC (Sept. 7, 2009) ("Clearwater Comment Letter"); Comment Letter of Data Communiqué (Sept. 8, 2009) ("Data Communiqué Comment Letter"); Dreyfus Comment Letter; Fidelity Comment Letter; Fifth Third Comment Letter; GE Asset Mgt. Comment Letter; SIFMA Comment Letter; T. Rowe Price Comment Letter.

298 *See* Dreyfus Comment Letter; Fifth Third Comment Letter; SIFMA Comment Letter; T. Rowe Price Comment Letter.

299 *See* Clearwater Comment Letter; Data Communiqué Comment Letter (investors "only interested in the most recent data"); Fidelity Comment Letter; GE Asset Mgt. Comment Letter.

300 Two commenters stated that retaining portfolio holdings information on a fund's website for no more than six months would be consistent with the current requirements for portfolio holdings of open-end management investment companies. *See* Fifth Third Comment Letter; T. Rowe Price Comment Letter.

301 As we explained in the Proposing Release, our current information on money market portfolio holdings is limited to quarterly reports filed with us which, due to the high turnover rate of

discussed further below, the information will also be made public on a delayed basis.

New rule 30b1-7 requires money market funds to report portfolio information on new Form N-MFP. We received 49 comment letters on the proposed rule and form, most of which supported enhancing our oversight capabilities. Many of these commenters suggested technical modifications, a number of which we are adopting, as discussed below.[302] The rule and form that we are adopting today are substantially similar to what we proposed.[303]

Information. Money market funds must report on Form N-MFP, with respect to each portfolio security held on the last business day of the prior month, the following items:[304] (i) the name of the issuer; (ii) the title of the issue, including the coupon or yield;[305] (iii) the CUSIP number;[306] (iv) the category of investment (*e.g.*, Treasury debt, government agency debt, asset

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portfolio securities, quickly become stale. *See* Proposing Release, *supra* note 2, at Section II.F.2.

302 *See*, *e.g.*, Charles Schwab Comment Letter; Stradley Ronon Comment Letter; Tamarack Funds Comment Letter.

303 In September 2009, we adopted interim final temporary rule 30b1-6T. Disclosure of Certain Money Market Fund Portfolio Holdings, Investment Company Act Release No. 28903 (Sept. 18, 2009) [74 FR 48376 (Sept. 23, 2009)] ("Rule 30b1-6T Release"). We therefore have adopted proposed rule 30b1-6 as rule 30b1-7. The portfolio securities information that money market funds currently must report each quarter (pursuant to rule 30b1-5) is less timely and more limited in scope, and includes information about the issuer, the title of the issue, the balance held at the close of the period, and the value of each item at the close of the period. *See* Item 1 of Form N-Q [17 CFR 274.130] and Item 6 of Form N-CSR [17 CFR 274.128] (requiring funds to include a schedule of investments as set forth in rule 12-12 through 12-14 of Regulation S-X [17 CFR 210.12-12 – 12-14]).

304 We have revised the form's general instructions to clarify that a filer may amend the form at any time. *See* Form N-MFP at General Instruction A.

305 We understand that the title of an issue typically includes the coupon or yield of the instrument, and we have revised Item 27 to require this information, if applicable.

306 Item 20 of proposed Form N-MFP would have required a fund to disclose the CIK of the issuer. Several commenters suggested that the form not require the issuer's CIK because the CIK is not a widely used identifier for money market instruments and is not generally maintained by money market funds. *See*, *e.g.*, Dreyfus Comment Letter; Federated Comment Letter; SIFMA Comment Letter. Form N-MFP, as adopted, only requires the issuer's CIK number if the security does not have a CUSIP number and the issuer has a CIK. Item 28 and Item 30 of Form N-MFP. If the security does not have a CUSIP number, the fund must provide a unique identifier for the security if there is one. Item 29 of Form N-MFP.

backed commercial paper, structured investment vehicle note, repurchase agreement[307]); (v) the NRSROs designated by the fund, the credit ratings given by each NRSRO, and whether each security is first tier, second tier, unrated, or no longer eligible; (vi) the maturity date as determined under rule 2a-7, taking into account the maturity shortening provisions of rule 2a-7(d); (vii) the final legal maturity date, taking into account any maturity date extensions that may be effected at the option of the issuer; (viii) whether the instrument has certain enhancement features;[308] (ix) the principal amount; (x) the current amortized cost value;[309] (xi) the percentage of the money market fund's assets invested in the security;[310] (xii) whether the security is an

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307 For repurchase agreements we are also requiring funds to provide additional information regarding the underlying collateral. Item 32 of Form N-MFP. This information would have been required under our proposed amendments to rule 2a-7 regarding the website disclosure of portfolio holdings. Although we continue to believe that the information is important to understanding the risks associated with a repurchase agreement and should be readily available to investors who seek it, we agree with commenters who asserted that that level of detail may not be necessary on the website disclosure. Fidelity Comment Letter ("detailed information regarding repurchase agreement counterparties and collateral" is contained across multiple systems); ICI Comment Letter. Accordingly, we have added the disclosure requirement to Form N-MFP.

308 At the suggestion of one commenter, we are incorporating defined terms from amended rule 2a-7 into Form N-MFP. *See* Federated Comment Letter. The form requires a fund to report: (i) whether the instrument has a "demand feature" (as defined in amended rule 2a-7(a)(9)); (ii) the identity of the issuer of the demand feature; (iii) the designated NRSRO(s) for the demand feature or its provider; (iv) the credit rating provided by each designated NRSRO, if any; (v) whether the instrument has a "guarantee" (as defined in amended rule 2a-7(a)(17)); (vi) the identity of the guarantor; (vii) the designated NRSRO(s) for the guarantee or guarantor; (viii) the credit rating provided by each designated NRSRO, if any; (ix) whether the instrument has any other enhancements (*i.e.*, other than a demand feature or guarantee); (x) the type of enhancement; (xi) the identity of the enhancement provider; (xii) the designated NRSRO(s) for the enhancement or enhancement provider; and (xiii) the credit rating provided by each designated NRSRO, if any. *See* Items 37-39 of Form N-MFP.

309 Under Item 37 of proposed Form N-MFP, a fund would have had to provide the amortized cost of a security to the nearest hundredth of a cent. Commenters pointed out that fund accounting systems carry costs of securities in whole cents, and recommended that funds therefore be required to report the amortized cost to the nearest cent. *See, e.g.*, Dreyfus Comment Letter; ICI Comment Letter; State Street Comment Letter. We therefore have revised the form to require the amortized cost of each portfolio security to the nearest cent. Item 41 of Form N-MFP.

310 Under Item 39 of proposed Form N-MFP, a fund would have had to disclose the percentage of gross assets invested in the security. We have revised the form to require that funds disclose the percentage of net assets invested in the security (Item 42 of Form N-MFP) to conform to existing disclosure requirements. *See* rule 12-12 of Regulation S-X.

illiquid security (as defined in amended rule 2a-7(a)(19));[311] and (xiii) "Explanatory notes."[312] Form N-MFP also requires funds to report to us information about the fund,[313] including information about the fund's risk characteristics such as the dollar weighted average maturity of the fund's portfolio and its seven-day gross yield.[314]

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311 *See* Item 44 of Form N-MFP. We have added this disclosure requirement at the suggestion of one commenter who believed that it would be useful for us to know if different funds have taken different positions regarding the liquidity of a commonly held security. *See* Federated Comment Letter. Conversely, we are not adopting proposed Item 38, which would have required funds to disclose whether the inputs used in determining the value of the securities are Level 1, Level 2, or Level 3, if applicable. *See* Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 157, "Fair Value Measurement," available at* http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175818754924&blobheader=application%2Fpdf. Commenters explained that industry practice is to categorize all securities valued through reference to amortized cost as Level 2. *See, e.g.*, Dreyfus Comment Letter; ICI Comment Letter. We understand that industry practice is to determine the value of an illiquid security using Level 3 inputs. Requiring funds to disclose whether a security is illiquid will provide comparable information regarding the classification of the security.

312 *See* Item 43 of Form N-MFP. This item permits funds to add miscellaneous information that may be material to other disclosure in the form.

313 As proposed, many of the items would have been disclosed with regard to each *series* of the fund. As adopted, however, we are requiring that funds provide some of this information with regard to each *class* of the fund, where relevant (*e.g.*, minimum initial investment and flow activity). We believe that class-specific information about these items will be more useful for analysis. We also understand that funds typically maintain this information with regard to each class of the fund. For example, funds are required to disclose class-specific information about net assets and flow activities in financial statements. *See* Rules 6-04 and 6-09 of Regulation S-X. Therefore we do not believe that requiring certain information on a class-basis will be any more burdensome than what we proposed. *See also* Clearwater Comment Letter (suggesting that total net asset value should be disclosed on a class-level basis).

314 We also have revised or augmented some of the disclosure items of Form N-MFP. In addition to the seven-day gross yield, the form as adopted requires the fund's seven-day net yield for each class as calculated under Item 26(a)(1) of Form N-1A. Item 24 of Form N-MFP. Item 15 of proposed Form N-MFP would have required that a fund provide its net shareholder flow activity for the month ended. As adopted, Form N-MFP requires the net shareholder flow information for each class and also requires the fund to provide the gross subscriptions and redemptions for the month from which the net shareholder flow is calculated. Item 23 of Form N-MFP. Item 9 of proposed Form N-MFP would have required a fund to indicate if the fund was primarily used to invest cash collateral. One commenter stated that the term "cash collateral" is ambiguous (it could include corporate trust accounts and escrows as well as collateral for securities loans or over-the-counter derivatives) and that it would be difficult for a fund to know when it is being used "primarily" for these investments. *See* Federated Comment Letter. As adopted, Form N-MFP does not require this information. Items 12-14 of proposed Form N-MFP would have

Money market funds also must report on Form N-MFP the market-based values of each portfolio security[315] and the fund's market-based net asset value per share, with separate entries for values that do and do not take into account any capital support agreements into which the fund may have entered.[316] When we proposed Form N-MFP, we solicited comment on requiring funds to report market-based values, including the value of any capital support agreement, on the form.[317] Two commenters supported requiring money market funds to report market-based values to the Commission.[318] Other commenters objected to the *public disclosure* of market-based values.[319] We have decided to require market-based information in the monthly reports, because it will assist us in our understanding of fund portfolio valuation practices as well as the potential risks associated with a fund, *e.g.*, a fund that has a market-based net asset value that suggests that it may be at risk of breaking the buck. The information regarding capital support agreements will help show the extent to which the funds' valuations depend on external support agreements.

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required certain assets and liabilities information to the nearest hundredth of a cent. We have slightly revised these items to conform to accounting conventions and added an item for the net assets of the class. Items 13-16 and 21-22 of Form N-MFP. In addition, in response to commenters' assertion that fund accounting systems only carry costs in whole cents, Form N-MFP as adopted requires this information to the nearest cent. *Id.*

315 *See* Items 45-46 of Form N-MFP. It should be noted that Form N-MFP requires the total market-based value of each portfolio security, not the per-unit price of the security.

316 *See* Item 18 (shadow NAV of the series) and Item 25 of Form N-MFP (shadow NAV of each class).

317 *See* Proposing Release, *supra* note 2, at paragraph accompanying n.253.

318 *See* Fund Democracy/CFA Comment Letter ("We strongly support the SEC's proposal to require that additional information be filed with the Commission on a temporarily confidential basis. It is critical that the Commission be able to gauge the stability of the MMF industry on an ongoing basis. .... We believe strongly that the values at which MMFs are carrying portfolio securities is the most important piece of information for monitoring potential liquidity problems."); Tamarack Funds Comment Letter.

319 *See, e.g.,* ABA Comment Letter; Dreyfus Comment Letter; Goldman Sachs Comment Letter; Tamarack Funds Comment Letter.

Public availability. Under rule 30b1-7, the information contained in the portfolio reports that money market funds file with the Commission on Form N-MFP will be available to the public 60 days after the end of the month to which the information pertains.[320] Although the portfolio information and other information reported to the Commission on Form N-MFP is not primarily designed for individual investors, we anticipate that many investors, as well as academic researchers, financial analysts, and economic research firms, will use this information to study money market fund holdings and evaluate their risk. Their analyses may help other investors and regulators better understand risks in money market fund portfolios.[321] Therefore we believe that it is important to make this information publicly available.

In the Proposing Release, we stated that we expected to make the information filed on Form N-MFP available to the public on a delayed basis, and we also requested comment on whether the rule should require funds to report, and therefore disclose to the public, the market-based valuations of the portfolio securities and of the net asset value of the fund.[322] As discussed further below, commenters' objections to public availability of the information collected on Form N-MFP generally fell into two categories – the competitive effects of portfolio information and the potentially de-stabilizing effects of market-based value information. We address each objection in turn.

First, some commenters objected to the disclosure of information filed on Form N-MFP

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320 Rule 30b1-7(b). As discussed above, money market fund portfolio information will be required to be posted on fund websites within five business days after the end of the month. *See supra* notes 292-294 and accompanying text.

321 *See* Proposing Release, *supra* note 2, at paragraph accompanying n.245. *See also* Clearwater Comment Letter ("[R]egular disclosure will also allow third-party analytics and reporting providers to make meaningful comparisons of money funds and highlight certain characteristics that are of interest to investors and the market generally.").

322 We stated that we intended to make Form N-MFP information public two weeks after the filing of the form. *See* Proposing Release, *supra* note 2, at paragraph accompanying n.245.

because of its competitive effects on funds or fund managers. Three commenters argued that the information to be provided on the form is proprietary, sensitive, or confidential in nature.[323] Others expressed concern that making the information public could result in "investor confusion."[324] Two other commenters, however, supported making Form N-MFP information available to the public on a delayed basis.[325] One of them emphasized the positive effect that public disclosure can have on portfolio management practices.[326]

We believe commenters overstated the *competitive* risks for money market funds of public access to the fund's information. As we discussed in the Proposing Release, the risks of trading ahead of funds are severely curtailed in the context of money market funds, because of the short-term nature of money market fund investments and the restricted universe of eligible portfolio securities.[327] For similar reasons, we believe that the potential for "free riding" on a money market fund's investment strategies, *i.e.*, obtaining for free the benefits of fund research and investment strategies, is minimal. Because shares of money market funds are ordinarily purchased and redeemed at the stable price per share, we believe that there would be relatively few opportunities for profitable arbitrage by investors. Moreover, most funds currently disclose

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[323] *See* BlackRock Comment Letter; Federated Comment Letter; T. Rowe Price Comment Letter.

[324] *See, e.g.*, Fidelity Comment Letter; GE Asset Mgt. Comment Letter; Vanguard Comment Letter. Some commenters stated that the monthly fund website postings would provide sufficient transparency for investors. *See, e.g.*, Fifth Third Comment Letter; ICI Comment Letter; Vanguard Comment Letter.

[325] *See* Fund Democracy/CFA Comment Letter; Comment Letter of J.P. Morgan Investor Services Co. (Sept. 4, 2009).

[326] *See* Fund Democracy/CFA Comment Letter.

[327] *See* Proposing Release, *supra* note 2, at n.379 and accompanying and following text; ICI REPORT, *supra* note 14, at 93 ("Because of the specific characteristics of money market funds and their holdings … the frontrunning concerns are far less significant for this type of fund. For example, money market funds' holdings are by definition very short-term in nature and therefore would not lend themselves to frontrunning by those who may want to profit by trading in a money market fund's particular holdings. Rule 2a-7 also restricts the universe of Eligible Securities to such an extent that frontrunning, to the extent it exists at all, tends to be immaterial to money market fund performance.").

their *current* portfolios on their websites, and much of the information contained in Form N-MFP is already available through other publicly available filings with the Commission, albeit on a less frequent basis.[328]

Second, many commenters objected to the disclosure of the *market-based* values of portfolio securities and of fund net asset value per share, because of the possible destabilizing effects on money market funds. These commenters stated that disclosure of market-based values would result in investor confusion and alarm that could result in redemption requests that exacerbate pricing deviations.[329] One commenter supported the disclosure of market-based net asset values, stating that the disclosure could provide discipline to managers operating their funds near the level of breaking the buck, and would level the informational playing field for less sophisticated investors.[330] Another commenter supported only the public disclosure of market-based *portfolio securities* values.[331]

We appreciate the risks that are involved with the real-time public disclosure of a fund's market-based portfolio and net asset values. Money market funds normally pay redeeming shareholders $1.00 per share even if their market-based net asset value is less than $1.00. These redemptions can hurt the fund's remaining shareholders because the realized and unrealized losses are spread across fewer shares, further depressing the fund's market-based net asset value. If enough shareholders redeem shares under these conditions, the fund, absent a capital

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328 As noted above, money market funds must provide a full schedule of their portfolio holdings in quarterly filings to the Commission. *See supra* note 287.

329 *See, e.g.*, ABA Comment Letter; T. Rowe Price Comment Letter; USAA Comment Letter (redemptions might lead to greater volatility in cash flows and increase the instability of the fund). In addition, one commenter stated that the investor confusion might result in additional costs for funds due to the need to answer investor inquiries. *See* Dreyfus Comment Letter.

330 *See* Shadow FRC Comment Letter.

331 *See* Clearwater Comment Letter.

contribution by its investment adviser or another person, can break the buck, causing remaining shareholders to receive less than $1.00 per share. We believe that many institutional investors are currently well aware of this dynamic. If more shareholders understand the mechanical relationship between shareholder redemptions and market-based net asset value, the disclosure of a market-based net asset value below $1.00 might precipitate a run on the fund. If one fund were to fail for this reason, runs might develop in other money market funds, even those with relatively high market-based net asset values.

Notwithstanding these risks, we believe that shareholders will benefit from knowing the monthly market-based net asset values of money market funds.[332] We anticipate that the public availability of these values will help investors make better informed decisions about whether to invest, or maintain their investments, in money market funds. This disclosure will indicate the extent to which the fund is managing its portfolio to achieve its fundamental objective of maintaining a stable net asset value. In addition, if market-based prices indicate significant risks in a fund's portfolio, investors, advisers and others can have a more meaningful dialogue with the fund's manager about such risks and any plans the fund manager may have to address any discounts between the market-based net asset value and the stable net asset value. This type of dialogue already takes place between sophisticated investors and funds that disclose portfolio information on a current basis. These sophisticated, often institutional, investors have the resources to estimate current market values and make purchase and redemption decisions on the basis of information that, in the past, has been beyond the reach of most retail investors.

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[332] Adequate disclosure to investors is a fundamental principle of the Commission's regulatory mandate. *See*, *e.g.*, section 1(b), 1(b)(1) of the Investment Company Act ("[N]ational public interest and the interests of investors are adversely affected … when investors purchase, pay for, exchange, … sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information ….").

As a collateral effect, we expect that the public disclosure of monthly market-based net asset values may have the effect of discouraging a fund's portfolio manager from taking risks that might reduce the fund's market-based net asset value.[333] We also anticipate that such disclosure may lead to greater cash flows into funds that have a smaller discount from the $1.00 NAV (or less historical volatility in that discount). This disclosure, which will provide values that include and exclude the effect of any capital support agreements, might also have the effect of encouraging funds that have affiliates to request financial support or other appropriate measures as soon as problems develop. Such support or other measures could provide greater stability to money market funds.

Nevertheless, we understand commenters' concerns that the disclosure of certain fund information, including market-based values, might result in investor confusion and alarm, at least in the short term, that could result in redemption requests that exacerbate pricing deviations.[334] In response to these and other concerns discussed above, we are delaying the public availability of the information filed on Form N-MFP for 60 days after the end of the reporting period.[335] This 60-day delay in public availability mirrors the current 60-day lag under other rules between the end of a fund's reporting period and the public filing of portfolio information with the Commission.[336] In addition, funds currently are required to file twice a year a public report that includes the fund's market-based net asset value, within 60 days after the end of the reporting

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333 *See* Fund Democracy/CFA Comment Letter ("[G]reater transparency should provide a strong incentive for funds to avoid the excessively risky practices that lead to instability and encourage redemption.").

334 *See supra* note 329 and accompanying text.

335 Rule 30b1-7(b).

336 Funds are required to file each quarter with the Commission portfolio holdings reports, which are available to the public, within 60 days after the end of the quarter. *See supra* note 287.

period.[337]

We anticipate that, during the 60 days between the end of the reporting period and public availability of the information, funds will take steps to resolve issues that may raise concerns with investors and analysts. In addition, because money market fund portfolios have a limited maturity, many of the portfolio securities will have matured by the time the information is released to the public. Thus we expect that the 60-day delay will ameliorate many of the risks associated with public disclosure. We also expect that, over time, investors and analysts will become more accustomed to the information disclosed about fund portfolios, and thus there may be less need in the future to require a 60-day delay between the end of the reporting period and the public availability of the information. We therefore may revisit in a subsequent release whether to retain the same (or any) delay in public availability of this information.

Timing. Each money market fund must submit Form N-MFP electronically to the Commission within five business days after the end of each month.[338] Under the proposed rule, a fund would have been required to file Form N-MFP with the Commission no later than two business days after the end of each month. Commenters asserted that the second business day deadline would not have provided funds enough time to compile, review, and file the requested portfolio information accurately.[339]

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337 Money market funds currently must disclose their mark-to-market net asset value per share, to four decimals, twice a year in their Form N-SAR filings [17 CFR 274.101]. *See* Sub-Item 74W of Form N-SAR. Form N-SAR must be filed with the Commission no later than the 60th day after the end of the fiscal period for which the report is being prepared. *See* General Instruction C to Form N-SAR. Information supplied on Form N-SAR is publicly available on EDGAR and in the public files of the Commission. *See* General Instruction A to Form N-SAR.

338 *See* rule 30b1-7.

339 *See, e.g.*, BlackRock Comment Letter; Dreyfus Comment Letter; Vanguard Comment Letter. The recommended deadlines submitted by commenters ranged from five business days to 15 to 30 business days. We are providing for an extended implementation period before compliance with rule 30b1-7 is required, as discussed below, during which time funds will be able to build or update systems to compile the data and file the new form, test those systems, and possibly

In response to commenters, we are delaying the mandatory filing date for several months after the effective date of the amendments, to permit money market funds to develop systems necessary to collect and submit the portfolio information on Form N-MFP.[340] Thus, the first mandatory filing will be due on December 7, 2010, for holdings as of the end of November 2010. For approximately two months before the first mandatory filing, our staff will accept the submission of trial data so that money market funds may voluntarily make (non-public) electronic submissions with us. We anticipate that these submissions will help money market funds gain experience collecting and submitting the information, and we will use these submissions and the experiences of the funds to make technical adjustments to our systems and provide any guidance. Because of the possibility of errors or mistakes in the information submitted, we do not intend to make the trial data public.

Method of filing. As proposed, Form N-MFP must be filed electronically through the Commission's EDGAR system in an eXtensible Markup Language ("XML") tagged data format.[341] We understand that money market funds already maintain most of the information that will be filed on the form, and therefore the main requirement for funds will be the tagging of the data and filing of the reports with the Commission.[342] Some commenters recommended that the

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participate in the voluntary compliance program. Therefore, we believe that lengthening the deadline to five business days should provide funds sufficient time to compile, review, and file Form N-MFP accurately.

340 Several commenters requested that the Commission allow funds at least six months before mandatory compliance with the new reporting requirement on Form N-MFP. *See, e.g.*, FAF Advisors Comment Letter; ICI Comment Letter; J.P. Morgan Asset Mgt. Comment Letter.

341 We anticipate that the XML interactive data file will be compatible with a wide range of open source and proprietary information management software applications. Continued advances in interactive data software, search engines, and other web-based tools may further enhance the accessibility and usability of the data.

342 We understand that many funds often provide this type of information in different formats to various information services and third-parties, including NRSROs. Standardizing the data format in Form N-MFP may encourage standardization across the industry, resulting in cost savings for

Commission require that Form N-MFP be filed in an eXtensible Business Reporting Language ("XBRL") format.[343] Although XBRL may allow for more comparative analysis or more opportunities for manipulation of data than XML allows, we believe that the data required by Form N-MFP will be clearly defined and often repetitive from one month to the next, and therefore the XML format will provide us with the necessary information in the most timely and cost-effective manner.[344] Over time we expect these filings will become highly automated and involve minimal costs.

3. *Phase-out of Weekly Reporting by Certain Funds*

We are adopting as final rule 30b1-6T, the temporary rule that requires the weekly filing of portfolio information by money market funds in certain circumstances. As adopted, the only change to the rule is the expiration date. Rule 30b1-6T will expire on December 1, 2010, which corresponds with the first filing of portfolio information required by new rule 30b1-7.

In September 2009, we adopted rule 30b1-6T.[345] The rule requires any money market fund that has a market-based net asset value per share below $0.9975 to provide the Commission with weekly portfolio and valuation information. The information required by the rule is similar

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money market funds.

343 *See, e.g.*, Comment Letter of the American Institute of Certified Public Accountants (Sept. 8, 2009); Comment Letter of EDGAR Online, Inc. (July 23, 2009); Comment Letter of XBRL US (Sept. 8, 2009). Most commenters were neutral on the submission format for Form N-MFP. *See, e.g.*, Clearwater Comment Letter; Fund Democracy/CFA Comment Letter; ICI Comment Letter.

344 The XBRL format would require a longer period for implementation by the Commission and funds, and would entail additional costs. However, the XBRL format derives from and is compatible with the XML format. Moreover, to the extent possible, we intend to follow the naming convention for the XBRL-tagging of the Schedule of Investments in the voluntary filer program. *See* Interactive Data for Mutual Fund Risk/Return Summary, Investment Company Act Release No. 28617 (Feb. 11, 2009) [74 Fed. Reg. 7748 (Feb. 19, 2009)]. If the Commission determines at a future date to require the filing of Form N-MFP in an XBRL format, the Commission and funds might benefit from their experience with their existing XML technology.

345 *See* Rule 30b1-6T Release, *supra* note 303. We adopted the rule on an interim final basis. *See id.* at Section II.C.

to the information money market funds participating in the Treasury Department's Guarantee Program were required to provide under similar circumstances.[346] We requested comments on the rule when we adopted it, but received none.[347]

Rule 30b1-6T originally would have expired one year after we adopted it, *i.e.*, on September 17, 2010.[348] The information that rule 30b1-7, which we are adopting today, will require *all* money market funds to file on a monthly basis subsumes the information that funds with lower market-based NAVs were required to file under rule 30b1-6T. Therefore we are phasing out the latter rule, but are extending its expiration date so that we will continue to receive weekly reports until the monthly reporting requirements of rule 30b1-7 are mandatory. After that time, our monitoring of information filed by money market funds on Form N-MFP, as well as notifications of purchases of certain assets from funds in reliance on rule 17a-9 should enable our staff to identify, and analyze information from, money market funds that exhibit signs of distress and the need for further monitoring.[349]

Because the compliance date for filing monthly portfolio information on Form N-MFP is December 7, 2010, we are amending rule 30b1-6T so that it expires on December 1, 2010. The last date that funds will be required to file information under rule 30b1-6T therefore will be on November 30, 2010.

F. Processing of Transactions

We are amending rule 2a-7, substantially as proposed, to require that a fund (or its transfer agent) have the capacity to redeem and sell its securities at a price based on the fund's

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[346] *See* rule 30b1-6T(b)(3). *See also supra* note 16.

[347] *See* Rule 30b1-6T Release, *supra* note 303, at Section III.

[348] Rule 30b1-6T(d).

[349] *See infra* Section II.G.2 (notification provision under amended rule 2a-7 concerning purchases undertaken in reliance on rule 17a-9).

current net asset value per share, including the capacity to sell and redeem shares at prices that do not correspond to the stable net asset value or price per share.[350] This amendment will require that shareholder transactions be processed in an orderly manner, even under circumstances that require a fund to "break a dollar."[351] Other types of mutual funds already have this ability to process transactions at varying prices.

Several commenters supported the proposed amendment, noting that it is important that funds be able to redeem shareholders at prices based on the current net asset value of the fund.[352] Some commenters expressed concerns about the costs for funds to modify their systems under the amendment.[353] We noted when we proposed the amendment that, because funds are already obligated to redeem at a price other than the stable net asset value per share, there should be no new cost associated with the requirement that funds (or their transfer agents) have systems that can meet these requirements.[354] It is the responsibility of money market funds, as issuers of redeemable securities, to be able to satisfy redemption requests within seven days after tender of the securities, even if a fund has re-priced its net asset value at a price other than its stable net asset value per share.[355] Based on our recent experience, we believe it is unlikely that a fund that breaks the dollar would be able to satisfy redemption requests within seven days if it did not

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350 Amended rule 2a-7(c)(13).

351 Once a fund has broken a dollar, the fund could no longer use penny-rounding method of pricing or the amortized cost method of valuing portfolio securities, and therefore would have to compute share price by reference to the market values of the portfolio with the accuracy of at least a tenth of a cent. *See* 1983 Adopting Release, *supra* note 6, at n.6 and accompanying text. Thus, a fund whose market-based net asset value was determined to be $0.994 would, upon ceasing to use the amortized cost method of valuation, begin to redeem shares at $0.994 (rather than at $0.990). *See generally id.*

352 *See, e.g.*, Dreyfus Comment Letter; Fund Democracy/CFA Comment Letter; MFDF Comment Letter.

353 *See, e.g.*, Federated Comment Letter; RidgeWorth Comment Letter.

354 *See* Proposing Release, *supra* note 2, at Section V.A.6 (cost benefit analysis).

355 *See* section 22(e) of the Act.

already have the capacity to process redemptions at prices other than the stable net asset value.[356] To the extent that funds incur costs in meeting the new requirement, we believe the benefits to shareholders justify those costs, which we discuss in detail in the cost benefit section below.[357]

When we proposed the amendment, we proposed to require that the fund's *board of directors determine* that the fund has the capacity to sell and redeem securities at the current net asset value.[358] We asked for comments on the board's role, and specifically whether the rule should require that the fund simply *have* the ability to process transactions at the fund's current net asset value without a specific board determination.[359] Some commenters preferred that the board not be required to make such a determination, arguing that the determination is operational in nature and more appropriate for the fund's investment adviser or chief compliance officer to make.[360] We agree that the focus of the rule should be on the fund's ability to process transactions, rather than on the board's determination regarding that ability, because the issue is operational in nature and need not directly involve the board. We have therefore revised the rule accordingly.[361]

Some commenters raised the issue of whether the rule applies to third-party intermediaries, *i.e.,* whether it requires third parties to have the capacity to process transactions

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356 As we noted in the Proposing Release, the inability of one money market fund in 2008 to be able to process securities at prices other than $1.00 per share impeded its ability to distribute assets during its liquidation. *See* Proposing Release, *supra* note 2, at n.262 and accompanying text. Even if a fund were to break a dollar, decide to liquidate, and suspend redemptions in reliance on new rule 22e-3 that we are adopting today, *see infra* Section II.H, the fund's ability to process redemptions at prices other than the stable net asset value is necessary to facilitate the orderly liquidation of the fund.

357 *See infra* Section V.

358 Proposed rule 2a-7(c)(1) (last two sentences).

359 *See* Proposing Release, *supra* note 2, at text following n.263.

360 *See*, *e.g.*, Federated Comment Letter; MFDF Comment Letter; NYC Bar Assoc. Comment Letter.

361 As adopted, the new requirement is paragraph (c)(13) of amended rule 2a-7, titled "Processing of Transactions."

in a money market fund at prices other than the fund's stable net asset value.[362] The rule by its terms applies only to money market funds and their transfer agents. We note, however, that intermediaries themselves typically have separate obligations to investors with regard to the distribution of proceeds received in connection with investments made or assets held on behalf of those investors.[363]

Several commenters requested that, if the Commission adopted the rule amendment, it provide ample time for money market funds to change their systems to accommodate purchases and redemptions at the current net asset value.[364] We have established a compliance date of October 31, 2011, which is approximately 18 months after the *effective* date of the rule amendments, and more than 20 months after adoption of the amendments. This compliance period is designed to enable funds and those who act on their behalf sufficient time to come into full compliance with the amended rule.

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362 *See, e.g.*, Tamarack Funds Comment Letter (requesting that the Commission clarify that funds "are not responsible for ensuring that intermediaries have the capacity to effect share transactions at other than $1.00"); Russell Inv. Comment Letter (stating that the proposed rule amendment would not apply to intermediaries); *see also* ICI Comment Letter ("proposed amendments are silent with respect to ... similar systems changes for broker-dealers, banks, insurance companies, trusts, 401(k) recordkeepers, and others that process such amendments"). Some commenters raised concerns about the costs that third parties might bear to revise their computer systems to have the capacity to accommodate purchases and redemptions of money market fund shares at prices other than the fund's stable net asset value. *See, e.g.*, ICI Comment Letter.

363 *Cf.* rule 15c3-3(e)(3) under the Securities Exchange Act [17 CFR 240.15c3-3(e)(3)] (requiring broker-dealers to periodically re-compute the value of bank accounts held on behalf of broker-dealer customers); rule 15c3-2 under the Securities Exchange Act [17 CFR 240.15c3-2] (prohibiting a broker-dealer from using proceeds from free credit balances unless the proceeds are payable on demand of the customer). *See also Gilman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 404 N.Y.S.2d 258, 262 (N.Y. Sup. Ct. 1978) (holding that after an investment is sold and proceeds belonging to the customer come into the broker's possession, the broker becomes a fiduciary with respect to those proceeds and may not consciously use them to the detriment of his customer and for his own benefit).

364 *See, e.g.*, Federated Comment Letter (requesting at least one year); ICI Comment Letter (requesting at least two and a half years); SIFMA Comment Letter (requesting an "adequate period of time").

G. Exemption for Affiliate Purchases

The Commission is adopting an amendment to rule 17a-9 under the Investment Company Act to expand the circumstances under which certain affiliated persons can purchase portfolio securities from a money market fund.[365] The amendment permits money market funds to dispose of distressed securities (*e.g.*, securities depressed in value as a result of market conditions) quickly during times of market stress. The Commission is also adopting a related amendment to rule 2a-7, which requires funds to report all such transactions to the Commission.

1. *Expanded Exemptive Relief*

We are adopting the amendment to rule 17a-9, as proposed. The amendment expands the exemption provided by the rule from the Act's prohibition on affiliated transactions to permit affiliated persons to purchase from a money market fund a portfolio security that has defaulted,[366] but that continues to be an eligible security, as long as the conditions of the rule governing the purchase price are satisfied.[367] These conditions require that the purchase price is paid in cash

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365 Rule 17a-9 provides an exemption from section 17(a) of the Act to permit affiliated persons of a money market fund to purchase distressed portfolio securities from the fund. Absent a Commission exemption, section 17(a)(2) prohibits any affiliated person or promoter of or principal underwriter for a fund (or any affiliated person of such a person), acting as principal, from knowingly purchasing securities from the fund. Rule 17a-9 exempts certain purchases of securities from a money market fund from section 17(a), if the purchase price is equal to the greater of the security's amortized cost or market value (in each case, including accrued interest). For convenience, in this Release we refer to all of the persons who would otherwise be prohibited by section 17(a)(2) from purchasing securities of a money market fund as "affiliated persons." "Affiliated person" is defined in section 2(a)(3) of the Act.

366 The rule excludes an immaterial default unrelated to the financial condition of the issuer, which would make the rule unavailable in the case of defaults that are technical in nature, such as where the obligor has failed to provide a required notice or information on a timely basis. *See* Proposing Release, *supra* note 2, at n.272. Other provisions of rule 2a-7 currently except immaterial defaults unrelated to the financial condition of the issuer. *See* amended rule 2a-7(c)(7)(ii)(A).

367 *See* amended rule 17a-9(a). Previously, the exemption was available only for the purchase of a portfolio security that was no longer an "eligible security." This could occur, for example, when a security's ratings are downgraded. As we explained in the Proposing Release, this limitation served as a proxy indicating that the market value of the security was likely less than its amortized cost value, and thus the resulting transaction was fair to the fund and did not involve overreaching. *See* Proposing Release, *supra* note 2, at n.269 and accompanying text.

and is equal to the greater of the security's amortized cost or its market value, including accrued interest.[368]

We are adding a new provision to the rule that will more broadly permit affiliated persons, under the same conditions as discussed above, to purchase other portfolio securities from an affiliated money market fund, for any reason, provided that such person promptly remits to the fund any profit it realizes from the later sale of the security.[369] In these circumstances there may not be an objective indication that the security is distressed and thus that the transaction is clearly in the interest of the fund. Therefore, as proposed, we have added the "claw back" requirement to eliminate incentives for fund advisers and other affiliated persons to buy securities for reasons other than protecting fund shareholders from potential future losses.

Commenters supported the proposed amendment, agreeing that it would provide money market fund advisers with important flexibility to manage fund assets for the benefit of all shareholders during volatile periods.[370] One commenter opposed the proposed amendment out of concern that the expansion of the rule may exacerbate the unwarranted expectation of some shareholders that advisers will take whatever steps are necessary to financially support the $1.00 share price of their money market funds.[371] While we appreciate the commenter's concern, we do not believe that today's action will materially change shareholders' perceptions about money market funds or the likelihood of sponsor support during times of market turmoil. The amendment simply extends the existing rule to types of transactions that historically have been permitted through no-action assurances obtained from the Commission's staff because the staff

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368 *See* amended rule 17a-9(a)(1)-(2).

369 *See* amended rule 17a-9(b)(1)-(2).

370 *See*, *e.g.*, Dreyfus Comment Letter; Vanguard Comment Letter.

371 *See* Federated Comment Letter.

believed they were in the best interest of the fund's shareholders.[372]

The amendment to rule 17a-9 that we are adopting today is intended to enable advisers to address acute credit or liquidity problems in a money market fund portfolio by purchasing securities from the fund that would be difficult or impossible to sell on the open market at or near their amortized cost. We have crafted the conditions of the rule, including the pricing conditions and the new claw back provision, to protect shareholders' interests and prevent overreaching by advisers. Our staff's experience is that, under such circumstances, these transactions appear to be fair and reasonable and in the best interests of fund shareholders.[373] Moreover, we believe that the alternative of funds obtaining no-action assurances from the Commission staff for these transactions, particularly during times of market stress, is time consuming and inefficient.

2. *New Reporting Requirement*

We also are adopting an amendment to rule 2a-7 to require a money market fund whose securities have been purchased by an affiliated person in reliance on rule 17a-9 to provide us with prompt notice by electronic mail of the transaction and the reasons for the purchase.[374] Such reasons might include, for example, that the fund's adviser expected that the security would be downgraded, that due to the decreased market value of the security the fund was at risk of breaking the buck, or that the fund was experiencing significant redemption requests and wished to avoid a "fire sale" of assets to satisfy such requests. The amendment is intended to provide us with more complete information about these transactions and to alert us to potential problems the

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[372] *See* Proposing Release, *supra* note 2, at nn.270-71 and preceding, accompanying, and following text.

[373] *See* Proposing Release, *supra* note 2, at text following n.271.

[374] Amended rule 2a-7(c)(7)(iii)(B). We have clarified that not only purchases by affiliated persons, but also purchases by promoters and principal underwriters of a fund, and any affiliated person of such persons, which are exempt under rule 17a-9, must be reported to the Commission under the provision. *Compare* amended rule 2a-7(c)(7)(iii)(B) *with* proposed rule 2a-7(c)(7)(iii)(B).

fund may be experiencing.

All commenters who addressed the proposed reporting requirement agreed with the need to provide the Commission with this information.[375] At the suggestion of one,[376] we have modified the requirement to provide that the notification must include the price at which the transaction was conducted and the amortized cost value of the security (which will be different if the market value is higher than the amortized cost), which will help us monitor whether the pricing conditions of rule 17a-9 have been satisfied.[377]

H. Fund Liquidation

The Commission is adopting new rule 22e-3, which exempts money market funds from section 22(e) of the Act to permit them to suspend redemptions and postpone payment of redemption proceeds in order to facilitate an orderly liquidation of the fund. The rule permits a fund to suspend redemptions and payment of redemption proceeds if (i) the fund's board, including a majority of disinterested directors, determines that the deviation between the fund's amortized cost price per share and the market-based net asset value per share may result in material dilution or other unfair results, (ii) the board, including a majority of disinterested directors, irrevocably has approved the liquidation of the fund, and (iii) the fund, prior to suspending redemptions, notifies the Commission of its decision to liquidate and suspend

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375 *See, e.g.*, BlackRock Comment Letter, Dreyfus Comment Letter. One suggested that sales prices of any securities purchased by the adviser pursuant to rule 17a-9 be promptly reported to the fund's board of directors as well as to the Commission. Comment Letter of the Independent Trustees of Fidelity Fixed Income Funds (Sept. 8, 2009) ("Fidelity Fixed Income Indep. Trustees Comment Letter"). We are not extending the reporting provision to include notification to fund boards because the provision is intended to enable the Commission to monitor how rule 17a-9 is being used. Nevertheless, we expect that fund boards will want to know this information and will request it.

376 *See* Fidelity Fixed Income Indep. Trustees Comment Letter.

377 *See* amended rule 2a-7(c)(iii)(B).

redemptions.[378] The new rule replaces rule 22e-3T, a temporary rule that provided a similar exemption for money market funds that participated in the Treasury Department's Guarantee Program.[379]

Rule 22e-3 is intended to reduce the vulnerability of investors to the harmful effects of a run on the fund, and minimize the potential for disruption to the securities markets. Because the suspension of redemptions may impose hardships on investors who rely on their ability to redeem shares, the conditions of the rule limit the fund's ability to suspend redemptions to circumstances that present a significant risk of a run on the fund and potential harm to shareholders. The rule is designed only to facilitate the permanent termination of a fund in an orderly manner. We are revising one of the conditions of the rule, which requires that the board approve the liquidation of the fund, to provide that the fund board must have *irrevocably* approved the liquidation of the fund.[380]

Commenters generally supported the rule, which we are adopting largely as proposed.[381] We have revised one of the rule's conditions in response to commenters' concerns. The

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378 Rule 22e-3(a). A fund that intends to be able to rely on rule 22e-3 may also need to update its prospectus to disclose the circumstances under which it may suspend redemptions. *See, e.g.*, Item 6 of Form N-1A ("Purchase and Sale of Fund Shares").

379 *See* Temporary Exemption for Liquidation of Certain Money Market Funds, Investment Company Act Release No. 28487 (Nov. 20, 2008) [73 FR 71919 (Nov. 26, 2008)]. The Treasury Department's Guarantee Program guaranteed that shareholders of a participating money market fund would receive the fund's stable share price for each share owned as of September 19, 2008, if the fund were to liquidate under the terms of the Program. *See supra* note 16 and accompanying text. The Program expired on September 19, 2009, and rule 22e-3T expired on October 18, 2009.

380 Rule 22e-3(a)(2). This revision is designed to limit the availability of the rule to extraordinary circumstances, by preventing a fund from invoking the rule if the board determines to liquidate the fund but subsequently revokes its determination, which might, in effect, enable the fund to temporarily suspend redemptions.

381 Commenters generally agreed that the rule would facilitate fair and orderly liquidations to the benefit of all fund shareholders. *See, e.g.*, IDC Comment Letter; MFDF Comment Letter.

proposed rule conditioned its relief on a fund breaking a dollar and re-pricing its shares.[382] Some commenters argued that the rule should allow a fund to suspend redemptions before it breaks a dollar.[383] We are concerned that, without appropriate limits, fund sponsors might use the rule in the course of routine liquidations. We also recognize, however, that requiring a money market fund to actually re-price its securities may not be necessary in order to warrant the suspension of redemptions. Therefore, we have revised the rule's condition to require that the fund's board of directors, including a majority of disinterested directors, determine pursuant to rule 2a-7(c)(8)(ii)(C)[384] that the extent of the deviation between the fund's amortized cost price per share and its shadow price may result in material dilution or other unfair results to investors or existing shareholders.[385] In order to invoke the exemption, therefore, the fund's board must make the same determination that it would make if it were deciding to break a dollar. We believe the revised condition provides fund directors with the appropriate amount of discretion to act in the interest of shareholders.[386]

Paragraph (b) of rule 22e-3 allows a conduit fund (*i.e.,* a fund that invests in a money market fund) to rely on the rule if the money market fund in which it invests has suspended

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382 Proposed rule 22e-3(a)(1).

383 *See, e.g.*, ABA Comment Letter; ICI Comment Letter; IMMFA Comment Letter.

384 Amended rule 2a-7(c)(8)(ii)(C) provides that, if a money market fund's board of directors believes that the deviation between the fund's amortized cost price per share and its shadow price may result in material dilution or other unfair results to investors or existing shareholders, it shall cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent practicable such dilution or unfair results.

385 Rule 22e-3(a)(1).

386 Under the final rule, the exemption applies to securities tendered for redemption but not yet priced at the time the fund begins to rely on the rule. Therefore, for example, if a shareholder submits a redemption order at noon and the fund decides to liquidate and suspend redemptions pursuant to rule 22e-3 at 2:00 pm, the shareholder would be entitled to receive only his or her *pro rata* share of the fund's liquidation proceeds. This is also the case for shareholders who submitted redemption orders after the last time as of which the fund computed its net asset value and shareholders who submitted redemption orders after 2:00 pm.

redemptions under the rule.[387] We anticipated when we proposed this provision that it would be used principally by insurance company separate accounts issuing variable insurance contracts and by funds participating in master-feeder arrangements.[388] At the suggestion of one commenter who pointed out that most insurance company separate accounts are organized as unit investment trusts rather than management companies,[389] we have expanded the rule to include unit investment trusts.[390]

Paragraph (c) of the rule provides that the Commission may take certain steps to protect shareholders. It permits the Commission to rescind or modify the relief provided by the rule (and thus require the fund to resume honoring redemptions) if, for example, a liquidating fund has not devised, or is not properly executing, a plan of liquidation that protects fund shareholders. Under this provision, the Commission may modify the relief after appropriate notice and opportunity for hearing in accordance with section 40 of the Act.[391] Commenters did not address this provision, and we are adopting it as proposed.

One commenter recommended that the rule not require prior notice to the Commission.[392] In light of the seriousness of the consequences to shareholders, we believe it is important that the Commission receive prior notice of a suspension of redemptions, particularly when the burden of providing such notice is minimal.[393] Another commenter suggested that the Commission require

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387 Rule 22e-3(b) also requires that the conduit fund promptly notify the Commission that it has suspended redemptions in reliance on the rule.

388 *See* Proposing Release, *supra* note 2, at text accompanying n.289.

389 *See* Committee Ann. Insur. Comment Letter.

390 Rule 22e-3(b) (providing relief to a "registered investment company" rather than to a "fund," or "registered open-end management investment company," as proposed).

391 Rule 22e-3(c).

392 *See* ABA Comment Letter.

393 In addition, these prior notices will, among other things, help us to ascertain whether a fund has erroneously invoked the rule in circumstances for which it was not intended to be used (*e.g.*, a

funds to disclose their plan of liquidation as a condition for suspending redemptions.[394] We are reluctant to impose such a requirement because the time needed to formulate such a plan may prevent fund boards from acting in a timely fashion in the case of an emergency, but we expect that funds would promptly communicate their plan of liquidation to shareholders. Another commenter recommended that the suspension period be limited to 60 days.[395] We have not modified the final rule in response to these comments because liquidations will proceed differently depending on a fund's particular circumstances, and we believe that fund management, under the supervision of the board, is best able to devise and execute a plan of liquidation that is in the best interest of fund shareholders. Furthermore, as discussed above, the Commission will retain authority under the rule to rescind or modify the relief (after appropriate notice and opportunity for hearing) if we conclude, for example, that a liquidating fund has not devised, or is not properly carrying out, a plan of liquidation that protects fund shareholders.[396]

III. Compliance Dates

The amendments to rules 2a-7, 17a-9 and 30b1-6T, and new rules 22e-3 and 30b1-7, and new Form N-MFP become effective May 5, 2010. Unless otherwise discussed below or in this Release, the compliance date is the date of effectiveness.

Some money market funds may have policies that can be changed only if authorized by a shareholder vote. For example, a money market fund may have a disclosed policy of maintaining a WAM (*i.e.*, weighted average maturity) no greater than 90 days, which is less restrictive than the amendment the Commission is adopting today requiring a money market fund

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routine liquidation).

394 *See* Federated Comment Letter.

395 *See* Bankers Trust Comment Letter.

396 *See supra* note 391 and accompanying paragraph.

to maintain a WAM no greater than 60 days.[397] The Commission believes that, in those circumstances where the existing policy is less restrictive than the amendments we are today adopting and does not conflict with those amendments, a money market fund would not need to hold a shareholder vote under sections 8(b) or 13(a) of the Act merely to comply with the amendments.[398] Moreover, we would not object if a fund were to amend its registration statement to reflect the fund's compliance with the amended rule pursuant to rule 485(b) under the Securities Act of 1933, if other changes in the fund's post-effective amendment meet the conditions for immediate effectiveness under that rule.[399]

A. Portfolio Requirements

Except as indicated below, the compliance date for amendments to rule 2a-7 related to portfolio quality, maturity, liquidity, and repurchase agreements, is May 28, 2010. Funds are not required to dispose of portfolio securities owned, or terminate repurchase agreements entered into, as of the time of adoption of the amendments to comply with the requirements of the rule as amended. Fund portfolios must meet the new maximum WAM and WAL limits by June 30, 2010.

B. Designation of NRSROs

Each fund must disclose the designated NRSROs in its Statement of Additional Information pursuant to amended rule 2a-7(a)(11)(iii) no later than December 31, 2010. This additional time should permit fund boards of directors to evaluate and designate NRSROs without the need to call a special board meeting. Fund boards are free to take advantage of the rule amendments any time after the effective date.

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397 *See supra* Section II.B.1.

398 15 U.S.C. 80a-8(b), 80a-13(a).

399 17 CFR 230.485(b).

C. Disclosure and Reporting of Portfolio Information

Website disclosure. The compliance date for public website disclosure is October 7, 2010. This should provide each fund sufficient time to revise its information and other systems to ensure that required information is accurately posted and maintained on its website.

Reporting to the Commission. All money market funds must begin filing information on Form N-MFP pursuant to rule 30b1-7 no later than December 7, 2010. This compliance date is designed to permit money market funds to develop systems necessary to collect and submit the portfolio information on Form N-MFP. Funds filing information with the Commission pursuant to rule 30b1-6T will no longer be required to file this information after December 1, 2010.

Beginning October 7, 2010, our staff will be able to receive trial data from funds, on a voluntary basis, pursuant to the requirements of rule 30b1-7. We will use these voluntary submissions and the experiences of funds during this period to make adjustments to our filing system and provide guidance to funds. We do not intend to make these submissions public.[400]

D. Processing of Transactions

Funds must comply with the new requirement to be able to process transactions at prices other than stable net asset value no later than October 31, 2011, which is more than 20 months after adoption of the amendments.[401] This compliance period is designed to enable funds and those who act on their behalf sufficient time to come into full compliance with the amended rule.

IV. Paperwork Reduction Act Analysis

Certain provisions of the amendments to rules 2a-7 and 30b1-6T, new rules 22e-3 and 30b1-7, and Form N-MFP under the Investment Company Act contain "collections of

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400 We do not intend to make public the information submitted to us on Form N-MFP as trial data before the mandatory compliance date because of the possibility of errors in the information submitted. *See supra* text following note 339.

401 *See supra* text accompanying and following note 364.

information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[402] The titles for the existing collections of information that are affected by the rule amendments are: "Rule 2a-7 under the Investment Company Act of 1940, Money market funds" (OMB Control No. 3235-0268), "Rule 30b1-6T under the Investment Company Act of 1940, Weekly portfolio report for certain money market funds" (OMB Control No. 3235-0652), and "Rule 38a-1 under the Investment Company Act of 1940, Compliance procedures and practices of registered investment companies" (OMB Control No. 3235-0586). The titles for the new collections of information are: "Rule 22e-3 under the Investment Company Act of 1940, Exemption for liquidation of money market funds," "Rule 30b1-7 under the Investment Company Act of 1940, Monthly report for money market funds," and "Form N-MFP under the Investment Company Act of 1940, Portfolio Holdings of Money Market Funds." We published notice soliciting comments on the collection of information requirements in the Proposing Release and submitted the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11 under the control numbers 3235-0268 (rule 2a-7), 3235-0654 (rule 22e-3), and 3235-0653 (rule 30b1-6 and Form N-MFP). OMB has approved the collection of information pursuant to rule 30b1-6T under the control number 3235-0652.

Our amendments and new rules are designed to make money market funds more resilient to risks in the short-term debt markets, and to provide greater protections for investors in a money market fund that is unable to maintain a stable net asset value. 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.

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402 44 U.S.C. 3501-3521.

A. Rule 2a-7

Rule 2a-7 under the Investment Company Act exempts money market funds from the Act's valuation requirements, permitting money market funds to maintain stable share pricing, subject to certain risk-limiting conditions. As discussed above, we are amending rule 2a-7 in several respects. Our amendments revise portfolio quality and maturity requirements; introduce liquidity requirements; require money market fund boards to adopt procedures providing for periodic stress testing of the fund's portfolio; require funds to disclose monthly on their websites information on portfolio securities; and finally, require money market funds to have the capability to redeem and issue their securities at prices other than the fund's stable net asset value per share.[403] Several of the amendments create new collection of information requirements. The respondents to these collections of information will be money market funds or their advisers, as noted below.

1. Designation of NRSROs

Under the amendments to rule 2a-7, money market funds will be required to disclose designated NRSROs (including any limitation in the use of the designated NRSRO) in their SAI,[404] which constitutes a collection of information. Compliance with this disclosure requirement will be mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a-7. This information will not be kept confidential. The disclosures are intended to provide investors and third party analysts with information on NRSROs that money market funds will look to when they have to consider credit ratings under rule 2a-7, which may be relevant to investors in choosing among funds. Many money market funds currently discuss credit rating agencies in their registration statements describing threshold credit ratings for

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403 *See supra* Section II.A-F.

404 Amended rule 2a-7(a)(11)(iii).

portfolio investments, and often specify NRSROs that rate instruments of the type the fund purchases. We anticipate that adding one or two sentences to the discussion identifying designated NRSROs (and any limitations on the use of a designated NRSRO) will not result in additional hourly burdens or printing costs beyond those currently approved in the existing collection of information titled "Form N-1A under the Securities Act of 1933 and under the Investment Company Act of 1940, registration statement of open-end management investment companies" (OMB Control No. 3235-0307).

2. Portfolio Liquidity

As discussed above, the amended rule includes a general liquidity requirement, under which each money market fund must hold securities that are sufficiently liquid to meet foreseeable shareholder redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders. We also noted that in order to comply with this provision in amended rule 2a-7 under the compliance rule, we expect that money market funds will adopt policies and procedures designed to assure that appropriate efforts are undertaken to identify risk characteristics of the fund's shareholders.[405] We anticipate that these policies and procedures may add additional burdens to those currently approved in the existing collection of information under rule 38a-1 under the Investment Company Act. Based on commenters' views, we assume that money market funds currently monitor and manage daily net flows in and out of the funds,[406] and in doing so, monitor the risk characteristics and likely redemptions of certain shareholders, which is a factor we would expect funds to consider under the general liquidity requirement in the amended rule. We believe, however, that many, if not most, funds may have to document the procedures they adopt for the compliance rule. For

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[405] *See supra* note 198 and accompanying text.

[406] *See* Dreyfus Comment Letter; RidgeWorth Comment Letter.

purposes of this PRA analysis, we estimate that funds would incur a one-time average burden of 8 hours to document policies and procedures to identify risk characteristics of the fund's investors. In addition, staff estimates that the board of directors (as a whole) would take 1 hour to review and adopt these policies and procedures. Amortized over a 3 year period, this would be an annual burden per fund complex of 3 hours. We believe that these characteristics would be applicable to and documented on behalf of all money market funds in a fund complex, and we estimate that 163 fund complexes with money market funds are subject to rule 2a-7. Accordingly, we estimate that the total additional burden to document these policies would be 1467 hours.[407] Amortized over a 3 year period, the estimated annual hourly burden would be 489 hours for all money market fund complexes.[408] We believe that any ongoing burdens to reevaluate the need for changes in the policies and procedures would be incorporated in the current estimated burdens for rule 38a-1.

3. *Stress Testing*

We are requiring, substantially as proposed, that a money market fund's board of directors adopt written procedures that provide for the periodic testing of the fund's ability to maintain a stable net asset value per share based on certain hypothetical events.[409] The rule requires the board to determine the frequency of testing. The procedures must provide for a report of the testing results to be submitted to the board of directors at its next regularly

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407 This estimate is based on the following calculation: (8 + 1) hours x 163 fund complexes = 1467 hours.

408 PRA submissions for approval are made every three years. To estimate an annual burden for a collection of information that occurs one time, the total burden is amortized over the three-year period.

409 *See supra* Section II.C.4. These events include, without limitation, a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund. *See* amended rule 2a-7(c)(10)(v)(A).

scheduled meeting, or sooner if appropriate based on the results. The report must include an assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.[410] Compliance with the new reporting requirement is mandatory for any fund that holds itself out as a money market fund and uses either the amortized cost method of valuing portfolio securities or the penny-rounding method of pricing fund shares. When provided to the Commission in connection with staff examinations or investigations, the information will be kept confidential to the extent permitted by law.

We anticipate that stress testing will give fund advisers a better understanding of the effect of potential market events and shareholder redemptions on their funds' ability to maintain a stable net asset value, the fund's exposure to the risk of not maintaining a stable net asset value, and actions the adviser may need to take to mitigate the possibility of the fund breaking the buck.[411]

Commission staff believes that in light of the events of the fall of 2008, most, if not all, money market funds currently conduct some stress testing of their portfolios as a matter of routine fund management and business practice.[412] These procedures likely vary depending on

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410 Amended rule 2a-7(c)(10)(v)(B). The report to the board must include the dates on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes that reflect current market conditions) from its net asset value per share calculated using amortized cost to exceed ½ of 1%.

411 *See* Proposing Release, *supra* note 2, at text following n.212.

412 Commenters corroborated our staff's belief. *See, e.g.*, State Street Comment Letter; T. Rowe Price Comment Letter. The estimates of hour burdens and costs provided in the PRA and cost benefit analyses in the Proposing Release were based on staff discussions with representatives of money market funds and on the experience of Commission staff. We did not receive any comment on the estimates and assumptions with respect to stress testing included in the analysis in our proposal. Accordingly, we have not modified any of those assumptions and estimates other than as necessary in light of the new requirement included in the amended rule.

the fund's investments. For example, a prime money market fund that is offered to institutional investors may test for hypothetical events such as potential downgrades or defaults in portfolio securities while a U.S. Treasury money market fund might not.[413] Some funds that currently conduct testing may be required to include additional hypothetical events under the amended rule. These funds likely provide regular reports of the test results to senior management. We assumed, however, that currently most funds do not have written procedures documenting the stress testing, do not report the results of testing to their boards of directors, and do not provide an assessment from the fund's adviser regarding the fund's ability to withstand the hypothetical events reasonably likely to occur in the next year.

Commission staff believes that stress testing procedures will be developed for all the money market funds in a fund complex by the fund adviser, and will address appropriate variations for individual money market funds within the complex.[414] Staff estimates that it will take a portfolio risk analyst an average of 22 hours initially to draft procedures documenting the complex's stress testing, and 3 hours for the board of directors (as a whole) to consider and adopt the written procedures.[415] We therefore estimate that the total burden to draft these procedures initially will be 4075 hours.[416] Amortized over a three-year period, this will result in an average annual burden of 8.33 hours for an individual fund complex and a total of 1358 hours for all fund

413 *See* TDAM Comment Letter (noting that testing Treasury funds for downgrades or defaults would be unnecessary).

414 We expect that the board of directors would be the same for all the money market funds in a complex, and thus could adopt the stress test procedures for all money market funds in the complex at the same meeting.

415 We have added 1 hour to the estimate of 21 hours in the Proposing Release to account for drafting procedures on when additional reports must be provided to the board based on the results of stress testing.

416 This estimate is based on the following calculation: (22 hours + 3 hours) x 163 fund complexes = 4075 hours.

complexes.[417] Staff estimates that a risk analyst will also spend an average of 6 hours per year revising the written procedures to reflect changes in the type or nature of hypothetical events appropriate to stress tests and the board will spend 1 hour to consider and adopt the revisions, for a total annual burden of 1141 hours.[418]

As noted above, each report to the board of directors will include an assessment by the fund's adviser of the funds' ability to withstand reasonably likely hypothetical events in the coming year. Staff estimates that it will take on average: (i) 10 hours of portfolio management time to draft each report to the board and 2 hours of an administrative assistant's time to compile and copy the report (for a total of 12 hours), and (ii) 15 hours for the fund adviser to provide its assessment. Under normal circumstances, the report must be provided at the next scheduled board meeting, and we estimate that the report and the adviser's assessment will cover all money market funds in a complex. We assume that funds will conduct stress tests no less than monthly. With an average of 6 board meetings each year, we estimate that the annual burden for regularly scheduled reports would be 162 hours for an individual fund complex.[419] Under the final rule, a report must be provided earlier if appropriate in light of the results of the test. Staff estimates that as a result of unanticipated changes in market conditions or other events, stress testing results are likely to prompt additional reports on average four times each year.[420] Thus, we

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[417] These estimates are based on the following calculations: (22 + 3) ÷ 3 = 8.33 hours; 8.33 x 163 fund complexes = 1357.79 hours. PRA submissions for approval are made every three years. To estimate an annual burden for a collection of information that occurs one time, the total burden is amortized over the three-year period.

[418] This estimate is based on the following calculation: (6 hours (analyst) + 1 hour (board)) x 163 fund complexes = 1141 hours.

[419] This estimate is based on the following calculation: (10 hours + 2 hours + 15 hours) x 6 meetings = 162 hours.

[420] We anticipate that in many years there will be no need for special reports, but that in a year in which there is severe market stress, a fund may report to the board weekly for a period of 3 to 6 months. Such reporting would generate 9 to 18 reports in addition to the regular monthly reports.

estimate these reports would result in an additional 108 hours for an individual fund complex each year.[421] We estimate the total annual burden for all fund complexes would be 44,010 hours.[422]

The amended rule requires a money market fund to retain records of the reports on stress tests for at least 6 years (the first two in an easily accessible place).[423] The retention of these records is necessary to allow the staff during examinations of funds to determine whether a fund is in compliance with the stress test requirements. We estimate that the burden will be 10 minutes per fund complex per report to retain these records for a total annual burden of 272 hours for all fund complexes.[424]

Thus, we estimate that for the three years following adoption, the average annual burden resulting from the stress testing requirements will be 287 hours for each fund complex with a total of 46,781 hours for all fund complexes.[425]

4. Repurchase Agreements

We are adopting, as proposed, amendments affecting a money market fund's ability to "look through" a repurchase agreement for purposes of rule 2a-7's diversification provisions.[426]

Assuming that this type of event may occur once every five years, and additional reports would be generated for 6 months, a fund would produce an average of four additional reports per year (18 additional reports ÷ 5 = 3.6 reports).

421 This estimate is based on the following calculation: (10 hours + 2 hours + 15 hours) x 4 = 108 hours.

422 This estimate is based on the following calculation: (162 hours + 108 hours) x 163 fund complexes = 44,010 hours.

423 Amended rule 2a-7(c)(11)(vii).

424 This estimate is based on the following calculation: 0.1667 hours x 10 reports x 163 fund complexes = 271.7 hours.

425 These estimates are based on the following calculations: 8.33 hours (draft procedures) + 7 hours (revise procedures) + 120 hours (10 reports) + 150 hours (10 assessments) + 1.67 hours (record retention) = 287 hours; 287 hours x 163 complexes = 46,781 hours.

426 *See supra* Section II.D; Proposing Release, *supra* note 2, at Section II.E.

One of these amendments is that a money market fund will be able to look through a repurchase agreement only if the fund's board of directors or its delegate evaluates the counterparty's creditworthiness.[427]

Several commenters stated that money market fund boards already evaluate the credit quality of counterparties in the course of making an overall credit risk determination under rule 2a-7(c)(3)(i).[428] Because we are adding a separate creditworthiness evaluation in rule 2a-7(c)(4)(ii)(A), funds will need to keep records of such evaluations pursuant to rule 2a-7(c)(11)(ii), which requires a money market fund to retain a record of considerations and actions under the rule for at least 6 years (the first two in an easily accessible place).[429] Compliance with this recordkeeping requirement is mandatory for all funds that take advantage of the special look-through treatment for diversification purposes. We estimate that the burden to keep those records will be 2 hours per fund complex, for a total annual burden of 326 hours for all fund complexes.[430]

5. *Public Website Posting*

The amendments require money market funds to post monthly portfolio information on their websites.[431] We believe that greater transparency of fund portfolios will provide investors with a better understanding of the fund's investment risks, and may allow investors to exert influence on risk-taking by fund advisers and thus reduce the likelihood that a fund will break the buck. Information will be posted on a public website, and compliance with this requirement is mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a-7. In

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427 Amended rule 2a-7(c)(4)(ii)(A).

428 *See supra* note 277.

429 Amended rule 2a-7(c)(11)(ii).

430 This estimate is based on the following calculation: 2 hours x 163 fund complexes = 326 hours.

431 Amended rule 2a-7(c)(12).

the Proposing Release, Commission staff estimated that there are approximately 750 money market funds that would be affected by the amendments. In addition, our staff noted that based on interviews with industry representatives, most money market funds already post portfolio information on their webpages at least quarterly.[432] Commission staff also estimated that 20 percent of money market funds, or 150 funds, do not currently post this information at least quarterly, and therefore would need to develop a webpage to comply with the amendments. Staff estimated that a money market fund would spend approximately 24 hours of internal money market fund staff time initially to develop the webpage. Staff further estimated that a money market fund would spend approximately 4 hours of professional time to maintain and update the relevant webpage with the required information on a monthly basis.

No commenters addressed the number of money market funds that would be affected by the proposal or the estimated burden hours for developing, maintaining and updating the webpage. Although, as described above, we have revised the proposed disclosure which should result in less information being required on a fund's website, Commission staff believes that the number of money market funds is currently 719 and that the hour burden per fund remains the same as previously estimated. Although it is possible that the reduced information required might result in a minimal decrease in the amount of time required to develop, maintain and update the webpage, Commission staff believes that the decrease would be negligible.

One commenter stated that the funds that currently post portfolio holdings information at least quarterly on their websites would need, under the rule amendments, to develop the

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432 Certain of the required information is currently maintained by money market funds for regulatory reasons, such as in connection with accounting, tax, and disclosure requirements. We understand that the remaining information is retained by funds in the ordinary course of business. Accordingly, for the purposes of our analysis, we do not ascribe any time to producing the required information.

capability to retain previous months' portfolio holdings information on their websites, resulting in an additional one-time burden that Commission staff did not include in its estimate in the Proposing Release.[433] Based on a review of some of the current portfolio website disclosure by some commenters and follow-up discussions with some commenters, Commission staff estimates that 500 of the 575 funds that currently post portfolio information on their webpages at least quarterly will need to develop this capability. Commission staff further estimates that each of these 500 funds will spend 12 hours to develop this capability, resulting in an additional one-time burden for all such funds of 6000 hours.[434]

Based on an estimate of 719 money market funds posting their portfolio holdings on their webpages, including 144 funds incurring start-up costs to develop a webpage and 500 funds incurring a one-time cost to develop the capability to retain previous months' portfolio holdings information on their websites, we estimate that, in the aggregate, the amendment will result in a total of 37,664 average burden hours for all money market funds for each of the first three years.[435]

6. Reporting of Rule 17a-9 Transactions

We are amending rule 2a-7 to require a money market fund to promptly notify the

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433 *See* Data Communiqué Comment Letter. Under our proposal, funds would have been required to maintain the portfolio holdings information on their websites for at least 12 months. We are adopting a 6-month maintenance period for portfolio holding information.

434 The estimated 12 hours is one-half the time that we estimated that a fund would need to set up a new webpage (24 hours).

435 The estimate is based on the following calculations. The staff estimates that 144 funds will require a total of 3456 hours initially to develop a webpage (144 funds x 24 hours per fund = 3456 hours) and 500 funds will require a total of 6000 hours initially to develop the capability to maintain historical portfolio holding information (500 funds x 12 hours per fund = 6000 hours). In addition, each of the 719 funds would require 48 hours per year to update and maintain the webpage, for a total of 34,512 hours per year (4 hours per month x 12 months = 48 hours per year; 48 hours per year x 719 funds = 34,512). The average annual hour burden for each of the first three years would thus equal 37,664 hours (3456 + 6000 + (34,512 x 3) ÷ 3).

Commission by electronic mail of the purchase of a money market fund's portfolio security by certain affiliated persons in reliance on rule 17a-9 and to explain the reasons for, and the transaction price of, such purchase.[436] The reporting requirement is designed to assist Commission staff in monitoring money market funds' affiliated transactions that otherwise would be prohibited. The new collection of information will be mandatory for money market funds that rely on rule 2a-7 and that rely on rule 17a-9 for an affiliated person to purchase a money market fund's portfolio security. Information submitted to the Commission related to a rule 17a-9 transaction will not be kept confidential.

We estimate that fund complexes will provide one notice for all money market funds in a particular fund complex holding a distressed security purchased in a transaction under rule 17a-9. As noted above, Commission staff estimates that there are 163 fund complexes with money market funds subject to rule 2a-7. Of these fund complexes, Commission staff estimates that an average of 25 per year will be required to provide notice to the Commission of a rule 17a-9 transaction, with the total annual response per fund complex, on average, requiring 1 hour of an in-house attorney's time. We received no comments on this estimate and have not modified it. Given these estimates, the total annual burden of this amendment to rule 2a-7 for all money market funds would be approximately 25 hours.[437]

7. *Total burden*

The currently approved burden for rule 2a-7 is 310,983 hours. The additional burden hours associated with the proposed amendments to rule 2a-7 will increase the renewal estimate to 395,779 hours annually.[438]

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[436] *See* amended rule 2a-7(c)(7)(iii)(B).

[437] The estimate is based on the following calculation: .(25 fund complexes x 1 hour) = 25 hours.

[438] This estimate is based on the following calculation: 310,983 hours (current burden) + 46,781

B. Rule 22e-3

Rule 22e-3 permits a money market fund that has broken the buck, or is at imminent risk of breaking the buck, to suspend redemptions and postpone the payment of proceeds pending board-approved liquidation proceedings. The rule also requires a money market fund to provide prior notification to the Commission of its decision to suspend redemption and liquidate. Rule 22e-3 is intended to facilitate an orderly liquidation, reduce the vulnerability of shareholders to the harmful effects of a run on a fund, and minimize the potential for market disruption. The notification requirement is a collection of information under the PRA, and is designed to assist Commission staff in monitoring a money market fund's suspension of redemption. The respondents to this information collection would be money market funds that break the buck, or are at imminent risk of breaking the buck, and elect to rely on the exemption afforded by the rule. Respondents also will include certain conduit funds that have invested in money market funds that suspended redemptions in reliance on the rule. Compliance with the notification requirement is mandatory for funds and conduit funds that rely on rule 22e-3, and the information will not be kept confidential.

In the Proposing Release, Commission staff estimated for purposes of the Paperwork Reduction Act that, on average, one money market fund would break the buck and liquidate every six years.[439] The staff further estimated that a fund would spend approximately one hour of an in-house attorney's time to prepare and submit the notice. No commenter addressed the estimated number of money market funds that would rely on the rule or the estimated burden hours associated with complying with the rule's notification requirement. The rule permits funds

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hours (stress testing) + 326 hours (repurchase agreements) + 37,664 hours (website posting) + 25 hours (reporting 17a-9 transactions) = 395,779 hours.

[439] As noted above, only two money market funds have broken the buck since the adoption of rule 2a-7 in 1983.

that invest in a money market fund pursuant to section 12(d)(1)(E) of the Act ("conduit funds") to rely on the rule, and requires the conduit fund to notify the Commission of its reliance on the rule.[440] The proposed rule would have applied only to conduit funds that are registered open-end management investment companies, and in response to one comment we have expanded the provision to also permit conduit funds that are organized as unit investment trusts to rely on the rule.[441] The staff estimates that there are a total of 780 conduit funds that may invest in money market funds that suspend redemptions in reliance on the rule, and that an average of 10 conduit funds may invest in any money market fund.[442] Given these estimates, the total annual burden of proposed rule 22e-3 for all money market funds and conduit funds would be approximately 110 minutes.[443]

C. Monthly Reporting of Portfolio Holdings

Rule 30b1-7 requires money market funds to file electronically a monthly report on Form N-MFP within five business days after the end of each month. The rule is intended to improve transparency of information about money market funds' portfolio holdings and facilitate oversight of money market funds. The information required by the form will be data-tagged in XML format and filed through EDGAR. The respondents to rule 30b1-7 will be investment companies that are regulated as money market funds under rule 2a-7. Compliance with rule 30b1-7 is mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a-7. Responses to the disclosure requirements will not be kept confidential.

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440 *See* rule 22e-3(b).

441 *See supra* note 390 and accompanying text.

442 These estimates are based on a review of filings with the Commission.

443 This estimate is based on the following calculations: (1 hour ÷ 6 years) = 10 minutes per year for each fund and conduit fund that is required to provide notice under the rule. 10 minutes per year x 11 (combined number of affected funds and conduit funds) = 110 minutes.

In the Proposing Release, Commission staff estimated that 750 money market funds would be required by proposed rule 30b1-6 to file, on a monthly basis, a complete Form N-MFP disclosing certain information regarding the fund and its portfolio holdings.[444] No commenters addressed this estimate. For purposes of this PRA analysis, the burden associated with the requirements of rule 30b1-7 has been included in the collection of information requirements of Form N-MFP.

Based on our experience with other interactive data filings, we estimated in the Proposing Release that money market funds would require an average of approximately 40 burden hours to compile, tag, and electronically file the required portfolio holdings information for the first time and an average of approximately 8 burden hours in subsequent filings.[445] Two commenters asserted that the Commission's estimates did not include time to review the information required in Form N-MFP.[446] While the estimate did include time for the review of the information, we nevertheless have increased our estimate to include an additional 2 hours per filing for review of the information to account for a full and careful review of the information to be filed. We now

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444 As noted above, in September 2009 we adopted interim final temporary rule 30b1-6T. In order to minimize confusion over rule numbering, we are adopting proposed rule 30b1-6 as rule 30b1-7.

445 *See* Proposing Release, *supra* note 2, at n.334 and accompanying text. We understand that the required information is currently maintained by money market funds pursuant to other regulatory requirements or in the ordinary course of business. Accordingly, for the purposes of our analysis, we do not ascribe any time to producing the required information.

446 *See* Data Communiqué Comment Letter; Comment Letter of Bowne & Co. Inc. (Oct. 29, 2009) ("Bowne Comment Letter"). In addition, one commenter asserted that the Commission's estimate of 128 burden hours per money market fund for the first year (1 filing x 40 hours + 11 filings x 8 hours) is far too low for subadvised funds. *See* Committee Ann. Insur. Comment Letter. The commenter, however, did not provide an estimate of the first year burden hour for subadvised funds. As explained below in our discussion of the effect the rule and form will have on competition, we do not believe that the one-time burden for subadvised funds will be much different than the burden on non-subadvised money market funds because the information already should be readily available to the subadviser and the lengthened time for filing Form N-MFP (from the proposed two business days to five business days after the end of each month) should provide subadvisers with sufficient time to send the information to the principal adviser without having to invest in new infrastructure to provide the information on a real-time basis. *See also infra* Section VI.D.

estimate that there are 719 money market funds and that they will require an average of approximately 42 burden hours to compile (including review of the information), tag and electronically file the required portfolio holdings information for the first time and an average of approximately 10 burden hours in subsequent filings. Based on these estimates, we estimate the average annual burden over a three-year period would be 131 hours per money market fund.[447] Based on an estimate of 719 money market funds submitting Form N-MFP in interactive data format, each incurring 131 hours per year on average, we estimate that, in the aggregate, Form N-MFP would result in 94,189 burden hours, on average, for all money market funds for each of the first three years.[448]

D. Weekly Reporting of Portfolio Holdings

Rule 30b1-6T requires a money market fund whose market-based net asset value is less than $0.9975 to electronically (i) notify the Commission promptly and submit a portfolio schedule within one business day, and (ii) submit a portfolio schedule within two business days after the end of each week until such time as the fund's market-based net asset value equals or exceeds $0.9975. The rule is intended to facilitate our oversight of money market funds. We are adopting as final rule 30b1-6T. As adopted, the only change to the rule is the expiration date. Rule 30b1-6T will expire on December 1, 2010. The respondents to rule 30b1-6T are investment companies that are regulated as money market funds under rule 2a-7. Compliance with the rule is mandatory for any money market fund whose market-based NAV is less than $0.9975. Responses to the disclosure requirements will be kept confidential.

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447 The staff estimates that a fund will make 36 filings in three years. The first filing will require 42 hours and subsequent filings would require 10 hours each, for an average annual burden of 131 hours (1 filing x 42 hours = 42 hours; 35 filings x 10 hours = 350 hours; 42 hours + 350 hours = 392 hours; 392 hours ÷ 3 years = 130.66 hours). Thereafter, filers generally would not incur the start-up burdens applicable to the first filing.

448 This estimate is based on the following calculation: 719 portfolios x 131 hours = 94,189 hours.

We previously estimated, based on past experience under the Guarantee Program, that at any given time 10 money market funds will be required by rule 30b1-6T to provide weekly reports disclosing certain information regarding the fund's portfolio holdings.[449] We received no comments on our estimates. We estimate that money market funds will require an average of approximately 6 burden hours to compile and electronically submit the initial required portfolio holdings information, and an average of approximately 4 burden hours in subsequent reports.[450] Based on these estimates, we estimate the annual burden will be 210 hours per money market fund that is required to provide the information.[451] Based on an estimate of 10 money market funds submitting information under the rule, we estimate that, in the aggregate, rule 30b1-6T will result in 2100 burden hours for all money market funds required to submit portfolio schedules.

V. COST BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. We have identified certain costs and benefits of the amendments and new rules. We received comments on the Commission's cost benefit analysis of our proposed amendments to rule 2a-7 and on new rule 30b1-7 and Form N-MFP, which are discussed below. The Commission notes that no comments addressed the Commission's analysis of the costs and benefits associated with the proposed amendments to rule 17a-9 and new rule 22e-3 contained in the Proposing Release. We also received no comments on the cost benefit analysis of rule 30b1-6T. As discussed

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449 *See* Rule 30b1-6T Release, *supra* note 303, at Section V.

450 We understand that the required information is currently maintained by money market funds pursuant to other regulatory requirements or in the ordinary course of business. Accordingly, for the purposes of our analysis, we do not ascribe any time to producing the required information.

451 Because one report is required each week, a fund would submit 52 reports in one year. The first report would require 6 hours and subsequent reports would require 4 hours each. The difference between the hours is due to the fact that funds generally would not incur the additional start-up time applicable to the first report. The burden of the reporting requirement would be 210 hours (1 report x 6 hours = 6 hours, 51 reports x 4 hours = 204 hours, and 6 hours + 204 hours = 210 hours).

throughout the release, although there are costs associated with the rules, we think the rules we are adopting will provide significant benefits to the investing public and money market funds. We believe these benefits justify the costs.

A. Rule 2a-7

1. Second Tier Securities, Portfolio Maturity, and Liquidity Requirements

We are adopting several changes to the risk-limiting conditions of rule 2a-7. While we believe that these changes will impart substantial benefits to money market funds, we recognize that they also may also impose certain costs.

First, we are amending rule 2a-7 to further restrict money market funds' exposure to the risks presented by second tier securities. Under the amendments, money market funds will not be permitted to acquire second tier securities unless immediately after their acquisition the money market fund would not have invested (i) more than three percent of its total assets in second tier securities and (ii) more than 0.5 percent of its total assets in second tier securities of any particular issuer.[452] In addition, money market funds will not be permitted to acquire any second tier security with a remaining maturity in excess of 45 days.[453]

Second, we are changing rule 2a-7's portfolio maturity limits. We are reducing the maximum weighted average maturity of a money market fund permitted by rule 2a-7 from 90 days to 60 days.[454] We also are adopting a new 120-day maturity limitation on the "weighted average life" of fund portfolio securities that will limit the portion of a fund's portfolio that can

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452 *See* amended rule 2a-7(c)(3)(ii) (portfolio quality—second tier securities); amended rule 2a-7(a)(27) (defining "total assets"); amended rule 2a-7(c)(4)(i)(C) (portfolio diversification—issuer diversification—second tier securities). We also are proportionately reducing by half the ability of a money market fund to acquire "demand features" or "guarantees" of a single issuer that are second tier securities from 5% to 2.5% of the money market fund's total assets. *See* amended rule 2a-7(c)(4)(iii)(B) and discussion of our rationale for making this change in note 59 *supra*.

453 *See* amended rule 2a-7(c)(3)(ii).

454 *See* amended rule 2a-7(c)(2)(ii).

be held in longer term floating- or variable-rate securities.[455] This restriction will require a fund to calculate the weighted average maturity of its portfolio without regard to interest rate reset dates. Finally, we are deleting a provision in rule 2a-7 that permitted money market funds not relying on the amortized cost method of valuation to acquire Government securities with a remaining maturity of up to 762 calendar days.[456] Under the amended rule, money market funds cannot acquire any security with a remaining maturity of more than 397 days, subject to the maturity shortening provisions for floating- and variable-rate securities and securities with a demand feature.[457]

Third, we are adopting new liquidity requirements for money market funds. In particular, we are amending rule 2a-7 to (i) require that each money market fund hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders;[458] (ii) further limit a money market fund's investments in illiquid securities (*i.e.* securities that cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to them by the money market fund);[459] and (iii) require a taxable money market fund to hold at least 10 percent of its total assets in "daily liquid assets" and any money market fund to hold at least 30 percent of its total assets in "weekly liquid

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455 *See* amended rule 2a-7(c)(2)(iii).

456 *Compare* amended rule 2a-7(c)(2)(i) *with* current rule 2a-7(c)(2)(ii). In a conforming change, we also are amending the maturity-shortening provision of the rule for variable-rate Government securities to require that the variable rate of interest is readjusted no less frequently than every 397 days, instead of 762 days as previously permitted. *See* amended rule 2a-7(d)(1).

457 *See* amended rule 2a-7(c)(2)(i); amended rule 2a-7(d)(1)-(5).

458 *See* amended rule 2a-7(c)(5).

459 *See* amended rule 2a-7(c)(5)(i). Under the amended rule, a money market fund cannot acquire illiquid securities if immediately after the acquisition, the fund would have invested more than five percent of its total assets in illiquid securities.

assets."[460]

a. Benefits

We believe that the amendments to rule 2a-7's risk-limiting conditions are likely to produce broad benefits for money market fund investors. As discussed in Sections II.A-C above, commenters agreed that the proposed rule 2a-7 amendments concerning second tier securities, maturity, and liquidity would benefit money market funds and their investors.[461] The amendments should reduce money market funds' exposure to certain credit, interest rate, spread, and liquidity risks. For example, limiting money market funds' ability to acquire second tier securities will decrease money market funds' exposure to credit, spread, and liquidity risks. Reducing the maximum weighted average maturity of money market funds' portfolios will further decrease their interest rate sensitivity. It also will increase their ability to maintain a stable net asset value in the face of multiple shocks to a money market fund, such as a simultaneous widening of spreads and increase in redemptions, such as occurred during the fall of 2008.[462] Introducing the weighted average life limitation on money market funds' portfolios will limit credit spread risk and interest rate spread risk to funds from longer term floating- or variable-rate securities. In addition, fund portfolios with a lower WAM and a 120-day maximum WAL will turn over more quickly, and the fund will be better able to increase its holdings of highly liquid securities in the face of illiquid markets than funds operating under a maximum 90-day WAM limitation.

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460 *See* amended rule 2a-7(c)(5)(ii)-(iii). *See also* amended rule 2a-7(a)(8) (defining "daily liquid assets") and 2a-7(a)(32) (defining "weekly liquid assets").

461 *See supra* notes 36-40 and accompanying text; notes 137-139 and accompanying text; notes 159-161 and accompanying text; and notes 184-185 and accompanying text.

462 *See* discussion in Section II.B.1 of this Release for an example of the size of simultaneous shocks that a money market fund could withstand with a WAM of 90 days as opposed to a WAM of 60 days.

We believe that the new liquidity requirements will decrease liquidity risk. As discussed above, they are designed to increase a money market fund's ability to withstand illiquid markets by ensuring that the fund further limits its acquisitions of illiquid securities and that a certain percentage of its assets are held in daily and weekly liquid assets.[463] Under the general liquidity requirement, moreover, each money market fund must assess its liquidity needs on an ongoing basis and take additional actions as appropriate in order to manage its liquidity. Together, these requirements should decrease the likelihood that a fund would have to realize losses from selling portfolio securities into an illiquid market to satisfy redemption requests, which could put pressure on the fund's ability to maintain a stable net asset value.[464] The minimum daily and weekly liquidity standards require a money market fund to hold cash or securities that can be readily converted to cash. In certain circumstances, funds would be required to increase the level of these assets under the general liquidity standard.[465] We believe that these requirements, rather than our traditional notion of liquidity, which was based on a fund's ability to find a buyer of a security, are more likely to enable money market fund advisers to meet their funds' liquidity needs and adjust the funds' portfolios to increase liquidity when needed.[466]

We believe that a reduction of these credit, interest rate, spread, and liquidity risks will better enable money market funds to weather market turbulence and maintain a stable net asset value per share. The amendments are designed to reduce the risk that a money market fund will break the buck, and thereby prevent losses to fund investors. To the extent that money market funds are more stable, they also will reduce systemic risk to the capital markets and provide a

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463 *See supra* Section II.C.

464 *See id.*

465 *See supra* Section II.C.1.

466 *See supra* Section II.C.

more stable source of financing for issuers of short-term credit instruments, thus promoting capital formation. If money market funds become more stable investments as a result of the rule amendments, they may attract further investment, increasing their role as a source of capital.

b. Costs

We recognize that our amendments regarding second tier securities, portfolio maturity, and liquidity will impose costs on some money market funds. For example, yields might decrease in funds depending on their current positions in second tier securities, less liquid securities, and longer term instruments because those instruments typically offer above average yields. We note that the yield offered by a security is tied to its risk. It is important to consider our rule amendments' impact on money market fund yields in this context.

Second Tier Securities. We received several comments on the estimated costs of eliminating money market funds' ability to acquire second tier securities. One commenter stated that such an elimination would cost a money market fund 2 basis points in yield, assuming that this money market fund held 5 percent of its assets in second tier securities.[467] This commenter stated that it believed that this cost would be appropriate to strengthen the stability of money market funds to weather potential future liquidity and credit crises and to promote investor confidence. Several commenters agreed, stating that they did not expect elimination to lead to market disruption.[468] One commenter added that given the small size of the second tier securities market, the benefits of elimination would far outweigh any disadvantages.[469]

Another commenter stated that the benefits of money market funds being able to invest in second tier securities, in terms of reducing portfolio concentration in financial institution

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467 This number was obtained in discussions with a commenter clarifying certain aspects of its comment letter. *See* J.P. Morgan Asset Mgt. Comment Letter.

468 ICI Comment Letter; TDAM Comment Letter; Thrivent Comment Letter.

469 TDAM Comment Letter.

securities and providing affordable financing for second tier security issuers, outweigh any potential increased credit risk.[470] This commenter estimated that elimination of a money market fund's ability to acquire second tier securities would cost it 3 basis points in yield, again assuming that the money market fund held a full 5 percent of its assets in second tier securities. Finally, a third commenter estimated that elimination of money market funds' ability to acquire second tier securities would cost a retail money market fund 4-8 basis points in yield, a non-rated institutional money market fund 2-4 basis points in yield, and a rated institutional fund 1-3 basis points in yield.[471] This commenter assumed that these money market funds held 5 percent of their assets in second tier securities and 5 percent of their assets in lower quality first tier assets, and that all of these assets would not be held if funds' ability to acquire second tier securities was eliminated.

As discussed above, we have determined not to eliminate money market funds' ability to acquire second tier securities, but instead are further restricting this ability. This change from our proposal should result in costs that are less than estimated in the proposal and less than commenters estimated for full-scale elimination. We believe that the 3 percent limitation on money market funds' ability to acquire second tier securities will have a small impact on money

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470 *See* Federated Comment Letter. As discussed in Section II.A.1 of this Release, other commenters also asserted that a complete ban on acquisition of second tier securities would not be justified on a cost-benefit basis, would have a material adverse impact on second tier security issuers, would have unintended effects on the capital markets, and would increase borrowing costs for second tier security issuers. We discuss these comments, and provide our response, *supra* notes 41-53 and accompanying and following text.

471 Fidelity Comment Letter. According to the iMoneyNet Money Market Fund Analyzer Database, as of November 17, 2009, 61% of money market fund assets were held in funds that were top rated by at least one NRSRO and 34% of money market funds had a top rating from at least one NRSRO. In order to retain a top rating, money market funds must only hold first tier securities. According to analysis of the iMoneyNet analyzer database, as of December 1, 2009, approximately 48% of money market funds were retail funds and 52% were institutional funds. Accordingly, Fidelity's estimates result in a blended impact on money market funds of (6 basis points x 48% retail funds) + (3 basis points x 34% non-rated institutional funds) + (2 basis points x 18% rated institutional funds) = 4.3 basis points per fund.

market funds.[472] Based on commenters' estimates described above, a reduction in a money market fund's investment in second tier securities from 5 percent to 3 percent of its total assets would reduce its yield on average by approximately 1.2 basis points.[473] However, very few money market funds hold more than 3 percent of their total assets in second tier securities, and even fewer hold a full 5 percent. Our staff's review of money market fund portfolios in September 2008 found that only 4 percent of money market funds held more than 3 percent of their assets in second tier securities. Accordingly, we estimate that each of only 29 money market funds[474] would face a reduction of yield of 1.2 basis points as a result of our amendments.

We also are further reducing the ability of money market funds to acquire second tier securities of any particular issuer from the greater of 1 percent of assets or $1 million to 0.5 percent of assets. Based on our staff's review of money market fund portfolios in September 2008, 8 percent of money market funds held second tier securities of any particular issuer in excess of 0.5 percent of the money market fund's assets. We expect that these money market funds, however, will simply reinvest this excess in the securities of other second tier issuers and, therefore, that there will be no loss in fund yield as a result of this restriction.[475] Several

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472 As discussed above, we do not believe that further limitations on money market funds' ability to acquire second tier securities will prevent their ability to achieve diversification benefits. *See supra* note 47 and accompanying text.

473 This estimate is based on averaging the 2 basis point, 3 basis point, and 4.3 basis point estimates from commenters for a reduction in second tier securities investment from 5% to 0%, proportionately adjusted to reflect a reduction in investment from 5% to 3%.

474 This estimate is based on the following calculation: 719 money market funds x 4% = 29 money market funds.

475 Commenters (for example, the Federated Comment Letter and the Fidelity Comment Letter) asserted that there are numerous quality second tier security issuers. Because this limitation, when combined with the 3% aggregate limitation on acquisition of second tier securities, only limits money market funds to holding a minimum of 6 second tier issuers if it were to maximize the limitations (rather than 5 second tier issuers under the current rule), we do not expect that money market funds would have difficulty finding six appropriate second tier security issuers in which to invest.

commenters argued that there are many second tier security issuers worthy of investment.[476] If any of these money market funds did not perform credit analysis of a large enough group of second tier security issuers, these funds may incur some administrative costs in tracking additional issuers.[477]

Finally, we are limiting money market funds to only acquiring second tier securities with a remaining maturity of less than 45 days. According to Federal Reserve data, in 2009, only 4 percent of A2/P2 non-financial commercial paper had a maturity of greater than 40 days on issuance, and thus we do not expect that the 45-day maturity limit will have more than a negligible cost impact on taxable money market funds.[478] In addition, based on our staff's review of tax-free money market fund portfolios in September 2008, we estimate that very few money market funds held second tier municipal securities with a maturity of greater than 45 days that were second tier securities at the time of acquisition. As a result, we do not expect that the 45-day maturity limit will have more than a negligible cost impact on money market funds.

WAM and WAL. Three commenters provided cost estimates for a reduction in the maximum weighted average maturity for money market funds. One commenter estimated that if all money market funds had a WAM of 75 days and reduced their WAM to 60 days, it would cost each money market fund 2.5 to 3 basis points in yield.[479] Similarly, another commenter estimated that this same reduction would cost each money market fund 3 basis points in yield,

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476 *See, e.g.*, Chamber/Tier 2 Issuers Comment Letter; Federated Comment Letter; Fidelity Comment Letter; USAA Comment Letter.

477 Based on discussions we had with certain commenters clarifying certain aspects of their comment letters, we understand that all of these larger managers track sufficient second tier security issuers that the 0.5% limitation per second tier security issuer should not create additional costs related to tracking additional issuers.

478 *See* Federal Reserve, *Volume Statistics for Commercial Paper, A2/P2 Nonfinancial, available at* http://www.federalreserve.gov/releases/cp/volumestats.htm.

479 J.P. Morgan Asset Mgt. Comment Letter.

and a reduction in WAM from 90 days to 75 days would also cost a money market fund 3 basis points in yield.[480] Finally, a third commenter estimated that if all money market funds had a WAM of 90 days and reduced their WAM to 60 days, it would cost each money market fund 5 to 10 basis points in yield.[481] According to these estimates, it would cost a money market fund 5 to 10 basis points in yield to reduce its WAM from 90 days to 60 days.

However, historically most money market funds have not maintained a WAM of more than 60 days. According to data provided by the ICI, from January 1998 through April 2009, even the 75th percentile of prime money market funds has maintained an average WAM of 53 days and the 90th percentile of prime money market funds has maintained an average WAM of 65 days.[482] As of November 17, 2009, despite the historically low interest rate environment in which money market funds have tended to extend WAM closer to the maximum limits to gain additional yield, only 1.5 percent of taxable money market funds reported a WAM of more than 75 days (with most of those having a WAM of only slightly over 75 days) and only 15.5 percent reported a WAM of 61-75 days (with these funds having an average WAM of 68 days).[483] We understand that most money market funds like to have some cushion by maintaining a WAM below the permitted maximum, but we do not believe that money market funds believe that such a large cushion must always be maintained. Rather, we believe that many money market funds have maintained lower WAMs than required because they believed that it is prudent

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480 Federated Comment Letter.

481 Fidelity Comment Letter.

482 Investment Company Institute, Average Maturity of Taxable Prime Money Market Funds, 1998-2009, *available at* http://www.sec.gov/comments/s7-11-09/s71109-14.htm.

483 Based on data from the iMoneyNet Money Market Fund Analyzer Database as of November 17, 2009. The WAMs of the funds with WAMs over 75 days were: 2 at 76 days, 1 at 77 days, and 3 at 78 days. Tax-free money market funds have WAMs considerably lower (30% of money market funds were tax-free as of December 8, 2009 according to data from the iMoneyNet Money Market Fund Analyzer Database).

management of their portfolio to do so.[484]

Based on this data, on the WAMs of taxable and prime money market funds and on commenters' estimates of the impact of a reduction in WAM, we estimate that 10 money market funds will have to reduce their WAM from 78 days to 55 days at a cost of 6 basis points per fund. We further estimate that 70 money market funds will have to reduce their WAM from 68 days to 55 days at a cost of 2 basis points per fund.

Three commenters provided cost estimates for a reduction in the maximum weighted average life for money market funds. One commenter estimated that if all money market funds had a WAL of 180 days and reduced their WAL to 120 days, it would cost each money market fund 2 to 4 basis points in yield.[485] Another commenter estimated that a WAL reduction of 150 to 120 days would cost each money market fund 1 to 3 basis points in yield.[486] Finally, a third commenter estimated that if all money market funds reduced their WAL to 120 days, it would cost each money market fund 3 basis points in yield.[487] According to these estimates, it would cost a money market fund 1 to 3 basis points in yield to reduce its WAL from 150 days to 120 days.[488] We estimate that two-thirds of taxable money market funds and all tax-free money market funds already maintain a WAL of 120 days or less and thus will incur no cost in

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484 *See, e.g., supra* notes 137-139 and accompanying text.

485 J.P. Morgan Asset Mgt. Comment Letter and subsequent Commission staff conversation with J.P. Morgan staff breaking down the cost estimate in the J.P. Morgan Asset Mgt. Comment Letter by each proposed amendment to rule 2a-7.

486 Fidelity Comment Letter (focusing on government money market funds).

487 Federated Comment Letter. The Federated Comment Letter did not specify a WAL starting point for its assumed reduction to a 120-day WAL. Rather, it evaluated instruments that it believed would likely be subject to greater demand or a shorter maturity with a 120-day maximum WAL requirement and estimated the increased cost to money market funds from those securities becoming more expensive as a result.

488 Based on discussions we had with certain commenters clarifying certain aspects of their comment letters, we do not believe that more than a negligible number of money market funds are maintaining a WAL of 180 days.

transitioning to this amendment to rule 2a-7.[489] We estimate that the other third of taxable money market funds, or 163 funds, maintain a maximum WAL of no greater than 150 days and will incur on average a cost of 2 basis points per fund to reduce their WAL to 120 days.

Several commenters stated that the new WAM limitation would reduce the range of securities available for money market fund investment and increase demand for shorter term securities.[490] No commenters provided any cost estimate for this potential impact. If this did occur, and if the increased demand was not met with increased supply of such securities, the new maturity limitations could result in additional incremental costs to money market funds.

A few commenters also believed that the amended maturity limitations would increase security issuer costs because they would have to issue shorter maturity securities and assume greater risk from having to roll over their securities more frequently.[491] No commenters provided any cost estimate for this potential impact. If security issuer costs do increase as a result of the amended maturity limitations and these issuers as a consequence are unable to obtain the same

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489 We are not aware of any data provider that tracks the WAL of all money market funds (likely because money market funds are not limited currently in the weighted average life that they must maintain). An analysis of the 16 largest, top-rated, prime institutional money market funds (representing 53% of all prime institutional money market fund assets as of June 30, 2009) found that of the 14 funds providing information on the final maturities of their portfolio securities, all had a WAL of under 120 days. *See* CAPITAL ADVISORS GROUP, HOW SAFE ARE PRIME MONEY MARKET FUNDS? (Nov. 1, 2009), *available at* http://web.capitaladvisors.com/whitepapers/How%20Safe%20Are%20MMFs.pdf ("CAG Report"). This information, combined with discussions we had with certain commenters clarifying certain aspects of their comment letters, leads us to estimate that two thirds of money market funds currently are maintaining a WAL of no greater than 120 days and that the other third currently are maintaining a WAL of no greater than 150 days. We also understand that the majority of money market funds currently are in compliance with the maximum 120-day WAL because of their voluntary compliance with the recommendations contained in the ICI Report. Because most securities held by tax-free money market funds have a demand feature reducing the security's maturity under the WAL calculation to a very short duration, we understand that tax-free money market funds do not have a WAL greater than 120 days.

490 *See, e.g.*, Charles Schwab Comment Letter; J.P. Morgan Asset Mgt. Comment Letter; State Street Comment Letter.

491 *See, e.g.*, Fannie Mae Comment Letter; State Street Comment Letter; Wells Fargo Comment Letter.

amount of financing, it may have a negative impact on capital formation.

General Liquidity Requirement. As discussed above, the amended rule includes a general liquidity requirement, under which a fund's management and its board must evaluate the funds' liquidity needs and protect shareholders from the harm that can occur from the failure to properly anticipate and provide for those needs. We also noted that in order to comply with this provision in amended rule 2a-7 under the compliance rule, we expect that money market funds would adopt policies and procedures designed to assure that appropriate efforts are undertaken to identify risk characteristics of the fund's shareholders.[492] For purposes of the PRA analysis, we estimated that each fund complex would incur, on average, 9 hours to document, review, and adopt policies and procedures for monitoring the risk characteristics of money market fund investors.[493] Based on this estimate, we estimate that it would cost a fund complex $6976 to document, review, and adopt these policies and procedures, for a total cost of $1,137,000.[494]

Illiquid Securities. Two commenters provided estimates with respect to the proposed ban on purchases of illiquid securities. One commenter estimated that the proposed ban would decrease money market funds' yields from 2 to 6 basis points, assuming that the fund holds 10 percent of its total assets in illiquid securities.[495] Another commenter submitted that the ban on illiquid securities would decrease yields by 3 basis points.[496] Based on commenters' estimates, a

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492 *See supra* note 198 and accompanying text.

493 *See supra* note 407 and accompanying and preceding text.

494 These estimates are based on the following calculations: 8 hours x $372/hour (for a senior portfolio manager) = $2976; 1 hour x $4000 (for a board of directors) = $4000; ($2976 + $4000) x 163 complexes = $1,137,088. The hourly wage used for senior portfolio managers is from the SIFMA *Report on Management & Professional Salaries Data* (Sept. 2008), modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

495 *See* Fidelity Comment Letter.

496 *See* Federated Comment Letter (without specifying the assumed holdings of illiquid securities).

money market fund that reduces its investments in illiquid securities from 10 percent to 5 percent would reduce its yield on average by 2 basis points.[497]

Our staff's review of money market funds' portfolios in September 2008 found that 24 percent of funds reported held any illiquid securities.[498] Based on the staff's review as applied to the current number of money market funds (719),[499] we estimate current money market fund holdings of illiquid securities as follows:

Percentage of total assets represented by illiquid securities	Percentage of funds	Number of funds
10 percent	0.6	4
9 percent	0.4	3
8 percent	0.4	3
7 percent	0.4	3
6 percent	1.0	7
5 percent or less	97.2	698

Based on these estimated holdings, staff makes the following estimates: 4 funds with 10 percent of assets invested in illiquid securities will experience a reduction in holdings of 5 percent and a yield impact of 2 basis points;[500] 3 funds with 9 percent of assets invested in illiquid securities holdings will experience a reduction in holdings of 4 percent and a yield

497 The individual reduction in basis points is calculated by taking the average of the estimated range of 2 to 6 basis points ((2+6) ÷ 2 = 4 basis points; 4 basis points ÷ 10% = 0.4 basis points per 1% reduction), proportionally adjusted to reflect an adjustment in investment in illiquid securities from 10% to 5% (5 x 0.4 = 2).

498 We note that these holdings are likely to include some securities that were not illiquid at acquisition. Thus, our estimates on the impact of reducing holdings of illiquid securities may be higher than the impact that would be experienced by some money market funds.

499 The number of money market funds is based on Investment Company Institute, *Trends in Mutual Fund Investing*, Oct. 2009, *available at* http://www.ici.org/research/stats/trends/trends_10_09.

500 (10% - 5% (allowable amount remaining) = 5%). 5 x 0.4 basis points (basis point impact per 1%) = 2 basis points.

impact of 1.6 basis points;[501] 3 funds with 8 percent of assets invested in illiquid securities holdings will experience a reduction in holdings of 3 percent and a yield impact of 1.2 basis points;[502] 3 funds with 7 percent of assets invested in illiquid securities holdings will experience a reduction in holdings of 2 percent and a yield impact of 0.8 basis points;[503] 7 funds with 6 percent of assets invested in illiquid securities holdings will experience a reduction in holdings of 1 percent and a yield impact of 0.4 basis points.[504]

Daily Liquidity Requirements. Two commenters specifically addressed the proposed daily liquidity requirements. Both commenters estimated that there would be no yield impact as a result of the proposed 10 percent threshold.[505] Based on these comments, we assume that the 10 percent daily minimum liquidity standard we are adopting will have no impact on money market funds' yield.[506]

Weekly Liquidity Requirements. A few commenters provided estimates on the costs of the proposed weekly liquidity requirements. One commenter estimated that the yield impact of the proposed 30 percent weekly liquidity standard for institutional funds would range from 15 to 20 basis points,[507] while another commenter estimated that the yield impact would be 10 basis

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501 (9% - 5% (allowable amount remaining) = 4%). 4 x 0.4 basis points = 1.6 basis points.

502 (8% - 5% (allowable amount remaining) = 3%). 3 x 0.4 basis points = 1.2 basis points.

503 (7% - 5% (allowable amount remaining) = 2%). 2 x 0.4 basis points = 0.8 basis points.

504 (6% - 5% (allowable amount remaining) = 1%). 1 x 0.4 basis points = 0.4 basis points.

505 *See* Federated Comment Letter; Fidelity Comment Letter.

506 Our understanding is that money market funds' current practice is to maintain approximately 10% of their portfolio in daily liquid assets. *See* CAG Report, *supra* note 489; Fitch Report, *supra* note 274, at 6 (Fitch-rated prime money market funds' aggregate exposure to sources of overnight liquidity, including repurchase agreements, time deposits and shares of other money market funds, was approximately 15% of total assets for the six-month period ended on May 15, 2009).

507 *See* Fidelity Comment Letter (noting that including agency discount notes with remaining maturities of 397 days or less in weekly liquid assets would have reduced this estimate by about 3 basis points for institutional money market funds).

points.[508] A third commenter submitted that the proposed 30 percent weekly liquidity requirement would have a yield impact of 9 basis points, but would have no impact if the threshold was 20 percent and included agency discount notes with remaining maturities of 95 days or less.[509] None of these commenters explained the baseline (*i.e.,* the percentage of weekly liquid assets institutional funds currently hold) on which their estimated impacts on yield are based. A fourth commenter estimated that if money market funds had to increase their weekly liquid assets by 10 percent, the yield impact would be between 3 and 6 basis points.[510] Thus, commenters' estimates of the yield impact to institutional funds of maintaining 30 percent of their portfolio in weekly liquid assets ranged from 3 to 20 basis points.[511] We have averaged these estimates to determine our estimated yield impact on institutional funds of 1.025 basis points per percentage increase in existing assets that would have to be converted to weekly liquid assets.[512]

We estimate that half of institutional money market funds currently maintain 30 percent or more of their total assets in weekly liquid assets and thus would experience no reduction in

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508 GE Asset Mgt. Comment Letter (arguing that the requirement could cause a more pronounced yield widening effect as a result of supply/demand dynamics, *i.e.*, there would be an increase in demand for securities with 7-day maturities or less, which would result in a corresponding decrease in yield for such instruments; consequently, there could also be a reduced demand for longer-dated instruments, which would adversely impact the short-term financing for issuers of such instruments).

509 Federated Comment Letter.

510 J.P. Morgan Asset Mgt. Comment Letter and subsequent Commission staff conversation with J.P. Morgan staff breaking down the cost estimate in the J.P. Morgan Asset Mgt. Comment Letter by each proposed amendment to rule 2a-7.

511 We note that the range of these estimates is likely to be lower if agency discount notes with remaining maturities of less than 60 days are included. We have not adjusted for that, however, to maintain a conservative estimate.

512 Our estimate is based on an average of the commenters' estimated (or the midpoint of commenters' estimated) impacts of 17.5, 10, 9, and 4.5 basis points per 10% increase in weekly liquid assets as proportionally adjusted: $1.75 + 1.0 + 0.9 + 0.45 = 4.1$; 4.1 basis points $\div 4 =$ 1.025 basis point increase. *See* notes 507-510 and accompanying text.

yield as a result of the weekly liquidity requirement. We further estimate that 38 percent of institutional funds maintain 25 percent of their assets in weekly liquid assets; 6 percent of institutional funds maintain 20 percent of their assets in weekly liquid assets and 6 percent of institutional funds maintain 15 percent of their assets in weekly liquid assets.[513] Based on these estimates, we estimate that 187 funds may experience no impact, 142 funds may experience a 5.125 basis point impact on yield, 22 funds may experience a 10.25 basis points, and 22 funds may experience a 15.375 basis point impact on yield.[514]

One commenter provided specific estimates for the impact of the proposed 15 percent weekly liquid asset requirement on retail money market funds of between two and four basis points.[515] Assuming that the starting point for these estimates was 10 percent of investments in weekly liquid assets, we estimate that the yield impact per percentage increase to satisfy the weekly liquid asset requirement would be 0.6 basis points.[516] We estimate that all retail money market funds maintain 15 percent of their total assets in weekly liquid assets.[517] Based on this

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[513] While we are not aware of any data provider that tracks the actual maturities of securities (as opposed to WAM, which estimates the maturity of floating rate notes based on the interest reset date rather than actual maturity), we are able to provide estimates based on the analysis of the Capital Advisors Group that found that on or near September 30, 2009, the 16 funds providing information on their portfolio securities averaged 30% of assets in securities convertible to cash in 1 to 7 days. In addition, 8 (50%) had 7- day liquidity of 30% or greater; 6 (38%) had 7-day liquidity of 25%-30%; 1 (6%) had liquidity of 20%-25%, and 1 (6%) had 7-day liquidity of 15%-20%. *See* CAG Report, *supra* note 489. For purposes of our estimates, we are assuming the funds in each category held the lowest level of weekly liquid assets in the category.

[514] As noted above, there are currently 719 money market funds, of which we estimate that 52% (374) are institutional funds. *See supra* notes 471 and 499.

[515] *See* Fidelity Comment Letter.

[516] This assumes an average of 3 basis points proportionally adjusted for an increase of 5%. We assume that the commenter based its estimate on an increase from 10% holdings because as noted above, we assume that all money market funds have on average daily liquidity of at least 10% and the commenter based its estimates on the proposed weekly liquid asset requirement of 15% for retail funds. *See supra* note 506 and accompanying text.

[517] We believe that most retail money market funds currently are in voluntary compliance with the 20% weekly liquidity standard recommended by the ICI Report, which would include agency

estimate, we estimate that the average yield impact for each retail money market fund would be 9 basis points.[518]

Investors. The decreased yield that some money market funds may offer as a result of the amendments we are adopting today may limit the range of choices that individual money market fund investors have to select their desired level of investment risk. This might cause some investors to shift their assets to, among other places, bank deposits or offshore or other enhanced cash funds unregulated by rule 2a-7 that are able to offer a higher yield.[519] Investors that choose to move to unregulated products may have fewer protections than they had in money market funds regulated under rule 2a-7. When markets come under stress, investors may be more likely to withdraw their money from these offshore or private funds due to their perceived higher risk[520] and substantial redemptions from those funds and accompanying sales of their portfolio securities could increase systemic risk to short-term credit markets, which would impact money market funds. In addition, the stricter portfolio quality, maturity, and liquidity requirements may result in some money market funds having fewer issuers from which to select securities if some issuers only offer second tier securities, less liquid securities, or a larger percentage of longer term securities.

Issuers. Our new portfolio quality, maturity, and liquidity restrictions also may impact

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discount notes with original issue maturity of 95 days or less. The final rule permits agency discount notes with remaining maturities of 60 days or less, and we are conservatively estimating that retail funds maintain an average of 15% of assets in weekly liquid assets.

518 0.6 basis points x 15% = 9 basis points. This estimate may be overstated because, as noted above, we believe that most retail funds hold 20% of their assets in weekly liquid assets, and thus would have to convert a smaller percentage of assets to weekly liquid assets.

519 Some commenters suggested this possibility. *See, e.g.*, Goldman Sachs Comment Letter; State Street Comment Letter (making this comment with respect to reducing the maximum permissible WAM).

520 During the market events of 2007-2008, investors redeemed substantial amounts of assets from certain bond funds and offshore money market funds. *See* ICI REPORT, *supra* note 14, at 106-07.

issuers. Issuers may experience increased financing costs to the extent that they are unable to find alternative purchasers at previous market rates of second tier securities, less liquid securities, longer term securities, or adjustable-rate securities that money market funds determine to no longer acquire because of the new restrictions. Several commenters stated that elimination of money market funds' ability to acquire second tier securities would increase issuers' borrowing costs and thus could increase the cost of capital formation.[521] No commenters provided estimates of such costs.

As noted earlier in this section, we do not believe that money market funds currently hold a significant amount of second tier securities or securities that are illiquid at acquisition in excess of the newly adopted limitations for these securities. Thus, we expect that the amendments' impact on issuers of these securities will be minimal. We also know that few money market funds maintain a WAM in excess of 60 days, and we therefore believe that our new WAM restriction will not have a significant impact on issuers of longer term securities.[522] To the extent that the new WAM limitation results in companies or governments issuing shorter maturity securities, those issuers may be exposed to an increased risk of insufficient demand for their securities and adverse credit market conditions because they must roll over their short-term financing more frequently. We note that this impact could be mitigated if money market funds sufficiently staggered or "laddered" the maturity of the securities in their portfolios.

Finally, we estimate that one third of taxable money market funds will have to reduce the WAL of their portfolio,[523] and thus it is possible that some adjustable-rate security issuers will

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[521] *See, e.g.*, Am. Elec. P. Comment Letter; Chamber/Tier 2 Issuers Comment Letter. *But see* ICI Comment Letter (stating their belief that elimination would have a manageable impact on second tier security issuers).

[522] *See supra* notes 482-483 and accompanying text.

[523] *See supra* note 489 and accompanying and following text.

need to shorten the maturities of some of the securities they offer, which may result in increased borrowing costs.[524] In addition, the markets for longer term securities may become less liquid if the rule amendments cause issuance of these instruments to decline.[525]

Government Securities. We do not believe that eliminating the provision in rule 2a-7 that allowed money market funds relying solely on the penny-rounding method of pricing to hold Government securities with remaining maturities of up to 762 days will have a material impact on money market funds, investors, or issuers of longer term Government securities because we believe that substantially all money market funds rely on the amortized cost method of valuation, and not exclusively on the penny-rounding method of pricing, and thus are not eligible to rely on this exception. We received one comment on this proposal, which stated that they were not aware of any money market funds that relied on the penny rounding method of pricing.[526]

2. *Designation of NRSROs*

The amendments to rule 2a-7 require a money market fund's board of directors to designate at least four NRSROs whose credit ratings the fund will use in determining the eligibility of portfolio securities under the rule and that the board determines annually issue credit ratings that are sufficiently reliable for this use.[527] In addition, money market funds are required to disclose designated NRSROs in their registration statements.[528]

We anticipate that the requirement to designate at least four NRSROs could foster competition among NRSROs to produce the most accurate ratings in order to obtain designation

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[524] *See supra* note 491 and accompanying text for comments asserting this possible negative impact.

[525] No commenters addressed this possibility.

[526] BlackRock Comment Letter.

[527] Amended rule 2a-7(a)(11) (defining the term "designated NRSRO").

[528] Amended rule 2a-7(a)(11)(iii). The fund would be required to make the disclosure in its SAI, under Part B of Form N-1A [17 CFR 239.15A].

by money market fund boards. Several commenters agreed that designating at least three NRSROs could encourage competition among NRSROs to achieve designation by money market fund boards.[529] To the extent that competition increases the reliability of the credit ratings of designated NRSROs, this could increase the efficiency of fund managers in determining eligibility of portfolio securities. Some commenters expressed concern, however, that a requirement to designate at least three NRSROs could result in fund boards designating only the three largest NRSROs that issue most of the ratings,[530] which could result in decreased competition among NRSROs. To address this concern, in light of the Commission's goal of increasing competition among NRSROs, we are requiring each fund to designate at least four NRSROs. In addition, requiring designation of four NRSROs may encourage new NRSROs that issue ratings specifically for money market fund instruments to enter the market.

We recognize that the requirement to designate and annually evaluate at least four NRSROs will result in costs to the fund.[531] For the purposes of the PRA, we estimate that the requirement that money market funds disclose this designation, including any limitations on the use of the designations, in their SAIs will not result in additional costs for funds.[532] We expect that boards will designate NRSROs based on recommendations from the fund's adviser and its credit analysts. Similarly, we believe the board's annual determination regarding designated NRSROs will be based on recommendations from the adviser and its credit analysts. Staff

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529 *See, e.g.*, HighMark Capital Comment Letter; Invesco Aim Comment Letter.

530 *See* DBRS Comment Letter; C. Wesselkamper Comment Letter. We note that of the 10 registered NRSROs, three issued over 97% of the ratings across categories that NRSROs reported to the Commission. *See* SEC, ANNUAL REPORT ON NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS at 9 (Sept. 2009).

531 While we received comments regarding the designation of NRSROs, none of the comments discussed the costs of designation to funds or their advisers.

532 *See supra* Section IV.A.1.

estimates that it will take each fund's board of directors approximately 6 hours each year to designate NRSROs and determine whether the NRSROs ratings are sufficiently reliable for such use. Based on an hourly rate for the board of $4000, we estimate that each money market fund will incur $24,000 and all fund complexes will incur $3.9 million annually for the boards of directors to initially designate and determine the reliability and sufficiency of the designated NRSROs' credit ratings for use in determining eligibility of portfolio securities.[533]

We expect that fund advisers currently evaluate the reliability of NRSRO ratings and ratings criteria as part of the credit analysis they perform (under delegated authority from the board) in determining the eligibility of portfolio securities. We also assume that this evaluation includes consideration and internal documentation of whether an NRSRO's rating is sufficient for that use. Accordingly, while we do not anticipate that fund advisers will incur additional time to prepare their recommendations, we expect that fund advisers will incur costs to draft those recommendations in a presentation or report for board review regarding designation of NRSROs and the sufficiency of designated NRSROs' ratings. Staff estimates that the investment adviser for each complex will spend 6 hours annually to prepare a report based on the adviser's internal review and documentation that summarizes its recommendation with respect to each NRSRO that may be considered for designation and any limits on the use of that NRSRO under the rule at a cost per fund complex of $1770 and a total cost of $288,510.[534]

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533 This estimate is based on the following calculation: $24,000 x 163 (fund complexes) = $3,912,000. We have estimated total costs for fund complexes because we assume that boards of directors will undertake to designate and determine for all funds in the complex at the same time (although boards may designate and make annual determinations with respect to different NRSROs for different money market funds).

534 These estimates are based on the following calculations: ($202/hour (intermediate portfolio manager) x 3 hours) + ($388/hour (senior portfolio manager) x 3 hours) = $1770; $1770 x 163 fund complexes = $288,510. Hourly wages used for purposes of the estimate of portfolio manager salaries are from the SIFMA *Report on Management & Professional Salaries Data* (Sept. 2008), modified to account for an 1800-hour work-year and multiplied by 2.93 to account

As noted above, we understand that money market fund advisers currently evaluate NRSROs that rate securities in which the fund invests. We also understand that fund advisers monitor NRSROs for potential downgrades of portfolio securities. Prior to today's amendments, if the fund invested in unrated or second tier securities, the adviser had to monitor all NRSROs in case there was a downgrade of a second tier security or an unrated security received a rating below one of the top two categories.[535] Thus, we do not expect that limiting the number of NRSROs that a fund must monitor to four (or more, if the fund chooses) will result in increased costs to fund advisers to monitor NRSROs.

3. *Stress Testing*

As proposed, we are amending rule 2a-7 to require that a money market fund's board of directors adopt written procedures that provide for the periodic stress testing of each money market fund's portfolio.[536] A fund's board of directors determines the frequency of stress testing. The procedures must require testing of the fund's ability to maintain a stable net asset value per share based upon certain hypothetical events.[537] The procedures also must provide for a report to be delivered to the fund's board of directors at its next regularly scheduled meeting on the results of the testing, or more often as appropriate in light of the results.[538] The report must include an

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for bonuses, firm size, employee benefits and overhead.

535 *See* current rule 2a-7(c)(6)(i)(A)(2).

536 *See supra* Section II.C.4. We did not receive any comment on the estimates and assumptions included in our proposal. Accordingly, we have not modified any of those estimates except to reflect the new requirement included in the amended rule.

537 As proposed, the hypothetical events described in the final rule include a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on a portfolio security, and widening or narrowing of spreads between yields on a benchmark selected by the fund and securities held by the fund. *See* amended rule 2a-7(c)(10)(v)(A).

538 Amended rule 2a-7(c)(10)(v)(B). The report must include dates on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value, calculated using available market quotations (or appropriate

assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.[539]

We anticipate that stress testing will give fund advisers a better understanding of the effect of potential market events and shareholder redemptions on their funds' ability to maintain a stable net asset value, the funds' exposure to the risk that they would break the buck, and actions the advisers may need to take to mitigate the possibility of the funds breaking the buck.[540] We believe that many funds currently conduct stress testing as a matter of routine fund management and business practice.[541] We anticipate, however, that funds that do not currently perform stress testing and funds that may revise their procedures in light of the amended rule will give their managers a tool to better manage those risks. For fund boards of directors that do not currently receive stress test results, we believe that the regular reports of the testing and assessments will provide money market fund boards a better understanding of the risks to which the fund is exposed.

We understand that today rigorous stress testing is a best practice followed by many money market funds.[542] We understand that the fund complexes that conduct stress tests include smaller complexes that offer money market funds externally managed by advisers experienced in this area of management.[543] Accordingly, staff estimates that as a result of the new requirement to adopt stress testing procedures: (i) funds that currently conduct rigorous stress testing,

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substitutes that reflect current market conditions), from its net asset value per share, calculated using amortized cost, to exceed ½ of 1%. Amended rule 2a-7(c)(10)(v)(B)(*1*).

539 Amended rule 2a-7(c)(10)(v)(B)(*2*).

540 *See supra* note 411 and accompanying and preceding text.

541 *See* Proposing Release, *supra* note 2, at paragraph following n.358.

542 *See id.* at n.359 and accompanying text.

543 These complexes do not, however, meet the definition of "small entities" under the Investment Company Act for purposes of the Regulatory Flexibility Act of 1980. 17 CFR 270.0-10. *See infra* note 636.

including tests for hypothetical events listed in the amended rule (and concurrent occurrences of those events), will incur some costs to evaluate whether their current test procedures comply with the new requirement, but will be likely to incur relatively few costs to revise those procedures or continue the stress testing they currently perform; (ii) funds that conduct less rigorous stress testing, or that do not test for all the hypothetical events listed in the amended rule, will incur somewhat greater expenses to revise those procedures in light of the new requirement and maintain the revised testing; and (iii) funds that do not conduct stress testing will incur costs to develop and adopt stress test procedures and conduct stress tests.

As noted above, we believe that there is a range in the extent and rigor of stress testing currently performed by money market funds. We also expect that stress test procedures are being or will be developed by the adviser to a fund complex for all money market funds in the complex, while specific stress tests are performed for each individual money market fund. We estimate that a fund complex that currently does not conduct stress testing will require approximately 1 month for 2 risk management specialists and 2 systems analysts to develop stress test procedures at a cost of approximately \$155,000, 22 hours for a risk management specialist to draft the procedures, and 3 hours of board of directors' time to adopt the procedures for a total of approximately \$173,000.[544] Costs for fund complexes that will have to revise or fine-tune their stress test procedures would be less. For purposes of this cost benefit analysis, we estimate that these funds will incur half the costs of development, for a total of approximately \$96,000.[545] Funds that will not have to change their test procedures will incur approximately

544 This estimate is based on the following calculations: \$275/hour x 280 hours (collectively, 2 senior risk management specialists) + \$244/hour x 320 hours (collectively, 2 senior systems analysts) = \$155,080; \$275/hour (senior risk management specialist) x 22 hours = \$6050; \$4000/hour x 3 hours = \$12,000; \$155,080 + \$6050 + \$12,000 = \$173,130.

545 This estimate is based on the following calculation: (\$155,080 x 0.5) (revise procedures) + \$6050 (draft procedures) + \$12,000 (board approval) = \$95,590.

$20,000 to determine compliance with the new requirement and to draft and adopt the procedures.[546] We also anticipate that in light of the new demand to develop stress testing procedures, third parties will develop programs that funds will be able to purchase for less than our estimated cost to develop the programs themselves.

As with the development of stress test procedures, the costs funds will incur each year as a result of the proposed amendments to update test procedures, conduct stress tests, and provide reports on the tests and assessments to the board of directors will vary. Funds that currently conduct stress tests already incur costs to perform the tests. In addition, some of those funds may currently provide reports to senior management (if not the board) of their test results. We assume, however, that few, if any, fund advisers provide a regular assessment to the board of the fund's ability to withstand the events reasonably likely to occur in the following year. For that reason, we estimate that for routine reports, each fund complex will incur costs of $3000 to provide a written report on the test results to the board, $4000 to provide the assessment in the report, and $10 to retain records of the reports for a total annual cost to a fund complex of $42,000.[547] As noted above, however, the procedures must provide for additional reports to the board as appropriate based on testing results, and we estimate that each fund complex will incur costs of $28,000 for an average of four of these reports each year.[548] We estimate that a portion

546 This estimate is based on the following calculation: $275/hour (senior risk management specialist) x 8 hours = $2200; $2200 + $6050 + $12,000 = $20,250.

547 *See supra* note 419 and preceding, accompanying, and following text. This estimate is based on the following calculation: *Report:* $275/hour x 10 hours (senior risk management specialist) + $62 x 2 hours (administrative assistant) = $2874; *Assessment:* $275/hour x 15 hours (senior risk management specialist) = $4125; *Record retention:* $62/hour x 0.1667 hours (administrative assistant) = $10.33; ($2874 + $4125 +$10) x 6 (board meetings per year) = $42,054. Hourly wages used for purposes of the estimate of administrative assistant salaries are from the SIFMA *Report on Management & Professional Salaries Data* (Sept. 2008), modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

548 *See supra* note 420 and accompanying text. This estimate is based on the following calculation:

of funds will incur additional costs to perform stress tests and update their procedures each year, up to a maximum of approximately $149,000.[549]

For purposes of this cost benefit analysis, Commission staff has estimated that 25 percent of fund complexes (or 41 complexes) will have to develop stress test procedures, 50 percent (or 81) would have stress test procedures, but have to revise those procedures, and 25 percent of complexes (or 41 complexes) will review the procedures without having to change them. Based on these estimates, staff further estimates that the total one-time costs for fund complexes to develop or refine existing stress test procedures will be approximately $16 million.[550] In addition, staff estimates that the annual costs to all funds to conduct stress tests, update test procedures, provide reports to fund boards, and retain records of the reports will be approximately $24 million.[551]

4. *Repurchase Agreements*

We are adopting, as proposed, changes affecting a money market fund's ability to "look through" a repurchase agreement for purposes of rule 2a-7's diversification provisions.[552] Under the amended rule, a money market fund will be able to look through a repurchase agreement only if it is collateralized by cash items or Government securities, and if the fund's board of directors or its delegate evaluates the counterparty's creditworthiness.

($2874 (reports) + ($4125) (assessment) + $10 (recordkeeping)) x 4 = $28,036.

549 This estimate is based on the following calculations: *Tests:* $275/hour x 15 hours (senior risk management specialist) + $244/hour x 20 hours (senior systems analyst) = $9005; $9005 x 12 (monthly testing) + ($9005 x 4 additional "appropriate" testing) = $144,080; *Update procedures:* $275/hour x 5 hours (senior risk management specialist) + $4000/hour x 1 hour = $5375; $144,080 + $5375 = $149,455.

550 This estimate is based on the following calculation: (41 x $173,000) + (81 x $95,000) + (41 x $20,000) = $15,608,000.

551 This estimate is based on the following calculation: (41 x $149,455) + (81 x $149,455 x 0.5) + (163 x $70,090 (reports, including assessments)) = $23,605,252.5.

552 *See supra* Section II.D; Proposing Release, *supra* note 2, at Section II.E.

The changes are designed to reduce money market funds' risks related to repurchase agreement investments so that funds will be better positioned to weather market turbulence and maintain a stable net asset value per share. A money market fund that invests in a repurchase agreement collateralized by cash items or Government securities is less likely to experience losses upon the sale of collateral in the event of a counterparty's default.[553] The creditworthiness evaluation, moreover, will diminish the risk that a money market fund in the first place enters into a repurchase agreement with a counterparty that subsequently defaults.

We believe that the costs associated with these changes will be minimal. As confirmed by commenters, most money market funds typically do not look through repurchase agreements collateralized with securities other than Government securities.[554] Under the amended rule, money market funds will be able, as they have in the past, to invest in such repurchase agreements, although the funds will not be able to look through the repurchase agreements for purposes of rule 2a-7's diversification provisions.[555]

With regard to the new creditworthiness evaluation, several commenters stated that money market funds already evaluate the credit quality of counterparties under rule 2a-7(c)(3).[556] We estimate, therefore, that investment advisers to only approximately 20 percent of all 163 fund complexes are not currently making such determinations. To the extent that boards or their delegates, in response to the amended rule, will make determinations that they would not otherwise make, those parties will expend time and/or resources in making those determinations.

553 *See supra* note 272 and accompanying text.

554 *See supra* note 274 and accompanying text.

555 No commenter has expressed the view that the new diversification requirement will increase money market funds' cost of investing in repurchase agreements.

556 As discussed above, three commenters argued that the proposed creditworthiness evaluation is unnecessary because it is already an element of the minimal credit risk determination that a fund makes pursuant to rule 2a-7(c)(3). *See supra* note 277.

We estimate that, if an investment adviser were to spend 10 hours a year making creditworthiness determinations that it would not otherwise make concerning repurchase agreement counterparties, it would spend approximately $2750 per year.[557] Therefore the total cost to all money market funds would be approximately $90,750 per year.[558] In addition to these costs, we also estimated above, for purposes of the Paperwork Reduction Act, that funds might spend 2 hours per year maintaining records concerning the determinations made under the amended rule.[559] We estimate the aggregate total costs associated with this recordkeeping to be $20,212 per year.[560]

5. *Public Website Posting*

The amendments to rule 2a-7 require money market funds to post monthly portfolio information on their websites.[561] The rule amendments are intended to provide shareholders with timely information about the securities held by the money market fund.

We anticipate that requiring funds to post monthly portfolio information on their websites will benefit investors by providing them a better understanding of their own risk exposure enabling them to make better informed investment decisions. The rule amendments may thus instill more discipline into portfolio management and reduce the likelihood of a money market fund breaking the buck.

The website posting requirement will impose certain costs on funds. We estimated in the

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557 This estimate is based on the following calculation: $275/hour (senior risk management specialist) x 10 hours= $2750.

558 This estimate is based on the following calculation: $275/hour (senior risk management specialist) x 10 hours x 33 fund complexes = $90,750.

559 *See supra* Section IV.A.4.

560 This estimate is based on the following calculation: $62/hour (administrative assistant) x 2 hours x 163 fund complexes = $20,212.

561 Amended rule 2a-7(c)(12).

Proposing Release that money market funds would be required to spend 24 hours of internal money market fund staff time initially to develop a webpage, at a cost of $4944 per fund.[562] We also estimated that all money market funds would be required to spend 4 hours of professional time to maintain and update the webpage each month, at a total annual cost of $9888 per fund.[563] We also stated that we believe, however, that our estimates may overstate the actual costs that would be incurred to comply with the website posting requirement because many funds currently post their portfolio holdings on a monthly, or more frequent, basis.[564] For purposes of the cost benefit analysis in the Proposing Release, Commission staff estimated that 20 percent of money market portfolios (150 portfolios) did not post portfolio holdings information on their websites.[565] We requested comment on these estimated costs in the Proposing Release.[566] One commenter suggested that we may have underestimated the costs associated with the initial development of the webpage, but also may have overestimated the costs associated with the ongoing maintenance of website reporting.[567] The commenter did not provide any cost estimates. Commission staff continues to believe that these cost estimates are appropriate. In addition, as discussed above, we have decided not to require some of the information required by Regulation S-X, which we proposed that funds post on their websites.[568] We expect that eliminating the

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562 *See* Proposing Release, *supra* note 2, at n.374 and accompanying text. The staff estimated that a webmaster at a money market fund would require 24 hours (at $206 per hour) to develop and review the webpage (24 hours x $206 = $4944).

563 *See* Proposing Release, *supra* note 2, at n.375 and accompanying text. The staff estimated that a webmaster would require 4 hours (at $206 per hour) to maintain and update the relevant webpages on a monthly basis (4 hours x $206 x 12 months = $9888).

564 *See* Proposing Release, *supra* note 2, at n.376 and accompanying text.

565 *See* Proposing Release, *supra* note 2, at text preceding n.377.

566 *See* Proposing Release, *supra* note 2, at Section V.A.5.

567 *See* Clearwater Comment Letter.

568 *See supra* note 285 and accompanying text.

mandatory posting of this information, which we believe is not critical to be made available to investors, will reduce costs for funds and their advisers.[569]

One commenter, however, stated that the cost estimates did not include the cost for the 80 percent of money market portfolios that currently post portfolio holdings information at least quarterly on their websites to develop the capability to retain previous months' portfolio holdings information on their websites.[570] Based on a review of some of the commenters' current portfolio website disclosure and follow-up discussions with some commenters, Commission staff estimates that 500 funds will need to develop this capability. Commission staff estimates that each of these 500 funds will spend approximately 12 hours, at a one-time cost of $2472 per fund, to develop this capability.[571]

Based on these estimates, we estimate that the total initial costs for the website disclosure will be $1,947,936.[572] In addition, we estimate that the annual costs for all money market funds to maintain and update their webpages will be $7.1 million.[573]

In addition, monthly website disclosure may impose other costs on funds and their shareholders. For example, more frequent disclosure of portfolio holdings may arguably expand the opportunities for professional traders to exploit this information by engaging in predatory trading practices, such as front-running. However, given the short-term nature of money market

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569 *Id.*

570 *See* Data Communiqué Comment Letter. Under our proposal, funds would have been required to maintain the portfolio holdings information on their websites for at least twelve months. We are adopting a six-month maintenance period for portfolio holding information.

571 The staff estimates that a webmaster at a money market fund would require 12 hours (at $206 per hour) to develop the capability to retain previous months' portfolio holdings information on their websites as required by the rule (12 hours x $206 = $2472).

572 This calculation was based on the following estimate: ($4944 x 144 portfolios) (cost to develop webpage) + ($2472 x 500 portfolios) (cost to develop capability to retain previous months' portfolio holdings information on existing websites) = $1,947,936.

573 This calculation was based on the following estimate: ($9888 x 719 portfolios) = $7,109,472.

fund investments and the restricted universe of eligible portfolio securities, we believe that the risk of trading ahead is severely curtailed in the context of money market funds.[574] For similar reasons, we believe that the potential for "free riding" on a money market fund's investment strategies, *i.e.*, obtaining for free the benefits of fund research and investment strategies, is minimal. Given that shares of money market funds are ordinarily purchased and redeemed at the stable price per share, we believe that there would be relatively few opportunities for profitable arbitrage. Thus, we estimate that the costs of predatory trading practices under the amended rule will be minimal. Furthermore, as previously noted, most money market fund portfolios (80 percent) already are posted on fund websites at least quarterly.

6. *Processing of Transactions*

The amendments to rule 2a-7 require a money market fund to have the capacity to redeem and sell its securities at a price based on the fund's current net asset value per share, including the capacity to sell and redeem shares at prices that do not correspond to the stable net asset value or price per share.[575] As discussed above, the events of fall 2008 revealed that some funds had not implemented automated systems to process redemptions at prices other than the funds' stable net asset value per share. As a result, transactions were processed manually, which extended the time that investors had to wait for the proceeds from their redeemed shares. This experience showed that funds that cannot electronically process redemptions at prices other than the funds' stable net asset value per share risk being unable to meet their obligations to redeem shares and pay redemption proceeds within seven days, as required under the Act.

The amendments to rule 2a-7 mitigate the risk that money market funds would not be able to meet these obligations in the event the fund breaks a buck. These amendments benefit

[574] *See* ICI REPORT, *supra* note 14, at 93.

[575] Amended rule 2a-7(c)(13).

shareholders because they increase the likelihood that shareholders will timely receive the proceeds of their investments when a fund breaks the buck.

Because funds have an existing obligation to redeem at other than their stable net asset value per share, we do not believe that this amendment to rule 2a-7 imposes any additional costs on funds or their transfer agents.[576] Nonetheless, to the extent that funds and transfer agents have to change their systems, we estimated in the Proposing Release that the total cost for a fund complex would be $39,040.[577] We further estimated that one-third of the fund complexes are not currently able to redeem at prices other than stable net asset value, and thus the total cost to all money market funds would be $2,225,280.[578]

Several commenters claimed that the costs of changing the systems would exceed our estimates.[579] One commenter estimated that the costs of making the required changes to the core transfer agent and ancillary systems would total approximately $24 million for ten fund complexes, representing 63 percent of money market fund assets, and two of the three largest transfer agent service providers.[580] Based on those figures, we have revised our estimate to reflect that the total cost of making the required systems changes for all money market funds would be approximately $38.1 million.[581]

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576 *See supra* Section II.F.

577 This estimate is based on the following calculation: $244/hour x 160 hours (senior systems analyst) = $39,040.

578 This estimate was based on the following calculation: (171 fund complexes ÷ 3) x $39,040 = $2,225,280.

579 *See, e.g.*, HighMark Capital Comment Letter; ICI Comment Letter.

580 *See* ICI Comment Letter. The ICI conducted a survey of its members and gathered data from 10 fund complexes and 2 transfer agent service providers. Six of the 12 respondents indicated that their transfer agent system already had the capability to process money market fund trades at other than a $1.00 stable net asset value.

581 We believe that the systems changes costs are correlated to the size of the fund complex. Accordingly, this estimate is based on the following calculations: $24 million ÷ 63% = $38.1

B. Rule 17a-9

The Commission is amending rule 17a-9 to expand the circumstances under which affiliated persons can purchase money market fund portfolio securities. Under the amendment, a money market fund generally will be able to sell a portfolio security that has defaulted to an affiliated person for cash equal to the greater of the security's amortized cost value or market value (including accrued interest), even though the security continues to be an eligible security.[582]

The amendment essentially codifies past Commission staff no-action letters[583] and should benefit investors by enabling money market funds to dispose of distressed securities (*e.g.*, securities depressed in value as a result of market conditions) from their portfolios quickly without any loss to fund shareholders. It also benefits money market funds by eliminating the cost and delay of requesting no-action assurances in these scenarios and the uncertainty whether such assurances will be granted.[584] We do not believe that there are any costs associated with this amendment, and we received no comments on this analysis.

In addition, the amendment permits affiliated persons to purchase other portfolio securities from an affiliated money market fund, for any reason, as long as the security's purchase price meets the rules' other conditions and such person promptly remits to the fund any profit it realizes from the later sale of the security.[585] Our staff provided temporary no-action assurances during the fall of 2008 to certain funds facing extraordinary levels of redemption

million. The ICI Comment Letter also provided additional cost estimates for changes to the systems of intermediaries who perform sub-transfer agency or similar recordkeeping functions. We do not discuss those additional costs here because, as discussed above, the rule does not impose any requirements on those intermediaries. *See supra* text preceding note 363.

582 *See* amended rule 17a-9(a).

583 *See supra* Section II.G.1.

584 Commission staff estimates that the costs to obtain staff no-action assurances range from $50,000 to $100,000.

585 *See* amended rule 17a-9(b).

requests for affiliated persons of such funds to purchase eligible securities from the funds at the greater of amortized cost or market value (plus accrued and unpaid interest).[586] In these circumstances, money market funds may need to obtain cash quickly to avoid selling securities into the market at fire sale prices to meet shareholder redemption requests, to the detriment of remaining shareholders. The staff also provided no-action assurances to money market funds for affiliated persons of the fund to purchase at the greater of amortized cost or market value (plus accrued and unpaid interest) certain distressed securities that were depressed in value due to market conditions potentially threatening the stable share price of the fund, but that remained eligible securities and had not defaulted.[587] Money market funds and their shareholders benefit if affiliated persons are able to purchase securities from the fund at the greater of amortized cost or market value (plus accrued and unpaid interest) in such circumstances without the time, expense, and uncertainty of applying to Commission staff for no-action assurances.

Affiliated persons purchasing such securities will have costs in creating and implementing a system for tracking the purchased securities and remitting to the money market fund any profit ultimately received as a result. We estimate that creating such a system on average would require 5 hours of a senior programmer's time, at a cost of $1460 for each of the 163 fund complexes with money market funds, and a total cost of $237,980.[588] After the initial creation of this system, we expect that the time spent noting in this system that a security was purchased under rule 17a-9 would require a negligible amount of compliance personnel's time. Based on our experience, we do not anticipate that there would be many instances, if any, in

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[586] Many of the no-action letters can be found on our website. *See* http://www.sec.gov/divisions/investment/im-noaction.shtml#money.

[587] *Id.*

[588] This estimate is based on the following calculation: $292/hour x 5 hours x 163 fund complexes = $237,980.

which an affiliated person will be required to repay profits in excess of the purchase price paid to the fund. However, if there is a payment, it would be made to the fund. If the payment is sufficiently large, we believe that funds are likely to include it with the next distribution to shareholders, which would not result in any additional costs to the fund. We received no comments on this analysis.

The Commission also is adopting a related amendment to rule 2a-7, which requires that funds report all transactions under rule 17a-9 to the Commission. We believe that this reporting requirement benefits fund investors by allowing the Commission to monitor the purchases for possible abuses and conflicts of interest on the part of the affiliates. It also allows the Commission to observe what types of securities are distressed and which money market funds are holding distressed securities or are subject to significant redemption pressures. This information will assist us in monitoring emerging risks at money market funds. For purposes of the Paperwork Reduction Act analysis, we estimate this amendment will impose relatively small reporting costs on money market funds of $7625 per year.[589] We received no comments on this analysis.

C. Rule 22e-3

Rule 22e-3 permits a money market fund that has broken the buck, or is at imminent risk of breaking the buck, to suspend redemptions and postpone the payment of proceeds pending board-approved liquidation proceedings. By facilitating orderly liquidations in distressed circumstances, we anticipate that rule 22e-3 will reduce the vulnerability of shareholders to the harmful effects of a run on a fund and minimize the potential for market disruption. The rule also enables funds to avoid the expense and delay of obtaining an exemptive order from the

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589 This estimate is based on the following calculation: 25 (notices) x $305/hour (attorney) x 1 hour = $7625. *See supra* note 437 and accompanying text.

Commission, which we estimate would otherwise cost approximately $75,000, and will provide legal certainty to funds that wish to suspend redemptions during a liquidation in the interest of fairness to all shareholders.

Rule 22e-3 will impose certain minimal costs on funds relying on the rule by requiring them to provide prior notice to the Commission of their decision to suspend redemptions in connection with a liquidation. Furthermore, the rule will impose minimal costs on certain conduit funds that have invested in money market funds that suspended redemptions in reliance on the rule by also requiring those conduit funds to provide notice to the Commission. We estimate that the total annual burden of the notification requirement for all money markets funds and conduit funds will be 110 minutes, at a cost of $559.[590] In addition, rule 22e-3 imposes costs on shareholders who seek to redeem their shares, but are unable to do so. In those instances, shareholders may have to borrow funds from another source, and thereby incur interest charges and other transaction fees. We believe, however, that the costs associated with rule 22e-3 are minimal because the rule provides a very limited exemption that is triggered only when a fund breaks the buck, or is in imminent risk of breaking the buck, and liquidates.

D. Rule 30b1-7 and Form N-MFP: Monthly Reporting of Portfolio Holdings

Rule 30b1-7 and Form N-MFP require money market funds to file with the Commission interactive data-formatted portfolio holdings information on a monthly basis. We expect that the rule and form will improve the efficiency and effectiveness of the Commission's oversight of money market funds by enabling Commission staff to manage and analyze comprehensive money market fund portfolio information more quickly and at a lower cost than is currently possible. The interactive data will also facilitate the flow of information between money market

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[590] *See supra* note 443 and accompanying text. This estimate is based on the following calculation: $305/hour x 110 minutes = $559.

funds and other users of this information, such as information services, academics, and investors. As a result, users of this information, including investors, may benefit by gaining a better understanding of money market funds' risk exposure and becoming better informed in their investment decisions. As the development of software products to analyze the data continues to grow, we expect these benefits will increase. Finally, the portfolio reporting may instill more discipline into portfolio management and reduce the likelihood of a money market fund breaking the buck.

Money market funds may also realize cost savings from the rule. Currently, money market funds provide portfolio holdings information in a variety of formats to different third-parties, such as information services and NRSROs. The rule may encourage the industry to adopt a standardized format, thereby reducing the burdens on money market funds of having to produce this information in multiple formats.

The reporting requirement will also impose certain costs. We estimated in the Proposing Release, that, for the purposes of the PRA, these filing requirements (including collecting, tagging, and electronically filing the report) would impose 128 burden hours at a cost of \$35,968[591] per money market fund for the first year, and 96 burden hours at a cost of \$26,976[592] per money market fund in subsequent years.[593] We requested comment on these estimated costs

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591 *See* Proposing Release, *supra* note 2, at n.396 and accompanying text. This estimate was based on the following calculation: \$281/hour x 128 hours (senior database administrator) = \$35,968.

592 *See* Proposing Release, *supra* note 2, at n.397 and accompanying text. This estimate was based on the following calculation: \$281/hour x 96 hours (senior database administrator) = \$26,976.

593 We understand that some money market funds may outsource all or a portion of these responsibilities to a filing agent, software consultant, or other third-party service provider. We believe, however, that a fund would engage third-party service providers only if the external costs were comparable, or less than, the estimated internal costs of compiling, tagging, and filing the Form N-MFP.

in the Proposing Release.[594]

As discussed above, two commenters asserted that the Commission's cost estimates did not include time to review the information required in Form N-MFP.[595] In response to these commenters, we revised our PRA estimates to include an additional 2 hours per filing for review of the information.[596] As a result of this increase, we have revised our cost estimates. We estimate that, for the purposes of the PRA, these filing requirements (including collecting (and review), tagging, and electronically filing the report) would impose 152 burden hours at a cost of $42,712[597] per money market fund for the first year, and 120 burden hours at a cost of $33,720[598] per money market fund in subsequent years.[599] We estimate that the total cost for all money market funds for the first year would be $30,709,928.[600] The total annual estimated cost for all money market funds in subsequent years would be $24,244,680.[601]

In addition, funds may incur additional costs as a result of the public availability of a fund's market-based net asset value, which is required to be included in Form N-MFP filings. In

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594 *See* Proposing Release, *supra* note 2, at paragraph following n.398.

595 *See* Bowne Comment Letter; Data Communiqué Comment Letter. Another commenter suggested that we may have underestimated the costs associated with the initial filing of Form N-MFP, but also may have overestimated the ongoing costs associated with subsequent filings. *See* Clearwater Comment Letter. The commenter, however, did not provide any cost estimates.

596 *See supra* Section IV.C.

597 This estimate is based on the following calculation: $281/hour x 152 hours (senior database administrator) = $42,712.

598 This estimate is based on the following calculation: $281/hour x 120 hours (senior database administrator) = $33,720.

599 We understand that some money market funds may outsource all or a portion of these responsibilities to a filing agent, software consultant, or other third-party service provider. We believe, however, that a fund would engage third-party service providers only if the external costs were comparable, or less than, the estimated internal costs of compiling, tagging, and filing the Form N-MFP.

600 This estimate is based on the following calculation: $42,712 (total estimated cost per fund for first year) x 719 funds = $30,709,928.

601 This estimate is based on the following calculation: $33,720 (total estimated cost per fund after the first year) x 719 funds = $24,244,680.

particular, some commenters noted that if investors systematically redeem shares for one dollar when the market-based net asset value is less than one dollar, the fund might have difficulty maintaining its stable price. However, in response to concerns about the disclosure of market-based values, we are delaying the public availability of the information filed on Form N-MFP for 60 days after the end of the reporting period.[602] We acknowledge that investors might choose to sell their money market fund shares that have a low market-based net asset value, and it is possible that a run could develop. Nevertheless, at least two other factors will reduce the risk of a run. First, portfolio managers may choose to follow less risky investment strategies in an effort to maintain a high market-based net asset value. Second, funds may be quicker to ask for help from their affiliates through, for example, rule 17a-9 transactions.

The money market fund industry is characterized by a mix of competitors with and without affiliates that can provide financial support. The disclosure of a fund's market-based net asset value might encourage funds that have affiliates with the ability to provide financial support to request such support as soon as any problems develop. This support could provide stability to funds that receive the support. This support might also give a competitive advantage to funds that receive it because they may be more willing to invest in securities with higher risk and higher yields. However, the extent of this competitive advantage may be mitigated because the amendments will require the disclosure of the fund's market-based NAV with and without capital support agreements. In addition, much of the extent to which fund managers might take advantage of capital support arrangements to boost fund yields is independent of the

[602] *See* rule 30b1-7(b). *See also supra* text accompanying note 320. As noted above, money market funds currently must disclose their mark-to-market net asset value per share semi-annually in their Form N-SAR filings [17 CFR 274.101], which are publicly available. Form N-SAR must be filed with the Commission no later than the 60th day after the end of the fiscal period for which the report is being prepared. *See supra* note 337 and accompanying text. Thus, investors already have access to market-based portfolio value information on the basis of which they could make redemptions.

amendments we are adopting today and affiliated persons of money market funds are not obligated to support these funds. For the reasons outlined in the discussion on the monthly website posting requirement, we estimate that there will be minimal additional costs incurred from predatory trading practices (*e.g.*, front-running or "free riding") as a result of the reporting requirement.[603]

E. Rule 30b1-6T

We adopted rule 30b1-6T to enable the Commission staff to continue to have effective oversight of money market funds. The rule was designed to improve the efficiency and effectiveness of the Commission's oversight by providing useful information about money market funds that report under the rule, and by enabling the staff to manage and analyze money market fund portfolio information more quickly and at a lower cost than possible without electronic submissions of portfolio schedules. When we adopted rule 30b1-6T in September 2009, we requested comments on the costs and benefits of the rule but received no comments.[604]

Rule 30b1-6T will impose some costs on funds. For the purposes of the PRA, we estimated that the rule will result in an increase of 2100 burden hours per year. We estimate that these burden hours will cost a total of $590,100.[605] We do not believe that rule 30b1-6T will impose other significant costs, especially given the nonpublic nature of the reports required under the rule.

VI. Competition, Efficiency, and Capital Formation

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is consistent with the

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603 *See supra* note 574 and accompanying and following text.

604 *See* Rule 30b1-6T Release, *supra* note 303, at Section VI.

605 This estimate is based on the following calculation: 2100 hours x $281/hour (senior database administrator) = $590,100.

public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[606]

A. Rule 2a-7

1. Second Tier Securities, Portfolio Maturity, and Liquidity Limits

We are adopting several amendments to rule 2a-7 to tighten the risk-limiting conditions of the rule. As discussed above, we are further restricting money market funds' ability to acquire second tier securities. The amendments reduce the maximum weighted average maturity of a money market fund permitted by rule 2a-7 from 90 days to 60 days.[607] They also impose a new maturity limitation based on the weighted average "life" of fund securities that limits the portion of a fund's portfolio that can be held in longer term floating- or variable-rate securities.[608] We are deleting a provision in rule 2a-7 that permitted money market funds not relying on the amortized cost method of valuation to acquire Government securities with a remaining maturity of up to 762 calendar days.

Finally, we are adopting new liquidity requirements for money market funds. In particular, we are amending rule 2a-7 to (i) require that each money market fund hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders;[609] (ii) further limit a money market fund's investments in illiquid securities (*i.e.* securities that cannot be sold or disposed of in the ordinary course of business within seven days

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606 15 U.S.C. 80a-2(c).

607 *See* amended rule 2a-7(c)(2)(ii).

608 *See* amended rule 2a-7(c)(2)(iii).

609 Amended rule 2a-7(c)(5).

at approximately the value ascribed to them by the money market fund);[610] and (iii) require a taxable money market fund to hold at least 10 percent of its total assets in "daily liquid assets" and any money market fund to hold at least 30 percent of its total assets in "weekly liquid assets."[611]

We believe that these changes will reduce money market funds' sensitivity to interest rate, credit, and liquidity risks. These changes will also limit the spread risk produced by longer term securities and second tier securities. A reduction of these risks will help individual money market funds to weather market turbulence and maintain a stable net asset value per share, which will increase the stability of the entire money market fund industry. To the extent that money market funds are more stable, the changes also will reduce systemic risk to the capital markets and ensure a stable source of financing for issuers of short-term credit instruments. We believe that these effects will encourage capital formation by encouraging investment in money market funds as well as the issuance of securities that money market funds can purchase.

These changes also may reduce maturities of short-term credit securities that issuers offer, which may increase financing costs for these issuers who might have to go back more frequently to the market for financing. As discussed above, several commenters stated that the elimination of money market funds' ability to acquire second tier securities could increase second tier security issuers' borrowing costs and thus increase capital formation costs.[612] Some of these commenters also asserted that such a prohibition could require second tier security issuers to rely more on bank financing, which could negatively impact banks' ability to lend to

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610 Amended rule 2a-7(c)(5)(i). Under the amended rule, a money market fund cannot acquire illiquid securities if immediately after the acquisition, the fund would have invested more than five percent of its total assets in illiquid securities.

611 *See* amended rule 2a-7(c)(5)(ii)-(iii). *See also* amended rule 2a-7(a)(8) (defining "daily liquid assets"); 2a-7(a)(32) (defining "weekly liquid assets").

612 *See supra* notes 48-49 and accompanying paragraph.

other parts of the economy.[613] We note that these impacts should be mitigated given that we are limiting and not eliminating money market funds' ability to acquire second tier securities. However, to the extent that some issuers are unwilling or unable to issue securities that match money market fund demand given these new restrictions or that banks become less willing to lend to finance new businesses, the amendments could have a negative impact on capital formation.

As discussed in the cost benefit analysis above, we expect that the amendments will reduce yields that some money market funds are able to offer. The lower yields may affect the ability of money market funds to compete with other investment vehicles. While money market funds compete with each other, they also compete for investors on the basis of risk-return tradeoff with other lower-risk investment vehicles, such as offshore or unregulated money market funds, bank money market deposit accounts, and deposit accounts in general. The reduction in yield may cause some investors to move their money to, among other places, offshore or unregulated money market funds that do not follow rule 2a-7's strictures and thus are able to offer a higher yield. Beyond the competitive impact, such a change could increase systemic risks to short-term credit markets and capital formation by increasing investment in less stable short-term instruments.

Further limitations on money market funds' ability to acquire second tier securities also may have anticompetitive effects on some relatively small money market funds that may compete with larger funds on the basis of yield. One commenter stated that elimination of money market funds' ability to acquire second tier securities could have a disproportionate

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[613] *See, e.g.*, Chamber/Tier 2 Issuers Comment Letter.

impact on smaller money market funds.[614] Our review of money market fund holdings of second tier securities during September 2008 did not reveal smaller money market funds holding second tier securities to a greater extent than larger funds, although smaller funds may try to increase their holdings of second tier securities in different market environments. Even if there were any anticompetitive effects on smaller money market funds, these effects should be reduced by the fact that we are only further limiting, and not eliminating, money market funds' ability to acquire second tier securities.

The further limitations on the ability of money market funds to invest in second tier securities may affect the capital raising ability and strategies of second tier security issuers or otherwise affect their financing arrangements, and may affect the flexibility of investing options for funds. As a preliminary matter, taking into account commenters' concerns, we have determined not to eliminate money market funds' ability to acquire second tier securities. Further, as noted above, second tier securities represent only a very small percentage of money market fund portfolios today and money market funds are not the primary purchasers of second tier securities, which suggests that our amendments would not in themselves have a material effect on capital formation.[615] Nonetheless, we recognize that some non-rule 2a-7 regulated cash management funds and investment pools voluntarily use rule 2a-7 as an investment guideline.[616] However, since we are only further limiting, and not eliminating, money market funds' ability to acquire second tier securities, we do not believe that the behavior of these non-rule 2a-7 funds

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614 *See* Thrivent Comment Letter.

615 Based on discussions with one commenter to clarify certain aspects of its comment letter, however, we understand that money market funds purchase approximately 80% of the commercial paper of at least one second tier issuer. *See* Chamber/Tier 2 Issuers Comment Letter. We understand that such a significant reliance on money market funds to purchase a second tier issuer's securities is quite unusual.

616 *See, e.g.*, Chamber/Tier 2 Issuers Comment Letter.

will have a material adverse effect on capital formation.

2. *Designation of NRSROs*

We are adopting amendments requiring money market fund boards to designate at least four NRSROs that the fund will use in determining the eligibility of portfolio securities and that the board determines annually issue credit ratings that are sufficiently reliable for this use.[617] As noted above, several commenters suggested that designating at least three NRSROs could encourage competition among NRSROs to achieve designation by money market fund boards.[618] We assume that three NRSROs issue more than 90 percent of ratings of short-term debt.[619] Requiring the designation of at least four NRSROs will ensure that money market funds will consider NRSROs beyond the dominant three. In addition, the amendment may encourage new NRSROs that issue ratings specifically for money market fund instruments to enter the market. To the extent that requiring designation of at least four NRSROs will further increase competition, it also should increase the reliability of the credit ratings of designated NRSROs. Having better information about risk could increase the efficiency of fund managers in determining eligibility of portfolio securities. We do not anticipate that the proposed designation of NRSROs will have an adverse impact on capital formation.

3. *Stress Testing*

We are amending rule 2a-7 to require the board of directors of each money market fund to adopt procedures providing for periodic stress testing of the money market fund's portfolio, reporting the results of the testing to fund boards, and providing an assessment to the board.[620]

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617 Amended rule 2a-7(a)(11)(i).

618 *See, e.g.*, HighMark Capital Comment Letter; Invesco Aim Comment Letter.

619 *See* Proposing Release, *supra* note 2, at text accompanying and following n.116. *See also supra* note 104 and accompanying text.

620 Amended rule 2a-7(c)(10)(v).

We believe that stress testing will increase the efficiency of money market funds by enhancing their risk management and thus making it more likely that the fund will be better prepared for potential stress on the fund due to market events or shareholder behavior. Money market funds will likely become more stable as a result of the risk management benefits provided by stress testing, allowing them to expand and attract further investment. If so, this result will promote capital formation. We do not believe that stress testing will have an adverse impact on competition or capital formation.[621]

4. Repurchase Agreements

We are adopting, as proposed, changes to the conditions under which a money market fund may take advantage of the special look-through treatment of repurchase agreements under rule 2a-7's diversification provisions.[622] In order to obtain such special treatment, a money market fund will be limited to investing in repurchase agreements collateralized by cash items or Government securities and the fund's board of directors or its delegate will have to evaluate the creditworthiness of the repurchase agreement's counterparty.

We believe that these changes will limit the risk that a money market fund incurs losses upon the sale of collateral in the event of a counterparty's default.[623] The lower risk will in turn increase money market funds' ability to maintain a stable net asset value per share, thereby preventing losses to fund investors. More stable money market funds may attract greater investments, thus promoting capital formation and providing a greater source of financing in the capital markets. The changes will not negatively impact competition, efficiency, or capital

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621 No commenters addressed the analysis in the Proposing Release regarding whether the proposed stress testing requirements would promote competition, efficiency, and capital formation.

622 *See supra* Section II.D; Proposing Release, *supra* note 2, at Section II.E.

623 *See supra* note 272 and accompanying text.

formation. In particular, commenters noted that most money market funds typically do not look through to collateral consisting of non-Government securities.[624]

5. Public Website Disclosure

One of the amendments to rule 2a-7 requires money market funds to disclose certain portfolio holdings information on their websites on a monthly basis.[625] In the Proposing Release, we requested comment on what effect this rule amendment would have on competition, efficiency, and capital formation.[626] No commenters addressed the effect of this amendment on competition, efficiency, and capital formation.

The rule amendment will provide greater transparency of the fund's investments for current and prospective shareholders, and may thus promote more efficient allocation of investments by investors.[627] We believe the rule amendment may also improve competition, as better-informed investors may prompt funds managers to provide better services and products. We do not anticipate that funds would be disadvantaged, with respect to competition, because so many already have chosen to provide the information more frequently than monthly. In addition, the investments selected by money market funds are less likely than, for example, equity funds, to be investments from which competing funds would obtain benefit by scrutinizing on a monthly basis.

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624 *See supra* note 274. Wells Fargo stated that the amendment would negatively affect capital formation because money market funds will no longer invest in repurchase agreements collateralized with securities with the highest rating or unrated securities of comparable quality, which would negatively affect counterparties and issuers of collateral. *See* Wells Fargo Comment Letter. We discuss those comments above. *See supra* note 273.

625 *See supra* Section II.E.1.

626 *See* Proposing Release, *supra* note 2, at Section VI.A.4.

627 Due to the availability of the portfolio holding information on fund websites, investors may allocate their investments away from funds with riskier portfolios. Among other things, this may reduce systemic risks as money market funds may respond by investing in securities with less risk.

The rule amendment may also promote capital formation by making portfolio holdings information readily accessible to investors, who may thus be more inclined to allocate their investments in a particular fund or in money market funds instead of an alternative product. Alternatively, the rule amendment might have the reverse effect if the portfolio holdings information makes investors less confident regarding the risks associated with money market funds, including the risk that market participants might use the information obtained through the disclosures to the detriment of the fund and its investors, such as by trading along with the fund or ahead of the fund by anticipating future transactions based on past transactions. We also recognize the potential for runs on money market funds that might result from any investors who compute market-based net asset values from the public disclosure of portfolio holdings. As discussed above, however, most money market funds currently disclose their portfolio holdings on their websites, and therefore we do not believe that our requirement that funds post monthly portfolio holdings will have a material effect on the ability of investors to compute market-based values and incite a run on the fund.

6. Processing of Transactions

The amendments to rule 2a-7 require a money market fund to have the capacity to redeem and sell its securities at a price based on the fund's current net asset value per share, even if the fund's current net asset values does not correspond to the fund's stable net asset value or price per share. This amendment increases efficiency at money market funds that break the buck by increasing the speed and minimizing the operational difficulties in satisfying shareholder redemption requests in such circumstances. It may also reduce investors' concerns that redemptions would be unduly delayed if a money market fund were to break the buck. We do not believe that this amendment has a material impact on competition or capital formation.

B. Rule 17a-9

The Commission is amending rule 17a-9 to expand the circumstances under which affiliated persons can purchase money market fund securities. Under the amendments, a money market fund generally will be able to sell a portfolio security that has defaulted to an affiliated person for the greater of the security's amortized cost value or market value (including accrued interest), even though the security continued to be an eligible security.[628] In addition, the amendment permits affiliated persons, for any reason, to purchase other portfolio securities from an affiliated money market fund on the same terms as long as such person is required to promptly remit to the fund any profit it realizes from the later sale of the security.[629] These amendments increase the efficiency of both the Commission and money market funds by allowing affiliated persons to purchase portfolio securities from money market funds under distress without having to seek no-action assurances from Commission staff. The money market fund industry is competitive; some money market funds have well-funded affiliates to support the money market fund while others do not. This amendment may increase the competitive advantage of money market funds with well-funded affiliates relative to other money market funds, which we balanced against the need to promote stability in money market funds. We do not believe that the amendments will have any material impact on capital formation. We received no comments on this analysis.

C. Rule 22e-3

Rule 22e-3 permits a money market fund that has broken the buck, or is at imminent risk of breaking the buck, to suspend redemptions and postpone the payment of proceeds pending board-approved liquidation proceedings. We anticipate the rule will promote efficiency in the

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628 *See* amended rule 17a-9(a).

629 *See* amended rule 17a-9(b).

financial markets by facilitating the orderly disposal of assets during a liquidation. To the extent that investors choose money market funds over alternative investments because the rule provides reassurance as to the protection of fund assets in the event a money market fund breaks the buck, the rule also may promote capital formation. If, however, the possibility that redemptions may be suspended during a liquidation makes money market funds less appealing to investors, the rule may have a negative effect on capital formation. The rule also may help make investors more confident that they will receive the proceeds from their investment in the event of a liquidation. We do not believe that the rule will have any adverse effect on competition. We received no comments on this analysis.

D. Rule 30b1-7 and Form N-MFP: Monthly Reporting of Portfolio Holdings

New rule 30b1-7 and Form N-MFP mandate the monthly electronic filing of each money market fund's portfolio holdings information in XML-tagged format. As discussed above, we believe the new reporting requirement will improve the efficiency and effectiveness of the Commission's oversight of money market funds. The availability, and usability, of this data will also promote efficiency for other third parties that may be interested in collecting and analyzing money market funds' portfolio holdings information. Money market funds currently are often required to provide this information to various third parties in different formats. To the extent that the new reporting requirement may encourage a standardized format for disclosure or transmission of portfolio holdings information, it may promote efficiency for money market funds. We do not believe that the reporting requirement will have an adverse effect on capital formation.

In the Proposing Release, we requested comment on what effect the proposed rule[630]

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630 The rule was proposed as rule 30b1-6. As noted above, in September 2009 we adopted interim final temporary rule 30b1-6T. We therefore have adopted proposed rule 30b1-6 as rule 30b1-7.

would have on competition, efficiency, and capital formation.[631] One commenter stated that the Commission's view that the proposed rule would not have an adverse effect on competition may be incorrect for subadvised money market funds, because a number of the information items in Form N-MFP require information that typically is in the possession of the subadviser who manages the portfolio and not the principal adviser who, in most cases, would be responsible for preparing Form N-MFP. The commenter stated that obtaining the data from subadvisers would be costly because it would have to be done on a real-time basis, which would require a significant investment in new infrastructure.[632] The information required by the items cited by the commenter, however, already should be readily available to the subadviser.[633] The information also is not needed on a real-time basis by the principal adviser because the form requires information as of the last business day of the preceding month. Moreover, we have lengthened the time for filing Form N-MFP from the proposed two business days after the end of each month to five business days after the end of each month. This change should provide subadvisers with sufficient time to send the information to the principal adviser without having

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631 *See* Proposing Release, *supra* note 2, at Section VI.D.

632 *See* Committee Ann. Insur. Comment Letter. In particular, the commenter stated that the information required by Items 17 (dollar weighted average life maturity), 20 (CIK of the issuer of security), 26(b) (credit rating given by the NRSROs for the security), and 30-35 (information on enhancements) of proposed Form N-MFP are not typically in the possession of the principal adviser and must be obtained from the subadviser managing the portfolio. The commenter asserted that the Commission's estimate of 128 burden hours per money market fund for the first year (1 filing x 40 hours + 11 filings x 8 hours) is far too low for subadvised funds. For the reasons discussed below, we do not believe that subadvised funds would be subject to significant investment in new infrastructure and thus we believe that the burden estimate is not too low for subadvised funds. The commenter does not state that there would be any ongoing additional costs for compliance with Form N-MFP by subadvised money market funds.

633 Subadvisers must have all of the information required by the particular items the commenter specifies in order to manage the portfolio on a day-to-day basis in compliance with rule 2a-7, other than an issuer's CIK. Under Form N-MFP, as adopted, the CIK of the issuer of the security is only required if the security does not have a CUSIP and the issuer has a CIK. Under our proposal the CIK number of the issuer would have been required for all securities.

to invest in new infrastructure to provide the information on a real-time basis.[634] We therefore continue to believe that the reporting requirement will not have an adverse effect on competition.

The amendments also will require the public disclosure of a money market fund's market-based net asset value. We expect that the disclosure of month-end market-based NAV may discourage the fund's portfolio manager from taking certain risks that could reduce the fund's market-based NAV. The money market fund industry is characterized by a mix of competitors with and without affiliates that can provide financial support. The new disclosure might encourage funds that have affiliates with the ability to provide financial support to request such support as soon as any problems develop. This support could provide stability to funds that receive the support. This support might also give a competitive advantage to funds that receive it because they may be more willing to invest in securities with higher risk and higher yields. However, the extent of this competitive advantage may be mitigated because the amendments will require the disclosure of the fund's market-based NAV with and without capital support agreements. In addition, much of the extent to which fund managers might take advantage of capital support arrangements to boost fund yields is independent of the amendments we are adopting today and affiliated persons of money market funds are not obligated to support these funds.

The disclosure of a market-based net asset value below $1.00 also might precipitate a run on the fund. If one fund were to fail for this reason, runs might develop in other money market funds, even those with relatively high market-based net asset values. However, we believe that shareholders will benefit from knowing the monthly market-based net asset values of money market funds. We anticipate that the public availability of these values will help investors make

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634 By increasing the deadline to five business days, filers also will have at least two non-business days (in addition to the extra three business days) in which to complete and submit the form.

informed decisions about whether to invest, or maintain their investments, in money market funds. We also anticipate that retail investors over time will become acclimated to the market-based net asset value information that money market funds will be required to disclose, and that most of those investors will not likely make decisions based on immaterial changes to funds' portfolio values. In response to concerns expressed by some commenters about the potential for harm that immediate public disclosure may pose for funds, we will delay for 60 days after the end of the reporting period, public disclosure of the information filed on Form N-MFP, including the market-based net asset values.[635]

E. Rule 30b1-6T

Rule 30b1-6T is intended to facilitate oversight of money market funds that present a greater risk that they will be unable to maintain their primary investment objectives. As noted above, the nonpublic reports are designed to improve the efficiency and effectiveness of the Commission's oversight of such money market funds, which may also provide reassurance to investors, which may in turn promote capital formation. We do not believe that the rule will have any effect on competition.

VII. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Commission certified, pursuant to section 605(b) of the Regulatory Flexibility Act of 1980 that the proposed amendments to rules 2a-7, 17a-9, and 30b1-5, and proposed rules 30b1-6 and 22e-3 under the Investment Company Act would not have a significant economic impact on a substantial number of small entities.[636] We included this certification in Section VII of the

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[635] *See supra* Section II.E.2.

[636] 5 U.S.C. 605(b). Based on information in filings submitted to the Commission, we believe that there are no money market funds that are small entities. Under rule 0-10 under the Investment Company Act, an investment company is considered a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.

Proposing Release. Although we encouraged written comments regarding this certification, no commenters responded to this request.[637]

VIII. STATUTORY AUTHORITY

The Commission is adopting amendments to rule 2a-7 under the exemptive and rulemaking authority set forth in sections 6(c), 8(b), 22(c), and 38(a) of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-8(b), 80a-22(c), 80a-37(a)]. The Commission is adopting amendments to rule 17a-9 pursuant to the authority set forth in sections 6(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-37(a)]. The Commission is adopting rule 22e-3 pursuant to the authority set forth in sections 6(c), 22(e) and 38(a) of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-22(e), and 80a-37(a)]. The Commission is adopting an amendment to rule 30b1-6T pursuant to authority set forth in sections 8(b), 30(b), 31(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a-8(b), 80a-29(b), 80a-30(a), and 80a-37(a)]. The Commission is adopting new rule 30b1-7 and Form N-MFP pursuant to authority set forth in sections 8(b), 30(b), 31(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a-8(b), 80a-29(b), 80a-30(a), and 80a-37(a)].

List of Subjects

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF RULES, RULE AMENDMENTS, AND FORM

For reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

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637 We also certified that rule 30b1-6T would not have a significant economic impact on a substantial number of small entities. *See* Rule 30b1-6T Release, *supra* note 303, at Section VIII. We received no comment on that certification.

PART 270 – RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

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2. Section 270.2a-7 is revised to read as follows:

§ 270.2a-7 Money market funds.

(a) *Definitions.*

(1) *Acquisition* (or *Acquire*) means any purchase or subsequent rollover (but does not include the failure to exercise a Demand Feature).

(2) *Amortized Cost Method* of valuation means the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's Acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors.

(3) *Asset Backed Security* means a fixed income security (other than a Government Security) issued by a Special Purpose Entity (as defined in this paragraph), substantially all of the assets of which consist of Qualifying Assets (as defined in this paragraph). *Special Purpose Entity* means a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle their holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company. *Qualifying Assets* means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or

timely distribution of proceeds to security holders.

(4) *Business Day* means any day, other than Saturday, Sunday, or any customary business holiday.

(5) *Collateralized Fully* means "Collateralized Fully" as defined in § 270.5b-3(c)(1) except that § 270.5b-3(c)(1)(iv)(C) and (D) shall not apply.

(6) *Conditional Demand Feature* means a Demand Feature that is not an Unconditional Demand Feature. A Conditional Demand Feature is not a Guarantee.

(7) *Conduit Security* means a security issued by a Municipal Issuer (as defined in this paragraph) involving an arrangement or agreement entered into, directly or indirectly, with a person other than a Municipal Issuer, which arrangement or agreement provides for or secures repayment of the security. *Municipal Issuer* means a state or territory of the United States (including the District of Columbia), or any political subdivision or public instrumentality of a state or territory of the United States. A Conduit Security does not include a security that is:

(i) Fully and unconditionally guaranteed by a Municipal Issuer;

(ii) Payable from the general revenues of the Municipal Issuer or other Municipal Issuers (other than those revenues derived from an agreement or arrangement with a person who is not a Municipal Issuer that provides for or secures repayment of the security issued by the Municipal Issuer);

(iii) Related to a project owned and operated by a Municipal Issuer; or

(iv) Related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a Municipal Issuer.

(8) *Daily Liquid Assets* means:

(i) Cash;

(ii) Direct obligations of the U.S. Government; or

(iii) Securities that will mature or are subject to a Demand Feature that is exercisable and payable within one Business Day.

(9) *Demand Feature* means:

(i) A feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise. A Demand Feature must be exercisable either:

(A) At any time on no more than 30 calendar days' notice; or

(B) At specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice; or

(ii) A feature permitting the holder of an Asset Backed Security unconditionally to receive principal and interest within 397 calendar days of making demand.

(10) *Demand Feature Issued By A Non-Controlled Person* means a Demand Feature issued by:

(i) A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the Demand Feature (*control* means "control" as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)); or

(ii) A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

(11) *Designated NRSRO* means any one of at least four nationally recognized statistical rating organizations, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(62)), that:

(i) The money market fund's board of directors:

(A) Has designated as an NRSRO whose credit ratings with respect to any obligor or security or particular obligors or securities will be used by the fund to determine whether a security is an Eligible Security; and

(B) Determines at least once each calendar year issues credit ratings that are sufficiently reliable for such use;

(ii) Is not an "affiliated person," as defined in section 2(a)(3)(C) of the Act (15 U.S.C. 80a-2(a)(3)(C)), of the issuer of, or any insurer or provider of credit support for, the security; and

(iii) The fund discloses in its statement of additional information is a Designated NRSRO, including any limitations with respect to the fund's use of such designation.

(12) *Eligible Security* means:

(i) A Rated Security with a remaining maturity of 397 calendar days or less that has received a rating from the Requisite NRSROs in one of the two highest short-term rating categories (within which there may be sub-categories or gradations indicating relative standing); or

(ii) An Unrated Security that is of comparable quality to a security meeting the requirements for a Rated Security in paragraph (a)(12)(i) of this section, as determined by the money market fund's board of directors; provided, however, that: a security that at the time of issuance had a remaining maturity of more than 397 calendar days but that has a remaining maturity of 397 calendar days or less and that is an Unrated Security is not an Eligible Security if the security has received a long-term rating from any Designated NRSRO that is not within the Designated NRSRO's three highest long-term ratings categories (within which there may be sub-categories or gradations indicating relative standing), unless the security has received a long-term rating from the Requisite NRSROs in one of the three highest rating categories.

(iii) In addition, in the case of a security that is subject to a Demand Feature or Guarantee:

(A) The Guarantee has received a rating from a Designated NRSRO or the Guarantee is issued by a guarantor that has received a rating from a Designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security to the Guarantee, unless:

(*1*) The Guarantee is issued by a person that, directly or indirectly, controls, is controlled by or is under common control with the issuer of the security subject to the Guarantee (other than a sponsor of a Special Purpose Entity with respect to an Asset Backed Security);

(*2*) The security subject to the Guarantee is a repurchase agreement that is Collateralized Fully; or

(*3*) The Guarantee is itself a Government Security; and

(B) The issuer of the Demand Feature or Guarantee, or another institution, has undertaken promptly to notify the holder of the security in the event the Demand Feature or Guarantee is substituted with another Demand Feature or Guarantee (if such substitution is permissible under the terms of the Demand Feature or Guarantee).

(13) *Event of Insolvency* means "Event of Insolvency" as defined in § 270.5b-3(c)(2).

(14) *First Tier Security* means any Eligible Security that:

(i) Is a Rated Security that has received a short-term rating from the Requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing);

(ii) Is an Unrated Security that is of comparable quality to a security meeting the requirements for a Rated Security in paragraph (a)(14)(i) of this section, as determined by the fund's board of directors;

(iii) Is a security issued by a registered investment company that is a money market fund; or

(iv) Is a Government Security.

(15) *Floating Rate Security* means a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(16) *Government Security* means any "Government security" as defined in section 2(a)(16) of the Act (15 U.S.C. 80a-2(a)(16)).

(17) *Guarantee* means an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the Guarantee (if required), the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an Unconditional Demand Feature, an obligation that entitles the holder to receive upon exercise the approximate amortized cost of the underlying security or securities, plus accrued interest, if any. A Guarantee includes a letter of credit, financial guaranty (bond) insurance, and an Unconditional Demand Feature (other than an Unconditional Demand Feature provided by the issuer of the security).

(18) *Guarantee Issued By A Non-Controlled Person* means a Guarantee issued by:

(i) A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the Guarantee (*control* means "control" as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)); or

(ii) A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

(19) *Illiquid Security* means a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund.

(20) *Penny-Rounding Method* of pricing means the method of computing an investment company's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent.

(21) *Rated Security* means a security that meets the requirements of paragraphs (a)(21)(i) or (ii) of this section, in each case subject to paragraph (a)(21)(iii) of this section:

(i) The security has received a short-term rating from a Designated NRSRO, or has been issued by an issuer that has received a short-term rating from a Designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the security; or

(ii) The security is subject to a Guarantee that has received a short-term rating from a Designated NRSRO, or a Guarantee issued by a guarantor that has received a short-term rating from a Designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the Guarantee; but

(iii) A security is not a Rated Security if it is subject to an external credit support agreement (including an arrangement by which the security has become a Refunded Security) that was not in effect when the security was assigned its rating, unless the security has received a short-term rating reflecting the existence of the credit support agreement as provided in paragraph (a)(21)(i) of this section, or the credit support agreement with respect to the security has received a short-term rating as provided in paragraph (a)(21)(ii) of this section.

(22) *Refunded Security* means "Refunded Security" as defined in § 270.5b-3(c)(4).

(23) *Requisite NRSROs* means:

(i) Any two Designated NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or

(ii) If only one Designated NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that Designated NRSRO.

(24) *Second Tier Security* means any Eligible Security that is not a First Tier Security.

(25) *Single State Fund* means a Tax Exempt Fund that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state and, where applicable, subdivisions thereof.

(26) *Tax Exempt Fund* means any money market fund that holds itself out as distributing income exempt from regular federal income tax.

(27) *Total Assets* means, with respect to a money market fund using the Amortized Cost Method, the total amortized cost of its assets and, with respect to any other money market fund, the total market-based value of its assets.

(28) *Unconditional Demand Feature* means a Demand Feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities.

(29) *United States Dollar-Denominated* means, with reference to a security, that all principal and interest payments on such security are payable to security holders in United States dollars under all circumstances and that the interest rate of, the principal amount to be repaid, and the timing of payments related to such security do not vary or float with the value of a

foreign currency, the rate of interest payable on foreign currency borrowings, or with any other interest rate or index expressed in a currency other than United States dollars.

(30) *Unrated Security* means a security that is not a Rated Security.

(31) *Variable Rate Security* means a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(32) *Weekly Liquid Assets* means:

(i) Cash;

(ii) Direct obligations of the U.S. Government;

(iii) Government Securities that are issued by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States that:

(A) Are issued at a discount to the principal amount to be repaid at maturity; and

(B) Have a remaining maturity date of 60 days or less; or

(iv) Securities that will mature or are subject to a Demand Feature that is exercisable and payable within five Business Days.

(b) *Holding Out and Use of Names and Titles.*

(1) It shall be an untrue statement of material fact within the meaning of section 34(b) of the Act (15 U.S.C. 80a-33(b)) for a registered investment company, in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Act, including any advertisement, pamphlet, circular, form letter, or other sales literature

addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act (15 U.S.C. 80a-24(b)), to hold itself out to investors as a money market fund or the equivalent of a money market fund, unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), (c)(4), and (c)(5) of this section.

(2) It shall constitute the use of a materially deceptive or misleading name or title within the meaning of section 35(d) of the Act (15 U.S.C. 80a-34(d)) for a registered investment company to adopt the term "money market" as part of its name or title or the name or title of any redeemable securities of which it is the issuer, or to adopt a name that suggests that it is a money market fund or the equivalent of a money market fund, unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), (c)(4), and (c)(5) of this section.

(3) For purposes of this paragraph, a name that suggests that a registered investment company is a money market fund or the equivalent thereof shall include one that uses such terms as "cash," "liquid," "money," "ready assets" or similar terms.

(c) *Share Price Calculations*. The current price per share, for purposes of distribution, redemption and repurchase, of any redeemable security issued by any registered investment company ("money market fund" or "fund"), notwithstanding the requirements of section 2(a)(41) of the Act (15 U.S.C. 80a-2(a)(41)) and of §§ 270.2a-4 and 270.22c-1 thereunder, may be computed by use of the Amortized Cost Method or the Penny-Rounding Method; provided, however, that:

(1) *Board Findings*. The board of directors of the money market fund shall determine, in good faith, that it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or stable price per share, by virtue of either the Amortized Cost Method

or the Penny-Rounding Method, and that the money market fund will continue to use such method only so long as the board of directors believes that it fairly reflects the market-based net asset value per share.

(2) *Portfolio Maturity.* The money market fund shall maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share; provided, however, that the money market fund will not:

(i) Acquire any instrument with a remaining maturity of greater than 397 calendar days;

(ii) Maintain a dollar-weighted average portfolio maturity that exceeds 60 calendar days; or

(iii) Maintain a dollar-weighted average portfolio maturity that exceeds 120 calendar days, determined without reference to the exceptions in paragraph (d) of this section regarding interest rate readjustments.

(3) *Portfolio Quality* –

(i) *General.* The money market fund shall limit its portfolio investments to those United States Dollar-Denominated securities that the fund's board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by a Designated NRSRO) and that are at the time of Acquisition Eligible Securities.

(ii) *Second Tier Securities.* No money market fund shall Acquire a Second Tier Security with a remaining maturity of greater than 45 calendar days. Immediately after the Acquisition of any Second Tier Security, a money market fund shall not have invested more than three percent of its Total Assets in Second Tier Securities.

(iii) *Securities Subject to Guarantees.* A security that is subject to a Guarantee may be determined to be an Eligible Security or a First Tier Security based solely on whether the Guarantee is an Eligible Security or First Tier Security, as the case may be.

(iv) *Securities Subject to Conditional Demand Features.* A security that is subject to a Conditional Demand Feature ("Underlying Security") may be determined to be an Eligible Security or a First Tier Security only if:

(A) The Conditional Demand Feature is an Eligible Security or First Tier Security, as the case may be;

(B) At the time of the Acquisition of the Underlying Security, the money market fund's board of directors has determined that there is minimal risk that the circumstances that would result in the Conditional Demand Feature not being exercisable will occur; and

(*1*) The conditions limiting exercise either can be monitored readily by the fund, or relate to the taxability, under federal, state or local law, of the interest payments on the security; or

(*2*) The terms of the Conditional Demand Feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the Demand Feature in accordance with its terms; and

(C) The Underlying Security or any Guarantee of such security (or the debt securities of the issuer of the Underlying Security or Guarantee that are comparable in priority and security with the Underlying Security or Guarantee) has received either a short-term rating or a long-term rating, as the case may be, from the Requisite NRSROs within the NRSROs' two highest short-term or long-term rating categories (within which there may be sub-categories or gradations indicating relative standing) or, if unrated, is determined to be of comparable quality by the money market fund's board of directors to a security that has received a rating from the Requisite NRSROs within the NRSROs' two highest short-term or long-term rating categories, as the case may be.

(4) *Portfolio Diversification* –

(i) *Issuer Diversification.* The money market fund shall be diversified with respect to issuers of securities Acquired by the fund as provided in paragraphs (c)(4)(i) and (c)(4)(ii) of this section, other than with respect to Government Securities and securities subject to a Guarantee Issued By A Non-Controlled Person.

(A) *Taxable and National Funds.* Immediately after the Acquisition of any security, a money market fund other than a Single State Fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security; provided, however, that such a fund may invest up to twenty-five percent of its Total Assets in the First Tier Securities of a single issuer for a period of up to three Business Days after the Acquisition thereof; provided, further, that the fund may not invest in the securities of more than one issuer in accordance with the foregoing proviso in this paragraph at any time.

(B) *Single State Funds.* With respect to seventy-five percent of its Total Assets, immediately after the Acquisition of any security, a Single State Fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security.

(C) *Second Tier Securities.* Immediately after the Acquisition of any Second Tier Security, a money market fund shall not have invested more than one half of one percent of its Total Assets in the Second Tier Securities of any single issuer.

(ii) *Issuer Diversification Calculations.* For purposes of making calculations under paragraph (c)(4)(i) of this section:

(A) *Repurchase Agreements.* The Acquisition of a repurchase agreement may be deemed to be an Acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the money market fund is Collateralized Fully and the fund's board of directors has evaluated the seller's creditworthiness.

(B) *Refunded Securities.* The Acquisition of a Refunded Security shall be deemed to be an Acquisition of the escrowed Government Securities.

(C) *Conduit Securities.* A Conduit Security shall be deemed to be issued by the person (other than the Municipal Issuer) ultimately responsible for payments of interest and principal on the security.

(D) *Asset Backed Securities –*

(*1*) *General.* An Asset Backed Security Acquired by a fund ("Primary ABS") shall be deemed to be issued by the Special Purpose Entity that issued the Asset Backed Security, provided, however:

(*i*) *Holdings of Primary ABS.* Any person whose obligations constitute ten percent or more of the principal amount of the Qualifying Assets of the Primary ABS ("Ten Percent Obligor") shall be deemed to be an issuer of the portion of the Primary ABS such obligations represent; and

(*ii*) *Holdings of Secondary ABS.* If a Ten Percent Obligor of a Primary ABS is itself a Special Purpose Entity issuing Asset Backed Securities ("Secondary ABS"), any Ten Percent Obligor of such Secondary ABS also shall be deemed to be an issuer of the portion of the Primary ABS that such Ten Percent Obligor represents.

(*2*) *Restricted Special Purpose Entities.* A Ten Percent Obligor with respect to a Primary or Secondary ABS shall not be deemed to have issued any portion of the assets of a

Primary ABS as provided in paragraph (c)(4)(ii)(D)(*1*) of this section if that Ten Percent Obligor is itself a Special Purpose Entity issuing Asset Backed Securities ("Restricted Special Purpose Entity"), and the securities that it issues (other than securities issued to a company that controls, or is controlled by or under common control with, the Restricted Special Purpose Entity and which is not itself a Special Purpose Entity issuing Asset Backed Securities) are held by only one other Special Purpose Entity.

(*3*) *Demand Features and Guarantees.* In the case of a Ten Percent Obligor deemed to be an issuer, the fund shall satisfy the diversification requirements of paragraph (c)(4)(iii) of this section with respect to any Demand Feature or Guarantee to which the Ten Percent Obligor's obligations are subject.

(E) *Shares of Other Money Market Funds.* A money market fund that Acquires shares issued by another money market fund in an amount that would otherwise be prohibited by paragraph (c)(4)(i) of this section shall nonetheless be deemed in compliance with this section if the board of directors of the Acquiring money market fund reasonably believes that the fund in which it has invested is in compliance with this section.

(iii) *Diversification Rules for Demand Features and Guarantees.* The money market fund shall be diversified with respect to Demand Features and Guarantees Acquired by the fund as provided in paragraphs (c)(4)(iii) and (c)(4)(iv) of this section, other than with respect to a Demand Feature issued by the same institution that issued the underlying security, or with respect to a Guarantee or Demand Feature that is itself a Government Security.

(A) *General.* Immediately after the Acquisition of any Demand Feature or Guarantee or security subject to a Demand Feature or Guarantee, a money market fund, with respect to seventy-five percent of its Total Assets, shall not have invested more than ten percent of its Total

Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, subject to paragraphs (c)(4)(iii)(B) and (C) of this section.

(B) *Second Tier Demand Features or Guarantees.* Immediately after the Acquisition of any Demand Feature or Guarantee (or a security after giving effect to the Demand Feature or Guarantee) that is a Second Tier Security, a money market fund shall not have invested more than 2.5 percent of its Total Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee.

(C) *Demand Features or Guarantees Issued by Non-Controlled Persons.* Immediately after the Acquisition of any security subject to a Demand Feature or Guarantee, a money market fund shall not have invested more than ten percent of its Total Assets in securities issued by, or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, unless, with respect to any security subject to Demand Features or Guarantees from that institution (other than securities issued by such institution), the Demand Feature or Guarantee is a Demand Feature or Guarantee Issued By A Non-Controlled Person.

(iv) *Demand Feature and Guarantee Diversification Calculations –*

(A) *Fractional Demand Features or Guarantees.* In the case of a security subject to a Demand Feature or Guarantee from an institution by which the institution guarantees a specified portion of the value of the security, the institution shall be deemed to guarantee the specified portion thereof.

(B) *Layered Demand Features or Guarantees.* In the case of a security subject to Demand Features or Guarantees from multiple institutions that have not limited the extent of their obligations as described in paragraph (c)(4)(iv)(A) of this section, each institution shall be deemed to have provided the Demand Feature or Guarantee with respect to the entire principal amount of the security.

(v) *Diversification Safe Harbor.* A money market fund that satisfies the applicable diversification requirements of paragraphs (c)(4) and (c)(6) of this section shall be deemed to have satisfied the diversification requirements of section 5(b)(1) of the Act (15 U.S.C. 80a-5(b)(1)) and the rules adopted thereunder.

(5) *Portfolio Liquidity.* The money market fund shall hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of the fund's obligations under section 22(e) of the Act (15 U.S.C. 80a-22(e)) and any commitments the fund has made to shareholders; provided, however, that:

(i) *Illiquid Securities.* The money market fund shall not Acquire any Illiquid Security if, immediately after the Acquisition, the money market fund would have invested more than five percent of its Total Assets in Illiquid Securities.

(ii) *Minimum Daily Liquidity Requirement.* The money market fund shall not Acquire any security other than a Daily Liquid Asset if, immediately after the Acquisition, the fund would have invested less than ten percent of its Total Assets in Daily Liquid Assets. This provision shall not apply to Tax Exempt Funds.

(iii) *Minimum Weekly Liquidity Requirement.* The money market fund shall not Acquire any security other than a Weekly Liquid Asset if, immediately after the Acquisition, the fund would have invested less than thirty percent of its Total Assets in Weekly Liquid Assets.

(6) *Demand Features and Guarantees Not Relied Upon.* If the fund's board of directors has determined that the fund is not relying on a Demand Feature or Guarantee to determine the quality (pursuant to paragraph (c)(3) of this section), or maturity (pursuant to

paragraph (d) of this section), or liquidity of a portfolio security, and maintains a record of this determination (pursuant to paragraphs (c)(10)(ii) and (c)(11)(vi) of this section), then the fund may disregard such Demand Feature or Guarantee for all purposes of this section.

(7) *Downgrades, Defaults and Other Events* –

(i) *Downgrades* –

(A) *General.* Upon the occurrence of either of the events specified in paragraphs (c)(7)(i)(A)(*1*) and (*2*) of this section with respect to a portfolio security, the board of directors of the money market fund shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders:

(*1*) A portfolio security of a money market fund ceases to be a First Tier Security (either because it no longer has the highest rating from the Requisite NRSROs or, in the case of an Unrated Security, the board of directors of the money market fund determines that it is no longer of comparable quality to a First Tier Security); and

(*2*) The money market fund's investment adviser (or any person to whom the fund's board of directors has delegated portfolio management responsibilities) becomes aware that any Unrated Security or Second Tier Security held by the money market fund has, since the security was Acquired by the fund, been given a rating by a Designated NRSRO below the Designated NRSRO's second highest short-term rating category.

(B) *Securities to Be Disposed Of.* The reassessments required by paragraph (c)(7)(i)(A) of this section shall not be required if the fund disposes of the security (or it matures) within five Business Days of the specified event and, in the case of events specified in paragraph (c)(7)(i)(A)(*2*) of this section, the board is subsequently notified of the adviser's actions.

(C) *Special Rule for Certain Securities Subject to Demand Features*. In the event that after giving effect to a rating downgrade, more than 2.5 percent of the fund's Total Assets are invested in securities issued by or subject to Demand Features from a single institution that are Second Tier Securities, the fund shall reduce its investment in securities issued by or subject to Demand Features from that institution to no more than 2.5 percent of its Total Assets by exercising the Demand Features at the next succeeding exercise date(s), absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund.

(ii) *Defaults and Other Events*. Upon the occurrence of any of the events specified in paragraphs (c)(7)(ii)(A) through (D) of this section with respect to a portfolio security, the money market fund shall dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, by sale, exercise of any Demand Feature or otherwise, absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund (which determination may take into account, among other factors, market conditions that could affect the orderly disposition of the portfolio security):

(A) The default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer);

(B) A portfolio security ceases to be an Eligible Security;

(C) A portfolio security has been determined to no longer present minimal credit risks; or

(D) An Event of Insolvency occurs with respect to the issuer of a portfolio security or the provider of any Demand Feature or Guarantee.

(iii) *Notice to the Commission.* The money market fund shall promptly notify the Commission by electronic mail directed to the Director of Investment Management or the Director's designee, of any:

(A) Default or Event of Insolvency with respect to the issuer of one or more portfolio securities (other than an immaterial default unrelated to the financial condition of the issuer) or any issuer of a Demand Feature or Guarantee to which one or more portfolio securities is subject, and the actions the money market fund intends to take in response to such event, where immediately before default the securities (or the securities subject to the Demand Feature or Guarantee) accounted for ½ of 1 percent or more of the money market fund's Total Assets; or

(B) Purchase of a security from the fund by an affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such a person, in reliance on § 270.17a-9, including identification of the security, its amortized cost, the sale price, and the reasons for such purchase.

(iv) *Defaults for Purposes of Paragraphs (c)(7)(ii) and (iii).* For purposes of paragraphs (c)(7)(ii) and (iii) of this section, an instrument subject to a Demand Feature or Guarantee shall not be deemed to be in default (and an Event of Insolvency with respect to the security shall not be deemed to have occurred) if:

(A) In the case of an instrument subject to a Demand Feature, the Demand Feature has been exercised and the fund has recovered either the principal amount or the amortized cost of the instrument, plus accrued interest; or

(B) The provider of the Guarantee is continuing, without protest, to make payments as due on the instrument.

(8) *Required Procedures: Amortized Cost Method.* In the case of a money market

fund using the Amortized Cost Method:

(i) *General*. In supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors, as a particular responsibility within the overall duty of care owed to its shareholders, shall establish written procedures reasonably designed, taking into account current market conditions and the money market fund's investment objectives, to stabilize the money market fund's net asset value per share, as computed for the purpose of distribution, redemption and repurchase, at a single value.

(ii) *Specific Procedures*. Included within the procedures adopted by the board of directors shall be the following:

(A) *Shadow Pricing*. Written procedures shall provide:

(*1*) That the extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) from the money market fund's amortized cost price per share, shall be calculated at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions;

(*2*) For the periodic review by the board of directors of the amount of the deviation as well as the methods used to calculate the deviation; and

(*3*) For the maintenance of records of the determination of deviation and the board's review thereof.

(B) *Prompt Consideration of Deviation*. In the event such deviation from the money market fund's amortized cost price per share exceeds ½ of 1 percent, the board of directors shall promptly consider what action, if any, should be initiated by the board of directors.

(C) *Material Dilution or Unfair Results.* Where the board of directors believes the extent of any deviation from the money market fund's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, it shall cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

(9) *Required Procedures: Penny-Rounding Method.* In the case of a money market fund using the Penny-Rounding Method, in supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors undertakes, as a particular responsibility within the overall duty of care owed to its shareholders, to assure to the extent reasonably practicable, taking into account current market conditions affecting the money market fund's investment objectives, that the money market fund's price per share as computed for the purpose of distribution, redemption and repurchase, rounded to the nearest one percent, will not deviate from the single price established by the board of directors.

(10) *Specific Procedures: Amortized Cost and Penny-Rounding Methods.* Included within the procedures adopted by the board of directors for money market funds using either the Amortized Cost or Penny-Rounding Methods shall be the following:

(i) *Securities for Which Maturity is Determined by Reference to Demand Features.* In the case of a security for which maturity is determined by reference to a Demand Feature, written procedures shall require ongoing review of the security's continued minimal credit risks, and that review must be based on, among other things, financial data for the most recent fiscal year of the issuer of the Demand Feature and, in the case of a security subject to a Conditional Demand Feature, the issuer of the security whose financial condition must be monitored under paragraph (c)(3)(iv) of this section, whether such data is publicly available or provided under the terms of the security's governing documentation.

(ii) *Securities Subject to Demand Features or Guarantees*. In the case of a security subject to one or more Demand Features or Guarantees that the fund's board of directors has determined that the fund is not relying on to determine the quality (pursuant to paragraph (c)(3) of this section), maturity (pursuant to paragraph (d) of this section) or liquidity (pursuant to paragraph (c)(5) of this section) of the security subject to the Demand Feature or Guarantee, written procedures shall require periodic evaluation of such determination.

(iii) *Adjustable Rate Securities Without Demand Features*. In the case of a Variable Rate or Floating Rate Security that is not subject to a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section, written procedures shall require periodic review of whether the interest rate formula, upon readjustment of its interest rate, can reasonably be expected to cause the security to have a market value that approximates its amortized cost value.

(iv) *Asset Backed Securities*. In the case of an Asset Backed Security, written procedures shall require the fund to periodically determine the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section; provided, however, written procedures need not require periodic determinations with respect to any Asset Backed Security that a fund's board of directors has determined, at the time of Acquisition, will not have, or is unlikely to have, Ten Percent Obligors that are deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section, and maintains a record of this determination.

(v) *Stress Testing*. Written procedures shall provide for:

(A) The periodic testing, at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions, of the money market fund's ability to maintain a stable net asset value per share based upon specified hypothetical events that include, but are not limited to, a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund.

(B) A report on the results of such testing to be provided to the board of directors at its next regularly scheduled meeting (or sooner, if appropriate in light of the results), which report shall include:

(*1*) The date(s) on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes which reflect current market conditions) from its net asset value per share calculated using amortized cost to exceed ½ of 1 percent; and

(*2*) An assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.

(11) *Record Keeping and Reporting* –

(i) *Written Procedures*. For a period of not less than six years following the replacement of such procedures with new procedures (the first two years in an easily accessible place), a written copy of the procedures (and any modifications thereto) described in paragraphs (c)(7) through (c)(10) and (e) of this section shall be maintained and preserved.

(ii) *Board Considerations and Actions.* For a period of not less than six years (the first two years in an easily accessible place) a written record shall be maintained and preserved of the board of directors' considerations and actions taken in connection with the discharge of its responsibilities, as set forth in this section, to be included in the minutes of the board of directors' meetings.

(iii) *Credit Risk Analysis.* For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record of the determination that a portfolio security presents minimal credit risks and the Designated NRSRO ratings (if any) used to determine the status of the security as an Eligible Security, First Tier Security or Second Tier Security shall be maintained and preserved in an easily accessible place.

(iv) *Determinations With Respect to Adjustable Rate Securities.* For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determination required by paragraph (c)(10)(iii) of this section (that a Variable Rate or Floating Rate Security that is not subject to a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section can reasonably be expected, upon readjustment of its interest rate at all times during the life of the instrument, to have a market value that approximates its amortized cost).

(v) *Determinations with Respect to Asset Backed Securities.* For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determinations required by paragraph (c)(10)(iv) of this section (the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section). The written record shall include:

(A) The identities of the Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section), the percentage of the Qualifying Assets constituted by the securities of each Ten Percent Obligor and the percentage of the fund's Total Assets that are invested in securities of each Ten Percent Obligor; and

(B) Any determination that an Asset Backed Security will not have, or is unlikely to have, Ten Percent Obligors deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section.

(vi) *Evaluations with Respect to Securities Subject to Demand Features or Guarantees*. For a period of not less than three years from the date when the evaluation was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the evaluation required by paragraph (c)(10)(ii) (regarding securities subject to one or more Demand Features or Guarantees) of this section.

(vii) *Reports with Respect to Stress Testing.* For a period of not less than six years (the first two years in an easily accessible place), a written copy of the report required under paragraph (c)(10)(v)(B) of this section shall be maintained and preserved.

(viii) *Inspection of Records*. The documents preserved pursuant to this paragraph (c)(11) shall be subject to inspection by the Commission in accordance with section 31(b) of the Act (15 U.S.C. 80a-30(b)) as if such documents were records required to be maintained pursuant to rules adopted under section 31(a) of the Act (15 U.S.C. 80a-30(a)). If any action was taken under paragraphs (c)(7)(ii) (with respect to defaulted securities and events of insolvency) or (c)(8)(ii) (with respect to a deviation from the fund's share price of more than 1/2 of 1 percent) of this section, the money market fund will file an exhibit to the Form N-SAR (17 CFR 274.101) filed for the period in which the action was taken describing with specificity the nature and circumstances of such action. The money market fund will report in an exhibit to such Form any securities it holds on the final day of the reporting period that are not Eligible Securities.

(12) *Website Disclosure of Portfolio Holdings.* The money market fund shall post on its website, for a period of not less than six months, beginning no later than the fifth Business Day of the month, a schedule of its investments, as of the last Business Day of the prior month, that includes the following information:

(i) With respect to the money market fund and each class thereof:

(A) The dollar-weighted average portfolio maturity; and

(B) The dollar-weighted average portfolio maturity determined without reference to the exceptions in paragraph (d) of this section regarding interest rate readjustments;

(ii) With respect to each security held by the money market fund:

(A) Name of the issuer;

(B) Category of investment (indicate the category that most closely identifies the instrument from among the following: Treasury Debt; Government Agency Debt; Variable Rate Demand Note; Other Municipal Debt; Financial Company Commercial Paper; Asset Backed Commercial Paper; Other Commercial Paper; Certificate of Deposit; Structured Investment Vehicle Note; Other Note; Treasury Repurchase Agreement; Government Agency Repurchase Agreement; Other Repurchase Agreement; Insurance Company Funding Agreement; Investment Company; Other Instrument);

(C) CUSIP number (if any);

(D) Principal amount;

(E) Maturity date as determined under this section;

(F) Final legal maturity date (taking into account any maturity date extensions that may be effected at the option of the issuer), if different from the maturity date as determined under this section;

(G) Coupon or yield; and

(H) Amortized cost value; and

(iii) A link to a website of the Securities and Exchange Commission where a user may obtain the most recent 12 months of publicly available information filed by the money market fund pursuant to § 270.30b1-7.

(13) *Processing of Transactions*. The money market fund (or its transfer agent) shall have the capacity to redeem and sell securities issued by the fund at a price based on the current net asset value per share pursuant to § 270.22c-1. Such capacity shall include the ability to redeem and sell securities at prices that do not correspond to a stable net asset value or price per share.

(d) *Maturity of Portfolio Securities*. For purposes of this section, the maturity of a portfolio security shall be deemed to be the period remaining (calculated from the trade date or such other date on which the fund's interest in the security is subject to market action) until the date on which, in accordance with the terms of the security, the principal amount must unconditionally be paid, or in the case of a security called for redemption, the date on which the redemption payment must be made, except as provided in paragraphs (d)(1) through (d)(8) of this section:

(1) *Adjustable Rate Government Securities*. A Government Security that is a Variable

Rate Security where the variable rate of interest is readjusted no less frequently than every 397 calendar days shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate. A Government Security that is a Floating Rate Security shall be deemed to have a remaining maturity of one day.

(2) *Short-Term Variable Rate Securities.* A Variable Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity equal to the earlier of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(3) *Long-Term Variable Rate Securities.* A Variable Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a Demand Feature, shall be deemed to have a maturity equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(4) *Short-Term Floating Rate Securities.* A Floating Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity of one day.

(5) *Long-Term Floating Rate Securities.* A Floating Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a Demand Feature, shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand.

(6) *Repurchase Agreements.* A repurchase agreement shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying

securities is scheduled to occur, or, where the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities.

(7) *Portfolio Lending Agreements*. A portfolio lending agreement shall be treated as having a maturity equal to the period remaining until the date on which the loaned securities are scheduled to be returned, or where the agreement is subject to demand, the notice period applicable to a demand for the return of the loaned securities.

(8) *Money Market Fund Securities*. An investment in a money market fund shall be treated as having a maturity equal to the period of time within which the Acquired money market fund is required to make payment upon redemption, unless the Acquired money market fund has agreed in writing to provide redemption proceeds to the investing money market fund within a shorter time period, in which case the maturity of such investment shall be deemed to be the shorter period.

(e) *Delegation*. The money market fund's board of directors may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board of directors under this section (other than the determinations required by paragraphs (a)(11)(i) (designation of NRSROs); (c)(1) (board findings); (c)(7)(ii) (defaults and other events); (c)(8)(i) (general required procedures: Amortized Cost Method); (c)(8)(ii)(A) (shadow pricing), (B) (prompt consideration of deviation), (C) (material dilution or unfair results); (c)(9) (required procedures: Penny Rounding Method); and (c)(10)(v)(A) (stress testing procedures) of this section; provided that:

(1) *Written Guidelines*. The Board shall establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in paragraph (c)(3) of this section) and procedures under which the delegate makes

such determinations.

(2) *Oversight.* The Board shall take any measures reasonably necessary (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of a security or Event of Insolvency with respect to the issuer of the security or any Guarantee to which it is subject that requires notification of the Commission under paragraph (c)(7)(iii) of this section) to assure that the guidelines and procedures are being followed.

3. Section 270.17a-9 is revised to read as follows:

§ 270.17a-9 Purchase of certain securities from a money market fund by an affiliate, or an affiliate of an affiliate.

The purchase of a security from the portfolio of an open-end investment company holding itself out as a money market fund by any affiliated person or promoter of or principal underwriter for the money market fund or any affiliated person of such person shall be exempt from section 17(a) of the Act (15 U.S.C. 80a-17(a)); provided that:

(a) In the case of a portfolio security that has ceased to be an Eligible Security (as defined in § 270.2a-7(a)(12)), or has defaulted (other than an immaterial default unrelated to the financial condition of the issuer):

(1) The purchase price is paid in cash; and

(2) The purchase price is equal to the greater of the amortized cost of the security or its market price (in each case, including accrued interest).

(b) In the case of any other portfolio security:

(1) The purchase price meets the requirements of paragraph (a)(1) and (2) of this section; and

(2) In the event that the purchaser thereafter sells the security for a higher price than the purchase price paid to the money market fund, the purchaser shall promptly pay to the fund the amount by which the subsequent sale price exceeds the purchase price paid to the fund.

4. Section 270.22e-3 is added to read as follows:

§ 270.22e-3 Exemption for liquidation of money market funds.

(a) *Exemption.* A registered open-end management investment company or series thereof ("fund") that is regulated as a money market fund under § 270.2a-7 is exempt from the requirements of section 22(e) of the Act (15 U.S.C. 80a-22(e)) if:

(1) The fund's board of directors, including a majority of directors who are not interested persons of the fund, determines pursuant to § 270.2a-7(c)(8)(ii)(C) that the extent of the deviation between the fund's amortized cost price per share and its current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) may result in material dilution or other unfair results to investors or existing shareholders;

(2) The fund's board of directors, including a majority of directors who are not interested persons of the fund, irrevocably has approved the liquidation of the fund; and

(3) The fund, prior to suspending redemptions, notifies the Commission of its decision to liquidate and suspend redemptions by electronic mail directed to the attention of the Director of the Division of Investment Management or the Director's designee.

(b) *Conduits.* Any registered investment company, or series thereof, that owns, pursuant to section 12(d)(1)(E) of the Act (15 U.S.C. 80a-12(d)(1)(E)), shares of a money market fund that has suspended redemptions of shares pursuant to paragraph (a) of this section also is exempt from the requirements of section 22(e) of the Act (15 U.S.C. 80a-22(e)). A registered investment company relying on the exemption provided in this paragraph must promptly notify the Commission that it has suspended redemptions in reliance on this section. Notification under this paragraph shall be made by electronic mail directed to the attention of the Director of the Division of Investment Management or the Director's designee.

(c) *Commission Orders*. For the protection of shareholders, the Commission may issue an order to rescind or modify the exemption provided by this section, after appropriate notice and opportunity for hearing in accordance with section 40 of the Act (15 U.S.C. 80a-39).

5. Section 270.30b1-6T is amended by revising paragraph (d) to read as follows:

§ 270.30b1-6T Weekly portfolio report for certain money market funds.

* * * * *

(d) *Expiration.* This section will expire on December 1, 2010.

6. Section 270.30b1-7 is added to read as follows:

§ 270.30b1-7 Monthly report for money market funds.

(a) *Report.* Every registered open-end management investment company, or series thereof, that is regulated as a money market fund under § 270.2a-7 must file with the Commission a monthly report of portfolio holdings on Form N-MFP (§ 274.201 of this chapter), current as of the last business day of the previous month, no later than the fifth business day of each month.

(b) *Public availability.* The Commission will make the information filed on Form N-MFP available to the public 60 days after the end of the month to which the information pertains.

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

7. The authority citation for Part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

8. Section 274.201 and Form N-MFP (referenced in § 274.201) are added to read as follows:

§ 274.201 Form N-MFP, portfolio holdings of money market funds

This form shall be used by registered open-end management investment companies that are regulated as money market funds under § 270.2a-7 of this chapter to file reports pursuant to § 270.30b1-7 of this chapter no later than the fifth business day of each month.

Note: The text of Form N-MFP will not appear in the Code of Federal Regulations.

FORM N-MFP

MONTHLY SCHEDULE OF PORTFOLIO HOLDINGS

OF MONEY MARKET FUNDS

Form N-MFP is to be used by registered open-end management investment companies, or series thereof, that are regulated as money market funds pursuant to rule 2a-7 under the Investment Company Act of 1940 ("Act") (17 CFR 270.2a-7) ("money market funds"), to file reports with the Commission pursuant to rule 30b1-7 under the Act (17 CFR 270.30b1-7). The

Commission may use the information provided on Form N-MFP in its regulatory, disclosure review, inspection, and policymaking roles.

GENERAL INSTRUCTIONS

A. Rule as to Use of Form N-MFP

Form N-MFP is the public reporting form that is to be used for monthly reports of money market funds required by section 30(b) of the Act and rule 30b1-7 under the Act (17 CFR 270.30b1-7). A money market fund must report information about the fund and its portfolio holdings as of the last business day of the preceding month. The Form N-MFP must be filed with the Commission no later than the fifth business day of each month, but may be filed any time beginning on the first business day of the month. Each money market fund, or series of a money market fund, is required to file a separate form. If the money market fund does not have any classes, the fund must provide the information required by Part I.B for the series.

A money market fund may file an amendment to a previously filed Form N-MFP at any time, including an amendment to correct a mistake or error in a previously filed form. A fund that files an amendment to a previously filed form must provide information in response to all items of Form N-MFP, regardless of why the amendment is filed.

B. Application of General Rules and Regulations

The General Rules and Regulations under the Act contain certain general requirements that are applicable to reporting on any form under the Act. These general requirements should be carefully read and observed in the preparation and filing of reports on this form, except that any provision in the form or in these instruction shall be controlling.

C. Filing of Form N-MFP

A money market fund must file Form N-MFP in accordance with rule 232.13 of

Regulation S-T. Form N-MFP must be filed electronically using the Commission's EDGAR system.

D. Paperwork Reduction Act Information

A registrant is not required to respond to the collection of information contained in Form N-MFP unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. 3507.

E. Definitions

References to sections and rules in this Form N-MFP are to the Investment Company Act of 1940 [15 U.S.C. 80a] (the "Investment Company Act"), unless otherwise indicated. Terms used in this Form N-MFP have the same meaning as in the Investment Company Act or related rules, unless otherwise indicated.

As used in this Form N-MFP, the terms set out below have the following meanings:

"Class" means a class of shares issued by a Multiple Class Fund that represents interests in the same portfolio of securities under rule 18f-3 [17 CFR 270.18f-3] or under an order exempting the Multiple Class Fund from sections 18(f), 18(g), and 18(i) [15 U.S.C. 80a-18(f), 18(g), and 18(i)].

"Fund" means the Registrant or a separate Series of the Registrant. When an item of Form N-MFP specifically applies to a Registrant or a Series, those terms will be used.

"Master-Feeder Fund" means a two-tiered arrangement in which one or more Funds (each a "Feeder Fund") holds shares of a single Fund (the "Master Fund") in accordance with section 12(d)(1)(E) [15 U.S.C. 80a-12(d)(1)(E)].

"Money Market Fund" means a Fund that holds itself out as money market fund and meets the maturity, quality, and diversification requirements of rule 2a-7 [17 CFR 270.2a-7].

"Securities Act" means the Securities Act of 1933 [15 U.S.C. 77a - aa].

"Series" means shares offered by a Registrant that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with rule 18f-2(a) [17 CFR 270.18f-2(a)].

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM N-MFP
MONTHLY SCHEDULE OF PORTFOLIO HOLDINGS
OF MONEY MARKET FUNDS

Report for [Month, Day, Year]

CIK Number of Registrant:

EDGAR Series Identifier:

Total number of share classes in the series:

Do you anticipate that this will be the fund's final filing on Form N-MFP? [Y/N]

Is the fund liquidating? [Y/N]

Is the fund merging with, or being acquired by, another fund? [Y/N]

If so, identify the successor fund by CIK, Securities Act file number, and EDGAR series identifier.

If this is not a final filing: has the fund acquired or merged with another fund since the last filing? [Y/N]

If so, identify the acquired or merged fund by CIK, Securities Act file number, and EDGAR series identifier.

Part I: Information about the Fund

A. Series-Level Information

Item 1. Securities Act File Number.

Item 2. Investment Adviser.

a. SEC file number of investment adviser.

Item 3. Sub-Adviser. If a fund has one or more sub-advisers, disclose the name of each sub-adviser.

a. SEC file number of each sub-adviser.

Item 4. Independent Public Accountant.

a. City and state of independent public accountant.

Item 5. Administrator. If a fund has one or more administrators, disclose the name of each administrator.

Item 6. Transfer Agent.

a. CIK Number.

b. SEC file number of transfer agent.

Item 7. Master-Feeder Funds. Is this a feeder fund? [Y/N]

a. Identify the master fund by CIK.

b. Securities Act file number of the master fund.

c. EDGAR series identifier of the master fund.

Item 8. Master-Feeder Funds. Is this a master fund? [Y/N]

a. If this is a master fund, identify all feeder funds by CIK or, if the fund does not have a CIK, by name.

b. Securities Act file number of each feeder fund.

c. EDGAR series identifier of each feeder fund.

Item 9. Is this series primarily used to fund insurance company separate accounts? [Y/N]

Item 10. Category. Indicate the category that most closely identifies the money market fund from among the following: Treasury, Government/Agency, Prime, Single State Fund, or Other Tax Exempt Fund.

Item 11. Dollar weighted average portfolio maturity.

Item 12. Dollar weighted average life maturity. Calculate the dollar weighted average portfolio maturity without reference to the exceptions in rule 2a-7(d) regarding interest rate readjustments.

Item 13. Total value of portfolio securities at amortized cost, to the nearest cent.

Item 14. Total value of other assets, to the nearest cent.

Item 15. Total value of liabilities, to the nearest cent.

Item 16. Net assets of the series, to the nearest cent.

Item 17. 7-day gross yield. Based on the 7 days ended on the last day of the prior month, calculate the fund's yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting yield figure carried to at least the nearest hundredth of one percent. The 7-day gross yield should not reflect a deduction of shareholders fees and fund operating expenses.

Item 18. Shadow Price of the Series.

a. The net asset value per share most recently calculated using available market quotations (or an appropriate substitute that reflects current market conditions), including the value of any capital support agreement, to the nearest hundredth of a cent;

b. The date as of which the market-based net asset value disclosed in Item 18a was calculated;

c. The net asset value per share most recently calculated using available market quotations (or an appropriate substitute that reflects current market conditions), excluding the value of any capital support agreement, to the nearest hundredth of a cent; and

d. The date as of which the market-based net asset value disclosed in Item 18c was calculated.

B. Class-Level Information. For each Class of the Series, disclose the following:

Item 19. EDGAR Class identifier.

Item 20. Minimum initial investment.

Item 21. Net assets of the Class, to the nearest cent.

Item 22. Net asset value per share for purposes of distributions, redemptions, and repurchase, to the nearest cent.

Item 23. Net shareholder flow activity for the month ended (subscriptions less redemptions), to the nearest cent.

a. Gross subscriptions for the month ended (including dividend reinvestments), to the nearest cent.

b. Gross redemptions for the month ended, to the nearest cent.

Item 24. 7-day net yield, as calculated under Item 26(a)(1) of Form N-1A.

Item 25. Shadow Price of each Class.

a. The net asset value per share most recently calculated using available market quotations (or an appropriate substitute that reflects current market conditions), including the value of any capital support agreement, to the nearest hundredth of a cent;

b. The date as of which the market-based net asset value disclosed in Item 25a was calculated;

c. The net asset value per share most recently calculated using available market quotations (or an appropriate substitute that reflects current market conditions), excluding the value of any capital support agreement, to the nearest hundredth of a cent; and

d. The date as of which the market-based net asset value disclosed in Item 25c was calculated.

Part 2: Schedule of Portfolio Securities. For each security held by the money market fund, disclose the following:

Item 26. The name of the issuer.

Item 27. The title of the issue (including coupon or yield).

Item 28. The CUSIP. If the security has a CUSIP, filers must provide the security's CUSIP pursuant to this Item and may skip Items 29 and 30.

Item 29. Other unique identifier, if the security has a unique identifier. If a CUSIP is provided pursuant to Item 28, skip this Item.

Item 30. The CIK of the issuer, if the issuer has a CIK. If a CUSIP is provided pursuant to Item 28, skip this Item.

Item 31. The category of investment. Indicate the category that most closely identifies the instrument from among the following: Treasury Debt; Government Agency Debt; Variable Rate Demand Note; Other Municipal Debt; Financial Company Commercial Paper; Asset Backed Commercial Paper; Other

Commercial Paper; Certificate of Deposit; Structured Investment Vehicle Note; Other Note; Treasury Repurchase Agreement; Government Agency Repurchase Agreement; Other Repurchase Agreement; Insurance Company Funding Agreement; Investment Company; Other Instrument. If Other Instrument, include a brief description.

Item 32. If the security is a repurchase agreement: is the fund treating the acquisition of the repurchase agreement as the acquisition of the underlying securities (*i.e.*, collateral) for purposes of portfolio diversification under rule 2a-7? [Y/N]

For repurchase agreements, describe the securities subject to the repurchase agreement, including:

a. The name of the issuer;

b. Maturity date;

c. Coupon or yield;

d. The category of investments, selected from Item 31 above;

e. The principal amount, to the nearest cent;

f. Value of collateral, to the nearest cent.

If multiple securities of an issuer are subject to the repurchase agreement, the securities may be aggregated, in which case disclose: (a) the total principal amount and value and (b) the range of maturity dates and interest rates.

Item 33. Rating. Indicate whether the security is a rated First Tier Security, rated Second Tier Security, an Unrated Security, or no longer an Eligible Security.

Item 34. Name of each Designated NRSRO.

a. For each Designated NRSRO, disclose the credit rating given by the Designated NRSRO. If the instrument and its issuer are not rated by the Designated NRSRO, indicate "NR."

Item 35. The maturity date as determined under rule 2a-7. Determine the maturity date, taking into account the maturity shortening provisions of rule 2a-7(d).

Item 36. The final legal maturity date, taking into account any maturity date extensions that may be effected at the option of the issuer.

Item 37. Does the security have a Demand Feature? [Y/N]

a. The identity of the Demand Feature issuer.

b. Designated NRSRO(s) for the Demand Feature or provider of the Demand Feature.

c. For each Designated NRSRO, disclose the credit rating given by the Designated NRSRO. If there is no rating given by the Designated NRSRO, indicate "NR."

Item 38. Does the security have a Guarantee? [Y/N]

a. The identity of the Guarantor.

b. Designated NRSRO(s) for the Guarantee or Guarantor.

c. For each Designated NRSRO, disclose the credit rating given by the Designated NRSRO. If there is no rating given by the Designated NRSRO, indicate "NR."

Item 39. Does the security have any enhancements, other than those identified in Items 37 and 38 above, on which the fund is relying to determine the quality, maturity or liquidity of the security? [Y/N]

a. The type of enhancement.

b. The identity of the enhancement provider.

c. Designated NRSRO(s) for the enhancement or enhancement provider.

d. For each Designated NRSRO, disclose the credit rating given by the Designated NRSRO. If there is no rating given by the Designated NRSRO, indicate "NR."

Item 40. The total principal amount of the security held by the series, to the nearest cent.

Item 41. The total current amortized cost, to the nearest cent.

Item 42. The percentage of the money market fund's net assets invested in the security, to the nearest hundredth of a percent.

Item 43. Explanatory notes. Disclose any other information that may be material to other disclosures related to the portfolio security.

Item 44. Is this an Illiquid Security as of the date of this report? [Y/N]

Item 45. The value of the security, calculated using available market quotations (or an appropriate substitute that reflects current market conditions), including the value of any capital support agreement, to the nearest cent.

Item 46. The value of the security, calculated using available market quotations (or an appropriate substitute that reflects current market conditions), excluding the value of any capital support agreement, to the nearest cent.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: February 23, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61584 / February 25, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13790

In the Matter of **Robert P. Copeland, 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 Robert P. Copeland, Esq. ("Copeland") 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. Copeland was an attorney admitted to practice law in Georgia.

2. On April 9, 2009, the United States Attorney for the Northern District of Georgia ("USAO") filed a criminal information against Copeland, alleging one count of wire fraud. The information alleged that Copeland knowingly and willfully devised and intended to devise a "Ponzi" scheme to defraud investors of money and property by making materially false and fraudulent representations to investors. This conduct, according to the information, defrauded more than 125 individuals out of more than $28 million.

3. On April 20, 2009, Copeland pled guilty to one count of wire fraud in violation of 18 U.S.C. 1343– a crime that involves moral turpitude.

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

4. On June 8, 2009, the Supreme Court of Georgia ordered that the name of Robert P. Copeland be removed from the rolls of persons entitled to practice law in the State of Georgia pursuant to Georgia Bar Rule 4-227.

5. On September 21, 2009, a judgment was entered by the United States District Court for the Northern District of Georgia against Copeland sentencing him to 121 months in federal prison, ordering him to pay $31,861,360 in restitution, and directing that he serve a three year period of supervised release upon being released from prison.

III.

In view of the foregoing, the Commission finds that Copeland is an attorney who has been convicted of a felony involving moral turpitude, as well as disbarred from the practice of law, within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice. Accordingly, it is ORDERED, that Robert P. Copeland 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61585 / February 25, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13791

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

I.

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

II.

In anticipation of the institution of these proceedings, Santos 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, Santos consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (" Order"), as set forth below.

III.

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

1. From March 2003 through May 2005, Santos was an attorney licensed in Connecticut who served as the executive vice president, chief compliance officer, and general

counsel of NevWest Securities Corporation ("NevWest"), a broker-dealer registered with the Commission during that period. Santos was also a registered representative associated with NevWest. Santos, 43 years old, is a resident of Las Vegas, Nevada.

2. On February 9, 2010, a judgment of permanent injunction was entered by consent against Santos, permanently enjoining him from future violations of Section 5 of the Securities Act of 1933, in the civil action entitled Securities and Exchange Commission v. CMKM Diamonds, Inc., et al., Civil Action Number 02:08-cv-00437-LRH-RJJ, in the United States District Court for the District of Nevada.

3. The Commission's complaint alleged that, among other things, from March 2003 until May 2005, Santos improperly participated in the sale of more than 259 billion shares of unregistered securities of CMKM Diamonds, Inc. The complaint also alleged that this unregistered distribution generated more than $53.3 million in proceeds.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Santos be, and hereby is barred from association with any broker or dealer, 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 Santos 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 Santos, 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61586 / February 25, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13792

In the Matter of **Tara R. Eisler** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Tara R. Eisler ("Eisler" 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 her and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

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

1. Eisler is a resident of Denver, Colorado who works for a real estate finance company. Eisler worked as a registered representative for approximately 15 months between November 1999 and February 2001, and at that time held Series 7 and Series 63 licenses.

2. John A. Foley ("Foley"), is a resident of Denver, Colorado. Foley worked in the Denver offices of Deloitte & Touche LLP ("Deloitte") from July 2005 until May 2007.

3. Spectralink Corporation ("Spectralink") is a Delaware corporation headquartered in Boulder, Colorado, that designs, manufactures and sells workplace wireless telephone systems. Prior to consummation of its merger with Polycom, Inc., Spectralink's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act, and quoted on the Nasdaq Global Market, under the ticker symbol SLNK. This merger was effected through a tender offer.

4. In November 2006, at the direction of Foley, Eisler opened an online brokerage account (the "Account") in her name. At the time, Eisler knew the general nature of Foley's work at Deloitte and specifically knew that he had access to nonpublic information about public companies. Foley asked her to open the online account to circumvent trading prohibitions Foley had as a result of his work at Deloitte.

5. Prior to opening the Account for Foley, Eisler knew or was reckless in not knowing that Foley had previously traded in the securities of other Deloitte clients in violation of the firm's trading restrictions. In one instance, at Foley's request, Eisler emailed a mutual friend of theirs regarding a posting the friend had placed on an internet bulletin board discussing Foley's trading. The email asked the friend to "take down that chart on the board just because [Foley is] not supposed to be trading it. [Foley] just doesn't want anything to be able to be traced back to him."

6. Eisler permitted Foley to maintain extensive control over the Account. Foley supplied the funds to open the Account, conducted trading in the Account, and reaped the proceeds of the trading. Eisler permitted Foley to log into the Account as Eisler, utilizing her password. To help Foley conceal his connection to the Account, Eisler deposited cash Foley gave her into a bank account in her name, and then wired the funds from her bank account to the Account.

7. While employed by Deloitte, Foley was assigned to work on the merger between Spectralink and Polycomm, Inc. Foley's work consisted of calculating the tax effects, under Section 280G of the Internal Revenue Code, of the executive compensation components of the potential merger, including analysis of the cost—in cash and stock—of payments to executives having severance or other employment agreements triggered by a change in control.[2] Because of the nature of his work, Foley knew not only of the existence of talks involving Spectralink, but also the price and timing of the potential transaction.

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[2] Under the Internal Revenue Code, "parachute payments" triggered by a change in control are subject to a federal excise tax and cannot be deducted as a business expense. See 26 U.S.C. §§ 280G & 4999.

8. On Monday, January 29, 2007, Foley logged into the Account using Eisler's login and password and began purchasing Spectralink call options. Over the next several trading days, Foley purchased a total of 540 Spectralink call options—all of which were out-of-the-money and set to expire in the near term: 340 March $10 calls and 200 February $10 calls.

9. Following the announcement of the tender offer for Spectralink on the morning of February 8, 2007, Foley sold his position in the Account, generating trading profits of $78,225.

10. Eisler then assisted Foley in realizing the profits he made in the Account. Eisler's general practice was for Foley first to transfer trading proceeds into Eisler's bank account. Eisler would then withdraw the proceeds in cash over time in $500 increments and deliver it to Foley. Eisler also permitted Foley to access the proceeds by writing checks on her account, forging Eisler's signature—or sometimes having Eisler sign—to disburse funds in his behalf. On another occasion, Eisler wired trading proceeds from her bank account to pay the rent on a vacation villa in Spain for a large group including Foley, who then had the group members reimburse him via PayPal.

11. Despite the fact that she knew or was reckless in not knowing about Foley's trading restrictions because of his work, and that Foley had previously traded in contravention of those restrictions, and the great lengths Foley went to in an effort to distance himself from the trading and profits, Eisler nonetheless permitted Foley to utilize the Account.

12. Through her above described activities, Eisler knew, or was reckless in not knowing, that Foley was committing insider trading in violation Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibits fraudulent conduct in connection with the purchase or sale of securities, and by taking the actions described above, was thus a cause of Foley's violations.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Eisler 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.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. PA-41; File No. S7-05-10]

Privacy Act of 1974: Systems of Records.

AGENCY: Securities and Exchange Commission.

ACTION: Notice of revised system of records.

SUMMARY: In accordance with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a, the Securities and Exchange Commission ("Commission" or "SEC") proposes to revise a Privacy Act system of records: "Mailing, Contact and Other Lists (SEC-56)", originally published in the Federal Register Volume 74, Number 139 on Wednesday, July 22, 2009.

DATES: The proposed changes will become effective [insert date that is 40 days after publication in the Federal Register] unless further notice is given. The Commission will publish a new notice if the effective date is delayed to review comments or if changes are made based on comments received. To be assured of consideration, comments should be received on or before [insert date that is 30 days after publication in the Federal Register].

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-05-10 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 S7-05-10. 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 available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 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 available publicly.

FOR FURTHER INFORMATION CONTACT: Barbara A. Stance, Chief Privacy Officer, Office of Information Technology, 202-551-7209.

SUPPLEMENTARY INFORMATION: The Commission proposes to revise a system of records: "Mailing, Contact and Other Lists (SEC-56)". As described in the original notice, the system contains records related to individuals and employees who submit requests for information, subscriptions, inquiries, guidance, informal advice and other assistance to the SEC, and records related to individuals who register for SEC-related activities and events. This notice is published to revise the system of records to add the following new routine use: "To individuals who register for SEC-sponsored seminars, training programs or compliance meetings, such as the CCOutreach Program."

The Commission has submitted a report of the revised system of records to the appropriate Congressional committees and to the Director of the Office of Management and Budget ("OMB") as required by 5 U.S.C. 552a(r) (Privacy Act of 1974) and guidelines issued by OMB on December 12, 2000 (65 FR 77677).

Accordingly, the Commission is revising the system of records to read as follows:

SEC-56

SYSTEM NAME:

Mailing, Contact and Other Lists.

SYSTEM LOCATION:

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Records are also maintained in the SEC Regional Offices.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

Records contain information related to individuals and employees who submit requests for information, subscriptions, inquiries, guidance, informal advice and other assistance to the SEC in any format, including but not limited to paper, telephone, and electronic submissions; SEC personnel assigned to handle such correspondence; individuals who have registered for SEC events, such as seminars, training programs or compliance meetings; and individuals who have responded to questionnaires, request forms and feedback forms.

CATEGORIES OF RECORDS IN THE SYSTEM:

Records may contain information relating to but not limited to name, title, affiliation, mailing address, telephone number, cell phone number, fax number, email address, business affiliation, other contact and related supporting information provided to the

Commission by individuals or derived from other sources covered by this system of records and not currently covered under an existing SORN.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

15 U.S.C. 77a et seq., 78a et seq., 80a-1 et seq., and 80b-1 et seq.

PURPOSE(S):

1. To track and process complaints/inquiries/requests/comments and communications from members of the public, including industry representatives, counsel, and others.
2. To handle subscription requests for informational literature, reports, and other SEC materials, via individual, mass, and targeted mailing in the furtherance of SEC activities.
3. To process registration to SEC-related activities and events, and allow the sharing of personal contact information of registrants who consent to the sharing of their personal information at the time of registration.

ROUTINE USES OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the Commission as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

1. When (1) it is suspected or confirmed that the security or confidentiality of information in the system of records has been compromised; (2) the SEC has determined that as a result of the suspected or confirmed compromise there is a risk of harm to economic or property interests, identity theft or fraud, or harm to the security or integrity of this system or other systems or programs (whether maintained

by the SEC or another agency or entity) that rely upon the compromised information; and (3) the disclosure is made to such agencies, entities, and persons who are reasonably necessary to assist in connection with the SEC's efforts to respond to the suspected or confirmed compromise and prevent, minimize, or remedy such harm.

2. Where there is an indication of a violation or potential violation of law, whether civil, criminal or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule or order issued pursuant thereto, the relevant records in the system of records may be referred, as a routine use, to the appropriate agency, whether federal, state, local, foreign or a securities self-regulatory organization charged with the responsibility of investigating or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation or order issued pursuant thereto.

3. Records in this system may, in the discretion of the Commission's staff, be disclosed to any person during the course of any inquiry or investigation conducted by the Commission staff, or in connection with civil litigation, if the staff has reason to believe that the person to whom the record is disclosed may have further information about the matters related therein, and those matters appeared to be relevant at the time to the subject matter of the inquiry.

4. A record or information in this system may be disclosed to any person with whom the Commission contracts to reproduce, by typing, photocopy or other means, any record within this system for use by the Commission and its staff in connection with their official duties or to any person who is utilized by the Commission to perform clerical or stenographic functions relating to the official business of the Commission.

5. Records or information in records contained in this system may be disclosed to members of advisory committees that are created by the Commission or by Congress to render advice and recommendations to the Commission or to Congress, to be used solely in connection with their official, designated functions.
6. Disclosure may be made to a Congressional office from the record of an individual in response to an inquiry from the Congressional office made at the request of that individual.
7. To interns, grantees, experts and contractors who have been engaged by the Commission to assist in the performance of a service related to this system of records and who need access to the records for the purpose of assisting the Commission in the efficient administration of its programs. Recipients of these records shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.
8. To individuals who register for SEC-sponsored seminars, training programs or compliance meetings, such as the CCOutreach Program.

POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:

STORAGE:

Records are maintained in electronic format, paper form, magnetic disk and tape. Electronic records are stored in computerized databases. Paper, magnetic disk or tape records are stored in locked file rooms or file cabinets.

RETRIEVABILITY:

Records may be retrieved by any of the following: email address, name, or an assigned file number for the purpose of responding to the requestor. Information may additionally be retrieved by other personal identifiers.

SAFEGUARDS:

Records are safeguarded in a secured environment. Buildings where records are stored have security cameras and 24 hour security guard service. The records are kept in limited access areas during duty hours and in locked file cabinets and/or locked offices or file rooms at all other times. Access is limited to those personnel whose official duties require access. Computerized records are safeguarded through use of access codes and information technology security. Contractors and other recipients providing services to the Commission are contractually obligated to maintain equivalent safeguards.

RETENTION AND DISPOSAL:

These records will be maintained until they become inactive, at which time they will be retired or destroyed in accordance with records schedules of the United States Securities and Exchange Commission and as approved by the National Archives and Records Administration.

SYSTEM MANAGER(S) AND ADDRESS:

For SEC Headquarters

U. S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Components: Office of the Chairman and Commissioners, Division of Corporation Finance, Division of Trading and Markets, Division of Investment Management, Division of Enforcement, Office of the General Counsel, Office of the Chief Accountant , Office of Economic Analysis, Office of Compliance Inspections and Examinations, Office of

International Affairs, Office of Investor Education and Advocacy, Office of Information Technology, Office of the Executive Director, Office of Human Resources, Office of Financial Management, Office of Administrative Services, Office of Risk Assessment, Office of the Inspector General, Office of Legislative and Intergovernmental Affairs, Office of Public Affairs, Office of the Secretary, Office of Equal Employment Opportunity, and Office of Administrative Law Judges.

For Regional Offices

New York Regional Office, Regional Director, 3 World Financial Center, Suite 400, New York, NY 10281-1022; Boston Regional Office, Regional Director, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424; Philadelphia Regional Office, Regional Director, The Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106-1532; Miami Regional Office, Regional Director, 801 Brickell Avenue, Suite 1800, Miami, FL 33131-4901, Atlanta Regional Office, Regional Director, 3475 Lenox Road, NE, Suite 1000, Atlanta, GA 30326-1232; Chicago Regional Office, Regional Director, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908; Denver Regional Office, Regional Director, 1801 California Street, Suite 1500, Denver, CO 80202-2656; Fort Worth Regional Office, Regional Director, Burnett Plaza, Suite 1900, 801 Cherry Street, Unit #18, Fort Worth, TX 76102-6882; Salt Lake Regional Office, Regional Director, 15 West South Temple Street, Suite 1800, Salt Lake City, UT 84101-1573; Los Angeles Regional Office, Regional Director, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, CA 90036-3648; San Francisco Regional Office, Regional Director, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104-4716.

NOTIFICATION PROCEDURE:

All requests to determine whether this system of records contains a record pertaining to the requesting individual may be directed to the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

RECORD ACCESS PROCEDURES:

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

CONTESTING RECORD PROCEDURES:

See Record Access Procedures above.

RECORD SOURCE CATEGORIES:

The information is supplied by the individual and/or company making the request; or the individual who has registered for an SEC-related event such as a seminar, training program or compliance meeting. Data may also be added pertaining to the fulfillment of the request. Information may also be obtained from other SEC records systems.

EXEMPTIONS CLAIMED FOR THE SYSTEM:

None.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: February 25, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 26, 2010

In the Matter of **U.S. Biomedical Corp.,** **(f/k/a United Textiles & Toys, Inc.),** **U.S. Environmental Solutions, Inc.** **(n/k/a EnviroResolutions, Inc.),** **USA Bridge Construction of N.Y., Inc.,** **USA Broadband, Inc.,** **USA Uranium Corp., and** **Utopia Marketing, Inc.** **(n/k/a Daytonabrands, 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 U.S. Biomedical Corp. (f/k/a United Textiles & Toys, Inc.) because it has not filed any periodic reports since the period ended December 31, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of U.S. Environmental Solutions, Inc. (n/k/a EnviroResolutions, Inc.) because it has not filed any periodic reports since the period ended March 31, 1996.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of USA Bridge Construction of N.Y., Inc. because it has not filed any periodic reports since the period ended September 30, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of USA Broadband, Inc. because it has not filed any periodic reports since the period ended December 31, 2003.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of USA Uranium Corp. because it has not filed any periodic reports since the period ended February 29, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Utopia Marketing, Inc. (n/k/a Daytonabrands, 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 February 26, 2010, through 11:59 p.m. EST on March 11, 2010.

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. 61597 / February 26, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13793

In the Matter of **U.S. Biomedical Corp. (f/k/a United Textiles & Toys, Inc.), U.S. Environmental Solutions, Inc. (n/k/a EnviroResolutions, Inc.), USA Bridge Construction of N.Y., Inc., USA Broadband, Inc., USA Uranium Corp., and Utopia Marketing, Inc. (n/k/a Daytonabrands, 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 U.S. Biomedical Corp. (f/k/a United Textiles & Toys, Inc.) , U.S. Environmental Solutions, Inc. (n/k/a EnviroResolutions, Inc.), USA Bridge Construction of N.Y., Inc., USA Broadband, Inc., USA Uranium Corp., and Utopia Marketing, Inc. (n/k/a Daytonabrands, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. U.S. Biomedical Corp. (f/k/a United Textiles & Toys, Inc.) (CIK No. 895092) 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). U.S. Biomedical 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, 2002, which reported a net loss of $74,676 for the prior nine months. In June 2003, the company's CEO, Ilan Arbel, plead guilty to securities fraud and money laundering in the U.S. District Court for the Eastern District of New York. As of February 22, 2010, the company's stock ("USBH") was quoted on the Pink Sheets operated by Pink Sheets OTC Markets, Inc. ("Pink Sheets"), had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. U.S. Environmental Solutions, Inc. (n/k/a EnviroResolutions, Inc.) (CIK No. 862150) is a void Delaware corporation located in N. Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). U.S. Environmental 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, 1996. As of February 22, 2010, the company's stock (symbol "ENVI") was quoted on the Pink Sheets, had eleven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. USA Bridge Construction of N.Y., Inc. (CIK No. 937931) is a dissolved New York corporation located in Corona, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). USA Bridge is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1998. On March 8, 1999, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of New York, which was terminated on August 3, 2004. As of February 22, 2010, the company's stock (symbol "USBR") 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).

4. USA Broadband, Inc. (CIK No. 1105947) is a void Delaware corporation located in Santa Fe Springs, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). USA Broadband 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, 2003, which reported a net loss of over $12.4 million for the prior six months. On March 30, 2004, the company sold substantially all of its assets. As of February 22, 2010, the company's stock (symbol "USBU") was quoted on the Pink Sheets, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. USA Uranium Corp. (CIK No. 1161135) is a Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). USA Uranium 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 February 29, 2008, which reported a net loss of over $1.01 million for the prior nine months. As of February 22, 2010, the company's stock (symbol "USAU") was quoted on the Pink Sheets, had thirteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Utopia Marketing, Inc. (n/k/a Daytonabrands, Inc.) (CIK No. 880241) is a dissolved Florida corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Utopia Marketing 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 $531,000 for the prior nine months. As of February 22, 2010, the company's stock (symbol "DYTB") 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. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61599 / February 26, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13794

In the Matter of **BERNARD DANIEL BRAVER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

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

III.

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

1. From at least October 2006 through November 2007, Braver was a salesman at Rabinovich & Associates, LP (the "Fund"), an unregistered broker-dealer and investment company. From August 2005 through March 2006, Braver was associated with a broker-dealer registered with the Commission.

2. On January 26, 2010, a final judgment was entered by consent against Braver, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Bernard Daniel Braver, Civil Action Number 1:10-CV-469, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that, from at least October 2006 through November 2007, Braver sold unregistered securities in the form of limited partnership interests in the Fund and unlawfully operated as an unregistered broker-dealer; that during that period, Braver knowingly or recklessly misrepresented to investors and prospective investors that the Fund was highly profitable, when in fact it had only lost money throughout its existence, and that the Fund was located on Wall Street when in fact it operated out of a boiler room in Brooklyn. The complaint also alleged that Braver failed to disclose to investors and prospective investors the disciplinary history of Alex Rabinovich, the Fund's general partner and portfolio manager.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Braver be, and hereby is barred from association with any broker or dealer;

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey and
Commissioner Paredes
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

Release No. 34-61595; File No. S7-08-09

RIN 3235-AK35

Amendments to Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting amendments to Regulation SHO under the Securities Exchange Act of 1934 ("Exchange Act"). We are adopting a short sale-related circuit breaker that, if triggered, will impose a restriction on the prices at which securities may be sold short ("short sale price test" or "short sale price test restriction"). Specifically, the Rule requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan. We believe it is appropriate at this time to adopt a short sale-related circuit breaker because, when triggered, it will prevent short selling, including potentially manipulative or abusive short selling,

from driving down further the price of a security that has already experienced a significant intra-day price decline, and will facilitate the ability of long sellers to sell first upon such a decline. This approach establishes a narrowly-tailored Rule that will target only those securities that are experiencing significant intra-day price declines. We believe that addressing short selling in connection with such declines in individual securities will help address erosion of investor confidence in our markets generally.

In addition, we are amending Regulation SHO to provide that a broker-dealer may mark certain qualifying sell orders "short exempt." In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt." This "short exempt" marking requirement will aid surveillance by self-regulatory organizations ("SROs") and the Commission for compliance with the provisions of Rule 201 of Regulation SHO.

DATES: Effective Date: [Insert date 60 days after publication in the Federal Register.]

Compliance Date: [Insert date 6 months from Effective Date.]

FOR FURTHER INFORMATION CONTACT: Josephine J. Tao, Assistant Director; Victoria Crane, Branch Chief; Katrina Wilson, Staff Attorney; and Angela Moudy, Staff Attorney, Division of Trading and Markets, at (202) 551-5720, at the Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION: The Commission is amending Rules 200(g) and 201 of Regulation SHO [17 CFR 242.200(g) and 17 CFR 242.201] under the Exchange Act.

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I. Executive Summary

In July 2007, the Commission eliminated all short sale price test restrictions. Prior to that time, short sale price test restrictions included Rule 10a-1 under the Exchange Act, also known as the "uptick rule" or "tick test" ("former Rule 10a-1"), that applied to exchange-listed securities,[1] and the National Association of Securities Dealers, Inc.'s ("NASD")[2] bid test, Rule 3350 ("NASD's former bid test"), that applied to certain Nasdaq securities.[3] The Commission's removal of short sale price test restrictions followed a careful, deliberative rulemaking process, carried out in multiple stages from 1999 through 2006, and was open to the public at every stage.

The Commission took a number of steps as part of that process, including seeking extensive public comment and conducting a comprehensive staff study to assess whether then-current short sale price test restrictions were appropriate. For example, beginning in 1999, the Commission published a concept release in which it sought comment regarding short sale price test regulation, including comment on whether to eliminate such regulation.[4] In 2004, the Commission initiated a year-long pilot ("Pilot") to study the removal of short sale price tests for approximately one-third of the largest stocks.[5] Short sale data was made publicly available during this Pilot to allow the public and Commission staff (the "Staff") to study the effects of eliminating short sale price test restrictions. The findings of third party researchers were

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1 See infra note 41 and accompanying text.

2 NASD is now known as the Financial Industry Regulatory Authority, Inc. ("FINRA").

3 See infra note 43 and accompanying text.

4 See Exchange Act Release No. 42037 (Oct. 20, 1999), 64 FR 57996 (Oct. 28, 1999) ("1999 Concept Release").

5 See Exchange Act Release No. 50104 (July 28, 2004), 69 FR 48032 (Aug. 6, 2004) ("Pilot Release").

presented and discussed in a public Roundtable in September 2006.[6] In addition, the results of the Staff study of the Pilot data were made publicly available in draft form in September 2006 and in final form in February 2007.[7]

Since then, there has been significant market turmoil. Concurrent with the development of the subprime mortgage crisis and credit crisis in 2007, market volatility, including steep price declines, particularly in the stocks of certain financial services companies, increased markedly in the U.S. and in every major stock market around the world (including markets that continued to operate under short sale price test restrictions).[8] As market conditions continued to worsen, investor confidence eroded, and the Commission received many requests from the public to consider imposing restrictions with respect to short selling, based in part on the belief that such action would help restore investor confidence.[9]

We determined that it was appropriate to re-examine the appropriateness of short sale price test restrictions and seek comment on whether to restore any such restrictions. Thus, in April 2009 we proposed two approaches to restrictions on short selling, one that would apply on a permanent, market-wide basis and another that would apply to a particular security upon a significant decline in the price of that security (the "proposed circuit breaker approach" or "proposed circuit breaker rules").[10]

6 See http://www.sec.gov/about/economic/shopilottrans091506.pdf (the "Regulation SHO 2006 Roundtable").

7 See http://www.sec.gov/about/economic/shopilot091506/draft_reg_sho_pilot_report.pdf and http://www.sec.gov/news/studies/2007/regshopilot020607.pdf. See also infra notes 48 to 62 and accompanying text (discussing findings of the Staff study).

8 See Exchange Act Release No. 59748 (Apr. 10, 2009), 74 FR 18042, 18043 (Apr. 20, 2009) (the "Proposal").

9 See id.

10 See Proposal, 74 FR 18042.

With respect to the permanent, market-wide approach, we proposed two alternative price tests. The first alternative price test, in many ways similar to NASD's former bid test, would be based on the national best bid (the "proposed modified uptick rule"). The second alternative price test, similar to former Rule 10a-1, would be based on the last sale price (the "proposed uptick rule").

With respect to the proposed circuit breaker approach, we proposed two basic alternatives. First, we proposed a circuit breaker rule that, when triggered by a significant price decline in a particular security, would temporarily prohibit any person from selling short that security, subject to certain exceptions ("proposed circuit breaker halt rule"). Second, we proposed a circuit breaker rule that, when triggered by a significant price decline in a particular security, would trigger a temporary short sale price test for that security. In connection with this alternative, we proposed two short sale price tests. One was the modified uptick rule – that is, we proposed a circuit breaker rule that, when triggered by a significant price decline in a particular security, would temporarily impose the proposed modified uptick rule for that security ("proposed circuit breaker modified uptick rule"). The other was the uptick rule – that is, we proposed a circuit breaker rule that, when triggered by a significant market decline in a particular security, would temporarily impose the proposed uptick rule for that security ("proposed circuit breaker uptick rule").

In addition, in the Proposal we inquired whether a short sale price test restriction that would permit short selling at a price above the current national best bid (the "alternative uptick rule"), would be preferable to the proposed modified uptick rule and the proposed uptick rule.[11] We sought comment regarding the application of the alternative uptick rule as a market-wide

[11] See Proposal, 74 FR at 18072, 18081, 18082.

permanent short sale price test restriction or in conjunction with a circuit breaker.[12] As a supplement to our request for comment in the Proposal and to help ensure the public had a full opportunity to comment on, among other things, the alternative uptick rule, on August 20, 2009 we re-opened the comment period to the Proposal.[13] In addition, on May 5, 2009, we held a Roundtable to Examine Short Sale Price Test and Circuit Breaker Restrictions (the "May 2009 Roundtable").[14] Panelists included representatives of public issuers, investors, financial services firms, SROs and the academic community.[15]

Although in recent months there has been an increase in stability in the securities markets, we remain concerned that excessive downward price pressure on individual securities accompanied by the fear of unconstrained short selling can undermine investor confidence in our markets generally.[16] In addition, we are concerned about potential future market turmoil, including significant increases in market volatility and steep price declines. Thus, as discussed in more detail below, after considering the comments, we have determined that it is appropriate at this time to adopt in Rule 201 a targeted short sale price test restriction that will apply the alternative uptick rule for the remainder of the day and the following day if the price of an

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12 See id.

13 See Exchange Act Release No. 60509 (Aug. 17, 2009), 74 FR 42033 (Aug. 20, 2009) (the "Re-Opening Release").

14 See Exchange Act Release No. 59855 (May 1, 2009); Press Release No. 2009-101 (agenda and panelists included); Press Release No. 2009-88 (preliminary agenda included).

15 See http://www.sec.gov/spotlight/shortsales/roundtable050509/shortsalesroundtable050509-transcript.txt (unofficial transcript of May 2009 Roundtable).

16 We note that investor confidence may include a number of different elements, such as investor perceptions about fundamental market risk, investor optimism about the economy, or investor trust in the fairness of financial markets as influenced by applicable regulatory protections. Although the latter can be directly influenced by Commission actions, the Commission does not have control over fundamental market risk and economic optimism. Thus, as used here, the term "investor confidence" refers to investor trust in the fairness of financial markets.

individual security declines intra-day by 10% or more from the prior day's closing price for that security as determined by the covered security's listing market.

By not allowing short sellers to sell at or below the current national best bid while the circuit breaker is in effect, the short sale price test restriction in Rule 201 will allow long sellers, who will be able to sell at the bid, to sell first in a declining market for a particular security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of such restrictions is to allow long sellers to sell first in a declining market.[17] A short seller that is seeking to profit quickly from accelerated, downward market moves may find it advantageous to be able to short sell at the current national best bid. In addition, by making such bids accessible only by long sellers when a security's price is undergoing significant downward price pressure, Rule 201 will help to facilitate and maintain stability in the markets and help ensure that they function efficiently. It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors.

In addition, combining the alternative uptick rule with a circuit breaker will strike the appropriate balance between our goal of preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets,

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[17] See Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62989 (Nov. 6, 2003) ("2003 Regulation SHO Proposing Release"); see also Exchange Act Release No. 30772 (June 3, 1992), 57 FR 24415, 24416 (June 9, 1992) (stating that former Rule 10a-1 was "designed to limit short selling of a security in a declining market, by requiring, in effect, that each successive lower price be established by a long seller").

including the provision of liquidity and price efficiency in the markets.[18] The circuit breaker approach of Rule 201 will help benefit the market for a particular security by allowing participants, when a security is undergoing a significant intra-day price decline, an opportunity to re-evaluate circumstances and respond to volatility in that security. We also believe that a circuit breaker will better target short selling that may be related to potential bear raids[19] and other forms of manipulation that may be used to exacerbate a price decline in a covered security.

At the same time, however, we recognize the benefits to the market of legitimate short selling, such as the provision of liquidity and price efficiency. Thus, by imposing a short sale price test restriction only when an individual security is undergoing significant downward price pressure, the short sale price test restrictions of Rule 201 will apply to a limited number of securities, rather than to all securities all the time. As discussed in more detail below,[20] in response to our request for comment on an appropriate threshold at which to trigger the proposed circuit breaker short sale price test restrictions, commenters submitted estimates of the number of securities that would trigger a circuit breaker rule at a 10% threshold.[21] While commenters'

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18 Where we use the terms "market efficiency" and "price efficiency" in this adopting release we are using terms of art as used in the economic literature proceeding under the "efficient markets hypothesis," under which financial prices are assumed to reflect all available information and accordingly adjust quickly to reflect new information. See, e.g., Eugene F. Fama, 1991, Efficient capital markets: II, Journal of Finance; 46: 1575-1617; Eugene F. Fama and Kenneth R. French, 1992, The Cross-Section of Expected Stock Returns, Journal of Finance, 47: 427-465. It should be noted that economic efficiency and price efficiency are not identical with the ordinary sense of the word "efficiency."

19 See infra note 36 and accompanying text.

20 See infra Section III.A.5. (discussing the circuit breaker trigger level).

21 See, e.g., letter from Mary Lou Von Kaenel, Managing Director, Management Consulting, Jordan & Jordan, dated June 19. 2009 ("Jordan & Jordan"); letter from John C. Nagel, Managing Director and Deputy General Counsel, Citadel Investment Group, John Liftin, Managing Director and General Counsel, The D.E. Shaw Group, and Mark Silber, Executive Vice President, Renaissance Technologies, dated June 19, 2009 ("Citadel et al. (June 2009)"); letter from Stuart J. Kaswell. Executive Vice President, Managing Director and General Counsel, Managed Funds Association, dated June 22, 2009 ("MFA (June 2009)"); letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated June 19, 2009 ("SIFMA (June 2009)"); letter from Daniel Mathisson, Managing Director, Credit Suisse Securities (USA), LLC, dated Sept. 21, 2009 ("Credit Suisse (Sept. 2009)").

analyses (including the facts and assumptions used) and their resulting estimates varied,[22] commenters' estimates reflect that a 10% circuit breaker threshold, on average, should affect a limited percentage of covered securities.[23] Given the variations in the facts and assumptions underlying the estimates submitted by commenters, the Staff also looked at trading data to confirm the reasonableness of those estimates. The Staff found that, during the period covering April 9, 2001 to September 30, 2009,[24] the price test restrictions of Rule 201 would have been triggered, on an average day, for approximately 4% of covered securities.[25] The Staff also found that for a low volatility period, covering January 1, 2004 to December 31, 2006, the 10% trigger level of Rule 201 would have, on an average day, been triggered for approximately 1.3% of covered securities.[26]

Thus, Rule 201 is structured so that the circuit breaker generally will not be triggered for the majority of covered securities at any given time and, thereby, will not interfere with the smooth functioning of the markets for those securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising. If the short sale price test restrictions of Rule 201 apply to a covered security it will be because and when that security is undergoing significant downward price pressure.

In addition, to help ensure the Rule's workability, we are amending Rule 200(g) of Regulation SHO, substantially as proposed, to provide that, once the circuit breaker has been triggered for a covered security, if a broker-dealer chooses to rely on its own determination that

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22 See infra note 306.

23 See infra note 307.

24 See infra note 309.

25 See infra note 310.

26 See infra note 311.

it is submitting a short sale order to a trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order "short exempt."[27] The short sale price test restrictions of Rule 201 generally will apply to a small number of securities for a limited duration, and will continue to permit short selling rather than, for example, halting short selling when the restrictions are in place. As such, we believe that the circumstances under which a broker-dealer may need to mark a short sale order "short exempt" under Rule 201 are limited.

II. Background on Short Sale Restrictions

Short selling involves a sale of a security that the seller does not own or a sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller.[28] In order to deliver the security to the purchaser, the short seller will borrow the security, usually from a broker-dealer or an institutional investor. Typically, the short seller later closes out the position by purchasing equivalent securities on the open market and returning the security to the lender. In general, short selling is used to profit from an expected downward price movement, to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security.[29]

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27 We note that, as discussed in more detail below, unless a sale order is marked "short exempt," a trading center's policies and procedures must be reasonably designed to prevent the execution or display of the order at a price that is less than or equal to the current national best bid.

28 See 17 CFR 242.200(a).

29 See, e.g., Exchange Act Release No. 54891 (Dec. 7, 2006), 71 FR 75068. 75069 (Dec. 13, 2006) ("2006 Price Test Elimination Proposing Release"); 2003 Regulation SHO Proposing Release, 68 FR at 62974. In this adopting release, we use the terms "liquidity provider" and "liquidity taker." and correlative terms, in their technical sense in the literature of market microstructure. See, e.g., Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, at 70 (2003) (an introductory textbook to the economics of market microstructure). As used therein, a liquidity taker is a buyer or seller (including a short seller) who submits an order designed for immediate execution, such as a market order or a marketable limit order, while a liquidity provider is a more patient buyer or seller (including a short seller) who submits orders that may or may not be executed, and thus provides depth to the market. This usage differs from the usage of the term "liquidity provider" to refer to a bank, central bank, or other financial institution or investor who provides cash financing or otherwise increases the money supply.

A. Short Selling and its Market Impact

Short selling provides the market with important benefits, including market liquidity and pricing efficiency.[30] Market liquidity is often provided through short selling by market professionals, such as market makers (including specialists) and block positioners, who offset temporary imbalances in the buying and selling interest for securities. Short sales effected in the market add to the selling interest of stock available to purchasers and reduce the risk that the price paid by investors is artificially high because of a temporary imbalance between buying and selling interest. Short sellers covering their sales also may add to the buying interest of stock available to sellers.[31]

Short selling also can contribute to the pricing efficiency of the equities markets.[32] When a short seller speculates or hedges against a downward movement in a security, his transaction is a mirror image of the person who purchases the security in anticipation that the security's price will rise or to hedge against such an increase. Both the purchaser and the short seller hope to profit, or hedge against loss, by buying the security at one price and selling at a higher price. The strategies primarily differ in the sequence of transactions. Market participants who believe a stock is overvalued may engage in short sales in an attempt to profit from a perceived divergence of prices from true economic values. Such short sellers add to stock pricing efficiency because

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30 See id.; see also Exchange Act Release No. 29278 (June 7, 1991), 56 FR 27280 (June 13, 1991); Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48009 n.6 (Aug. 6, 2004) ("2004 Regulation SHO Adopting Release"); Ekkehart Boehmer and J. Julie Wu, Short Selling and the Informational Efficiency of Prices, Working Paper, Jan. 8, 2009.

31 See, e.g., 2006 Price Test Elimination Proposing Release, 71 FR at 75069; 2003 Regulation SHO Proposing Release, 68 FR at 62974.

32 See id.

their transactions inform the market of their evaluation of future stock price performance. This evaluation is reflected in the resulting market price of the security.[33]

Although short selling serves useful market purposes, it also may be used to drive down the price of a security or as a tool to accelerate a declining market in a security.[34] In addition, short selling may be used to illegally manipulate stock prices.[35] One example is the "bear raid" where an equity security is sold short in an effort to drive down the price of the security by creating an imbalance of sell-side interest.[36] This unrestricted short selling could exacerbate a declining market in a security by increasing pressure from the sell-side, eliminating bids, and causing a further reduction in the price of a security by creating an appearance that the security's price is falling for fundamental reasons, when the decline, or the speed of the decline, is being driven by other factors.[37]

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33 See 2006 Price Test Elimination Proposing Release, 71 FR at 75069 – 75070; 2003 Regulation SHO Proposing Reelease, 68 FR at 62974. Arbitrageurs also contribute to pricing efficiency by utilizing short sales to profit from price disparities between a stock and a derivative security, such as a convertible security or an option on that stock. For example, an arbitrageur may purchase a convertible security and sell the underlying stock short to profit from a current price differential between two economically similar positions. See id.

34 See, e.g., Proposal, 74 FR at 18065 (noting that a short selling circuit breaker rule would be designed to target only those securities that experience rapid severe intra-day price declines and, therefore, might help to prevent short selling from being used to drive the price of a security down or to accelerate the decline in the price of those securities).

35 See, e.g., U.S. v. Russo, 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b-5); S.E.C. v. Gardiner, 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. Mar. 27, 1991) (alleged manipulation by sales representative by directing or inducing customers to sell stock short in order to depress its price).

36 Many people blamed "bear raids" for the 1929 stock market crash and the market's prolonged inability to recover from the crash. See, e.g., Steve Thel, $850,000 in Six Minutes – The Mechanics of Securities Manipulation, 79 Cornell L. Rev. 219, 295-296 (1994); Jonathan R. Macey, Mark Mitchell & Jeffry Netter, Restrictions on Short Sales: An Analysis of the Uptick Rule and its Role in View of the October 1987 Stock Market Crash, 74 Cornell L. Rev. 799, 801-802 (1989).

37 See 2006 Price Test Elimination Proposing Release, 71 FR at 75070; 2003 Regulation SHO Proposing Release, 68 FR at 62974.

B. History of Short Sale Price Test Restrictions in the U.S.

Section 10(a) of the Exchange Act[38] gives the Commission plenary authority to regulate short sales of securities registered on a national securities exchange, as necessary or appropriate in the public interest or for the protection of investors.[39] After conducting an inquiry into the effects of concentrated short selling during the market break of 1937,[40] the Commission adopted former Rule 10a-1 in 1938 to restrict short selling in a declining market.[41]

The core provisions of former Rule 10a-1 remained virtually unchanged for almost seventy years. Over the years, however, in response to changes in the securities markets, including changes in trading strategies and systems used in the marketplace, the Commission added exceptions to former Rule 10a-1 and granted numerous written requests for relief from the Rule's restrictions. These market changes included decimalization, the increased use of matching systems that execute trades at independently-derived prices during random times within specific time intervals,[42] and the spread of fully automated markets. In addition, market

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38 15 U.S.C. 78j(a).

39 See id.; see also 2006 Price Test Elimination Proposing Release, 71 FR at 75068; 2003 Regulation SHO Proposing Release, 68 FR at 62973.

40 The study covered two weekly periods, that of September 7-13, 1937, and that of October 18-23, 1937. See Exchange Act Release No. 1548 (Jan. 24, 1938), 3 FR 213 (Jan. 26, 1938) ("Former Rule 10a-1 Adopting Release").

41 See id. Former Rule 10a-1 provided that, subject to certain exceptions, a listed security could be sold short (i) at a price above the price at which the immediately preceding sale was effected (plus tick), or (ii) at the last sale price if it was higher than the last different price (zero plus tick).

42 See, e.g., letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Andre E. Owens, Schiff Hardin & Waite, dated Apr. 23, 2003 (granting exemptive relief from former Rule 10a-1 for trades executed through an alternative trading system ("ATS") that matches buying and selling interest among institutional investors and broker-dealers at various set times during the day).

developments over the years led to the application of different price tests to securities trading in different markets.[43]

In July 2004, the Commission adopted Rule 202T of Regulation SHO,[44] which established procedures for the Commission to temporarily suspend short sale price tests for a prescribed set of securities so that the Commission could study the effectiveness of these tests.[45] Pursuant to the process established in Rule 202T, the Commission issued an order creating the Pilot, which temporarily suspended the tick test of former Rule 10a-1 and any price test of any national securities exchange or national securities association for short sales of certain securities.[46] The Pilot was designed to assist the Commission in assessing whether changes to short sale price test regulation were appropriate at that time in light of then-current market practices and the purposes underlying short sale price test regulation.[47]

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43 See, e.g., Exchange Act Release No. 55245 (Feb. 5, 2007), 72 FR 6635 (Feb. 12, 2007). Former Rule 10a-1 applied only to short sale transactions in exchange-listed securities. In 1994, the Commission granted temporary approval to NASD to apply its own short sale rule, known as the "bid test," on a pilot basis that was renewed annually until the Commission repealed short sale price tests. NASD's former bid test prohibited short sales in Nasdaq Global Market securities (then known as Nasdaq National Market securities) at or below the current (inside) bid when the current best (inside) bid was below the previous best (inside) bid in a security. As a result, until the Commission eliminated former Rule 10a-1, and prohibited any SRO from having a short sale price test in July 2007, Nasdaq Global Market securities traded on Nasdaq or the over-the-counter ("OTC") market and reported to a NASD facility were subject to a bid test. Nasdaq securities traded on exchanges other than Nasdaq were not subject to any price test. In addition, many thinly-traded securities, such as Nasdaq Capital Market securities and securities quoted on the OTC Bulletin Board and Pink Sheets, were not subject to any price test wherever traded. According to the Staff, in 2005, prior to the start of the Pilot, NASD's former bid test applied to approximately 2,800 securities, while former Rule 10a-1 applied to approximately 4,000 securities.

44 17 CFR 242.202T.

45 See 17 CFR 242.202T; see also 2004 Regulation SHO Adopting Release, 69 FR at 48012-48013.

46 See Pilot Release, 69 FR 48032.

47 See id. In the 2004 Regulation SHO Adopting Release, we noted that "the purpose of the [P]ilot is to assist the Commission in considering alternatives, such as: (1) Eliminating a Commission-mandated price test for an appropriate group of securities, which may be all securities; (2) adopting a uniform bid test, and any exceptions, with the possibility of extending a uniform bid test to securities for which there is currently no price test; or (3) leaving in place the current price tests." 2004 Regulation SHO Adopting Release, 69 FR at 48010.

The Staff gathered the data made public during the Pilot, analyzed the data and provided the Commission with a summary report on the Pilot ("Staff's Summary Pilot Report").[48] The Staff's Summary Pilot Report, which was made public, examined several aspects of market quality including the overall effect of then-current price tests on short selling, liquidity, volatility and price efficiency.[49] The Pilot was also designed to allow the Commission and members of the public to examine whether the effects of the then-current short sale price tests were similar across stocks.[50]

As set forth in the Staff's Summary Pilot Report, the Staff found little empirical justification at that time for maintaining then-current short sale price test restrictions, especially for actively traded securities. Amongst its results, the Staff found that such short sale price tests did not have a significant impact on daily volatility. However, the Staff also found some evidence that the short sale price tests dampened intra-day volatility for smaller stocks.[51]

In addition, the Staff found that the Pilot data provided limited evidence that then-current price test restrictions distorted a security's price.[52] The Staff also found that the price test

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48 See http://www.sec.gov/about/economic/shopilot091506/draft_reg_sho_pilot_report.pdf and http://www.sec.gov/news/studies/2007/regshopilot020607.pdf.

49 See Staff's Summary Pilot Report at 40-47; see also id. at 22-24 (discussing the selection of securities included in the Pilot and the control group).

50 In the 2004 Regulation SHO Adopting Release, the Commission stated its expectation that data on trading during the Pilot would be made available to the public to encourage independent researchers to study the Pilot. See 2004 Regulation SHO Adopting Release, 69 FR at 48009, n.9. Accordingly, nine SROs began publicly releasing transactional short selling data on Jan. 3, 2005. The nine SROs at that time were the Amex, ARCA, BSE, CHX, NASD, Nasdaq, National Stock Exchange, NYSE and Phlx. The SROs agreed to collect and make publicly available trading data on each executed short sale involving equity securities reported by the SRO to a securities information processor ("SIP"). The SROs published the information on a monthly basis on their Internet Web sites.

51 See Staff's Summary Pilot Report at 55-56.

52 On the day the Pilot went into effect, listed Pilot securities underperformed listed control group securities by approximately 24 basis points. The Pilot and control group securities, however, had similar returns over the first six months of the Pilot. See Staff's Summary Pilot Report at 8.

restrictions resulted in an increase in quote depths.[53] Realized liquidity levels, however, were unaffected by the removal of such short sale price test restrictions.[54] The Pilot data also provided evidence that the short sale price test restrictions reduced the volume of executed short sales to total volume and, therefore, acted as a constraint on short selling.[55] The Staff did not find, however, a significant difference in short interest positions between those securities subject to a short sale price test versus those securities that were not subject to such a test during the Pilot.[56]

In addition, the Commission encouraged outside researchers to examine the Pilot data. In response to this request, the Commission received four completed studies (the "Academic Studies") from outside researchers that specifically examined the Pilot data.[57] The Commission also held the Regulation SHO 2006 Roundtable[58] that focused on the empirical evidence learned from the Pilot data (the Staff's Summary Pilot Report, Academic Studies, and Regulation SHO 2006 Roundtable are referred to collectively herein as the "Pilot Results").[59] The Pilot Results contained a variety of observations, which the Commission considered in determining whether or not to propose removal of then-current short sale price test restrictions and subsequently whether

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53 See Staff's Summary Pilot Report at 55.

54 This conclusion is based on the result that changes in effective spreads were not economically significant (less than a basis point) and that the changes in the bid and ask depth appear not to affect the transaction costs paid by investors. Arguably, the changes in bid and ask depth appeared to affect the intra-day volatility. However, the Staff concluded that overall, the Pilot data did not suggest a deleterious impact on market quality or liquidity. See Staff's Summary Pilot Report at 40-42, 55.

55 See Staff's Summary Pilot Report at 35.

56 See id.

57 See Karl B. Diether, Kuan Hui Lee and Ingrid M. Werner, 2009, It's SHO Time! Short-Sale Price-Tests and Market Quality, Journal of Finance 64:37-73; Gordon J. Alexander and Mark A. Peterson, 2008, The Effect of Price Tests on Trader Behavior and Market Quality: An Analysis of Reg. SHO, Journal of Financial Markets 11:84-111; J. Julie Wu, Uptick Rule, short selling and price efficiency, Aug. 14, 2006; Lynn Bai, 2008, The Uptick Rule of Short Sale Regulation – Can it Alleviate Downward Price Pressure from Negative Earnings Shocks? Rutgers Business Law Journal 5:1-63.

58 See supra note 6.

59 See id.

or not to eliminate such restrictions. For example, one study concluded that former Rule 10a-1 had little or no effect on price efficiency.[60] Another study found no evidence that former Rule 10a-1 negatively impacted price discovery.[61]

Generally, the Pilot Results supported removal of the short sale price test restrictions that were in effect at that time.[62] In addition to the Pilot Results, thirteen other analyses by SEC staff and various third party researchers were conducted between 1963 and 2004 addressing price test restrictions.[63] Among these were several studies that evaluated short sale price tests during times of significant market decline, including the market break of May 28, 1962, the market decline of September and October 1976, the market break of October 19, 1987, and the Nasdaq market decline of 2000-2001. The results of these studies were mixed, but generally the studies found that former Rule 10a-1 did not prevent short sales in extreme down markets and did limit short selling in up markets, and the studies provided additional support for the removal of the permanent, market-wide short sale price test restrictions in existence at that time.

In December 2006, the Commission proposed to eliminate former Rule 10a-1 by removing restrictions on the execution prices of short sales, as well as prohibiting any SRO from having a short sale price test.[64] The Commission received twenty-seven comment letters in response to its proposal to eliminate former Rule 10a-1 and prohibit any SRO from having a short sale price test. The comments in response to the proposed amendments varied. Most commenters (including individual traders, an academic, broker-dealers, SROs and trade

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60 See J. Julie Wu, Uptick Rule, short selling and price efficiency, Aug. 14, 2006.

61 See Lynn Bai, 2008, The Uptick Rule of Short Sale Regulation – Can it Alleviate Downward Price Pressure from Negative Earnings Shocks? Rutgers Business Law Journal 5:1-63.

62 See 2006 Price Test Elimination Proposing Release, 71 FR at 75072-75075 (discussing the Pilot Results).

63 See Staff's Summary Pilot Report at 14, 17-22 (discussing the thirteen studies).

64 See 2006 Price Test Elimination Proposing Release, 71 FR 75068.

associations) advocated removing all short sale price test restrictions.[65] Generally, these commenters believed that short sale price test restrictions were no longer necessary due to increased market transparency and the existence of real-time regulatory surveillance that could monitor for and detect any potential short sale manipulation.[66]

Two commenters (both individual investors) opposed the proposed amendments, noting the need for short sale price tests to prevent "bear raids."[67] One commenter, although generally in support of removing all short sale price test restrictions, stated the belief that at some level unrestricted short selling should be collared.[68] This commenter supported having a 10% circuit breaker to prevent panic in the event there is a major market collapse.[69] The New York Stock Exchange ("NYSE") also noted its concern about unrestricted short selling during periods of unusually rapid and large market declines. The NYSE stated that the effects of an unusually

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65 See, e.g., letter from Howard Teitelman, CSO, Trillium Trading, dated Feb. 6, 2007; letter from S. Kevin An, Deputy General Counsel, E*TRADE, dated Feb. 9, 2007 ("E*TRADE (Feb. 2007)"); letter from Carl Giannone, dated Feb. 11, 2007 ("Giannone (Feb. 2007)"); letter from David Schwarz, dated Feb. 12, 2007; letter from John G. Gaine, President, Managed Funds Association, dated Feb. 12, 2007; letter from Lisa M. Utasi, Chairman of the Board, John C. Giesea, President and CEO, Security Traders Association, dated Feb. 12, 2007 ("STA (Feb. 2007)"); letter from Gerard S. Citera, Executive Director, U.S. Equities, UBS, dated Feb. 14, 2007 ("UBS (Feb. 2007)"); letter from Mary Yeager, Assistant Secretary, NYSE Euronext, dated Feb. 14, 2007 ("NYSE Euronext (Feb. 2007)"); letter from James J. Angel, Ph.D., CFA, Associate Professor of Finance, McDonough School of Business, Georgetown University, dated Feb. 14, 2007; letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated Feb. 16, 2007; see also Exchange Act Release No. 55970 (June 28, 2007), 72 FR 36348, 36350-36351 (July 3, 2007) ("2007 Price Test Adopting Release") (discussing the comment letters).

66 See, e.g., letter from Giannone (Feb. 2007); letter from E*TRADE (Feb. 2007); letter from STA (Feb. 2007); letter from UBS (Feb. 2007); see also 2007 Price Test Adopting Release, 72 FR at 36350-36351 (discussing the comment letters).

67 See, e.g., letter from Jim Ferguson, dated Dec. 19, 2006; letter from David Patch, dated Jan. 1, 2007; letter from David Patch, dated Jan. 12, 2007.

68 See letter from Giannone (Feb. 2007).

69 See id.

rapid and large market decline could not be measured or analyzed during the Pilot because such decline did not occur during the period studied.[70]

Effective July 3, 2007, the Commission eliminated former Rule 10a-1 and added Rule 201 of Regulation SHO, prohibiting any SRO from having a short sale price test.[71] The Commission stated that it determined to eliminate all short sale price test restrictions after reviewing the comments received in response to its proposal to eliminate all short sale price test restrictions, reviewing the Pilot Results, and taking into account the market developments that had occurred in the securities industry since the Commission adopted former Rule 10a-1 in 1938.[72] In addition, the Commission stated its belief that the amendments would bring increased uniformity to short sale regulation, level the playing field for market participants, and remove an opportunity for regulatory arbitrage.[73]

C. Proposal to Adopt a Short Sale Price Test Restriction or Circuit Breaker

On April 8, 2009, following changes in market conditions since the elimination of former Rule 10a-1, we proposed to re-examine and seek comment on whether to impose price test restrictions or circuit breaker restrictions on short selling.[74] In the Proposal, we noted that market volatility had recently increased markedly in the U.S., as well as in every major stock market around the world.[75] We also noted that although we were not aware of specific empirical evidence that the elimination of short sale price tests contributed to the increased volatility in

70 See letter from NYSE Euronext (Feb. 2007).

71 See 2007 Price Test Adopting Release, 72 FR 36348.

72 See id. at 36352.

73 See id.

74 See Proposal, 74 FR 18042.

75 See id. at 18049.

U.S. markets, many members of the public associate the removal of former Rule 10a-1 with such volatility, including steep declines in some securities' prices. and loss of investor confidence in our markets.[76] Due to the market conditions with which we were faced and the resulting deterioration in investor confidence, we stated in the Proposal that we believed it was appropriate to propose amending Regulation SHO to add a short sale price test or a circuit breaker rule.[77]

In response to the Proposal and the Re-Opening Release, we received over 4,300 unique comment letters.[78] A number of commenters stated that they do not believe that we should reinstate any form of short sale price test restriction, whether in the form of a short sale price test restriction or a circuit breaker rule. For example, a number of commenters noted a lack of empirical evidence suggesting that such restrictions would advance the Commission's goals of restoring investor confidence and preventing short selling, including potentially abusive or manipulative short selling, from driving down the market or being used as a tool to exacerbate a declining market in a security.[79] In response to our specific request for empirical data in the

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76 See id.

77 See Proposal, 74 FR at 18047.

78 See http://www.sec.gov/comments/s7-08-09/s70809.shtml.

79 See, e.g., letter from Daniel Mathisson, Managing Director, Credit Suisse Securities (USA), LLC, dated June 16, 2009 ("Credit Suisse (June 2009)"); letter from Citadel et al. (June 2009); letter from Peter Kovac, Chief Operating Officer and Financial and Operations Principal, EWT, LLC, dated June 19, 2009 ("EWT (June 2009)"); letter from Stephen Schuler, Managing Member, Daniel Tierney, Managing Member, Global Electronic Trading Company, dated June 19, 2009 ("GETCO (June 2009)"); letter from SIFMA (June 2009); letter from Kimberly Unger, Executive Director, Security Traders Association of New York, Inc., dated June 18, 2009 ("STANY (June 2009)"); letter from Karrie McMillan, General Counsel, Investment Company Institute, dated June 19, 2009 ("ICI (June 2009)"); letter from Megan A. Flaherty, Chief Legal Counsel, Wolverine Trading, LLC, dated June 19, 2009 ("Wolverine"); letter from Eric Swanson, SVP and General Counsel, BATS Exchange, Inc., dated Sept. 21, 2009 ("BATS (Sept. 2009)"); letter from Michael R. Trocchio, Esq. on behalf of Bingham McCutchen, LLP, dated Sept. 30, 2009 ("Bingham McCutchen"); letter from James S. Chanos, Chairman, Coalition of Private Investment Companies, dated Sept. 21, 2009 ("CPIC (Sept. 2009)") (citing letter from Credit Suisse letter (June 2009)); letter from Luke Fichthorn, Managing Member, John Fichthorn, Managing Member, Dialectic Capital Management, LLC, dated Sept. 21, 2009 ("Dialectic Capital (Sept. 2009)"); letter from Eric W. Hess, General Counsel, Direct Edge Holdings LLC, dated Sept. 21, 2009 ("Direct Edge (Sept. 2009)"); letter from Paul M. Russo, Managing Director and Head of U.S. Equity Trading, Goldman, Sachs & Co., dated Sept. 21, 2009 ("Goldman Sachs (Sept. 2009)"); letter from Suhas Daftuar, Managing Director, Hudson River Trading LLC, dated Sept. 21, 2009 ("Hudson River Trading"); letter from

Proposal, a number of commenters submitted data or referenced studies in support of their position that a short sale price test restriction would not have a positive impact on the market.[80] In addition, several commenters stated they do not believe that short selling exacerbated market declines during the Fall 2008 financial crisis, and suggested that long sale activity was a more substantial factor in those declines.[81] Other commenters stated that short selling is a small

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Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc., dated Sept. 22, 2009 ("Knight Capital (Sept. 2009)"); letter from Richard Chase, Managing Director and General Counsel, RBC Capital Markets Corporation, dated Sept. 21, 2009 ("RBC (Sept. 2009)"); letter from Peter J. Driscoll, Chairman, John C. Giesea, President and CEO, Security Traders Association, dated Sept. 21, 2009 ("STA (Sept. 2009)"); letter from Barbara Palk, President, TD Asset Management, Inc., dated Sept. 14, 2009 ("TD Asset Management"); letter from George U. Sauter, Managing Director and Chief Investment Officer, The Vanguard Group, Inc., dated Sept. 21, 2009 ("Vanguard (Sept. 2009)"); letter from Chris Concannon, Virtu Financial, LLC, dated Sept. 21, 2009 ("Virtu Financial"); letter from Stuart J. Kaswell, Executive Vice President, Managing Director and General Counsel, Managed Funds Association, dated Oct. 1, 2009 ("MFA (Oct. 2009)"); letter from Jeffrey S. Davis, Vice President and Deputy General Counsel, The Nasdaq OMX Group, Inc., dated Oct. 7, 2009 ("Nasdaq OMX Group (Oct. 2009)").

80 See, e.g., letter from Michael D. Lipkin, Adjunct Assistant Professor, Columbia University, dated Apr. 9, 2009 ("Prof. Lipkin"); letter from Eric Swanson, SVP and General Counsel, BATS Exchange, Inc., dated May 14, 2009 ("BATS (May 2009)"); Autore, Billingsley, and Kovacs, Short Sale Constraints, Dispersion of Opinion, and Market Quality: Evidence from the Short Sale Ban on U.S. Financial Stocks (June 19, 2009); letter from William J. Brodsky, Chairman and CEO, Edward J. Joyce, President and COO, The Chicago Board Options Exchange, Inc., dated June 19, 2009 ("CBOE (June 2009)"); letter from James S. Chanos, Chairman, Coalition of Private Investment Companies, dated June 19, 2009 ("CPIC (June 2009)"); letter from STANY (June 2009); letter from SIFMA (June 2009); letter from MFA (June 2009); letter from ICI (June 2009); letter from Joan Hinchman, Executive Director, President and CEO, National Society of Compliance Professionals Inc., dated June 19, 2009 ("NSCP"); letter from Mary Richardson, Director of Regulatory and Tax Department, Alternative Investment Management Association, dated June 19, 2009 ("AIMA"); letter from Credit Suisse (June 2009); letter from Rory O'Kane, President, TD Professional Execution, Inc, dated June 19, 2009 ("T.D. Pro Ex"); letter from Citadel et al. (June 2009); letter from William Connell, President and CEO, Allston Trading, LLC, dated June 18, 2009 ("Allston Trading (June 2009)"); letter from Wolverine; letter from Roy J. Katzovicz, Chief Legal Officer, Pershing Square Capital Management L.P., dated June 19, 2009 ("Pershing Square"); letter from GETCO (June 2009); letter from Luke Fichthorn, Managing Member, John Fichthorn, Managing Member, Dialectic Capital Management, LLC, dated June 18, 2009 ("Dialectic Capital (June 2009)"); memorandum of a meeting between representatives of Credit Suisse and the Office of Commissioner Aguilar, dated July 2, 2009, and written materials submitted at the meeting ("Credit Suisse (July 2009)"); letter from CPIC (Sept. 2009); letter from STA (Sept. 2009); letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated Sept. 21, 2009 ("SIFMA (Sept. 2009)"); letter from TD Asset Management; letter from Goldman Sachs (Sept. 2009); letter from Peter Kovac, Chief Operating Officer and Financial and Operations Principal, EWT, LLC, dated Sept. 21, 2009 ("EWT (Sept. 2009)"); letter from Charles M. Jones, Ph.D., Robert W. Lear Professor of Finance and Economics, Columbia Business School, dated Sept. 21, 2009 ("Prof. Jones"). See also infra Section II.D. (discussing the data and studies submitted and/or referenced by commenters).

81 See, e.g., letter from MFA (June 2009); letter from STANY (June 2009); letter from Credit Suisse (June 2009); letter from STA (Sept. 2009) (noting that "[t]he STA believes that long sellers deleveraging and anticipating withdrawals and redemptions were largely responsible for the declines").

segment of the overall equity marketplace and active short sellers are an even smaller group of participants and, therefore, represented a de minimus amount of the selling pressure that the markets experienced recently.[82] As support for their arguments, commenters referenced, among other things, two recent studies by the Staff that were also discussed in the Proposal.[83] In these studies, the Staff analyzed the impact that a short sale price test might have had during a thirteen day period in September 2008,[84] as well as whether and the extent to which short selling and long selling exerted downward price pressure during a volatile period in early September 2008.[85] The first of these studies noted that, although its data was limited to historical trade and quote data from a period when no short sale price test was in place and the shape of order book and trading sequences might have differed had a short sale price test been in place, a short sale price test would likely have been most restrictive during periods of low volatility, with greatest impact on short selling in lower priced and more active stocks.[86] The second study found that during periods of price declines, the selling pressure was more intense from long sellers than from short sellers. It also found that, on average, short sale volume as a fraction of total volume was highest during periods of positive returns, noting, however, that it was also possible that there were instances in which short selling activity peaked during periods of extreme negative returns.[87]

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82 See, e.g., letter from STA (Sept. 2009).

83 See Proposal, 74 FR at 18049.

84 See Staff, Analysis of a short sale price test using intraday quote and trade data, Dec. 17, 2008 ("Staff Analysis (Dec. 17, 2008)") at http://www.sec.gov/comments/s7-08-09/s70809-368.pdf.

85 See Staff, Analysis of Short Selling Activity during the First Weeks of September, 2008, Dec. 16, 2008 ("Staff Analysis (Dec. 16, 2008)") at http://www.sec.gov/comments/s7-08-09/s70809-369.pdf.

86 See Staff Analysis (Dec. 17, 2008).

87 See Staff Analysis (Dec. 16, 2008).

Some commenters stated that the recent market stability suggests that investor confidence has been restored and, therefore, short sale price test restrictions are not necessary.[88] Several commenters submitted data or referenced studies showing that investor confidence has recently improved.[89] A number of commenters expressed concern that any short sale price test restriction would carry with it the unintended consequences of reduced liquidity and widened bid-ask spreads, resulting in less efficient pricing in the securities markets.[90] One commenter stated its belief that because short sale price test restrictions would weaken and erode benefits of short selling such as liquidity, price discovery and the ability to manage risk, they would also weaken and erode investor confidence.[91] Many commenters stated that the reinstatement of any short sale price test restriction would impose significant costs on market participants and lead to increased transaction costs for investors.[92] In addition, several commenters noted that while the

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88 See, e.g., letter from Renee M. Toth, President, National Association of Active Investment Managers, dated June 12, 2009 ("NAAIM"); letter from NSCP; letter from RBC (Sept. 2009).

89 See, e.g., memorandum of meeting between representative of TD Ameritrade and the Office of Commissioner Aguilar, dated June 1, 2009, and written materials submitted at the meeting ("TD Ameritrade"); letter from RBC (Sept. 2009); letter from EWT (Sept. 2009). In addition, one commenter submitted preliminary data on the relationship between short selling and investor confidence and stated that "[w]hile it is too early to draw conclusions from this data, the evidence presented below does not suggest that there is a negative relationship between short selling activity and investor confidence." See letter from Ingrid M. Werner, Ph.D., Martin and Andrew Murrer Professor of Finance, Fisher College of Business, The Ohio State University, dated June 19, 2009 ("Prof. Werner"). See also infra Section II.D. (discussing data submitted and/or referenced by commenters regarding investor confidence).

90 See e.g., letter from Jeffrey S. Wecker, CEO, Lime Brokerage LLC, dated June 19, 2009 ("Lime Brokerage (June 2009)") (noting that "[w]e believe there would be significant unintended consequences of the proposed restrictions, including reduction in overall market liquidity and widening of spreads …"); letter from Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc., dated June 18, 2009 ("Knight Capital (June 2009)"); letter from MFA (June 2009); see also infra Section II.D. (discussing empirical data regarding the potential impact of short sale price test restrictions).

91 See letter from AIMA; see also letter from CPIC (June 2009) (stating "investor confidence will not be served in the long term by the adoption of rules that the Commission itself has acknowledged have no sound empirical basis and may decrease market efficiency, limit price discovery, provide less protection against upward stock price manipulations, increase trading costs, reduce liquidity and impose other potential costs on investors").

92 See e.g., letter from Scott C. Goebel, Senior Vice President and General Counsel, Fidelity Investments, dated June 22, 2009 ("Fidelity"); letter from MFA (June 2009); letter from Credit Suisse (June 2009); letter from EWT (June 2009); letter from SIFMA (June 2009); letter from Wolverine; letter from T.D. Pro Ex; letter from ICI (June 2009); letter from Simon M. Lorne, Chief Legal Officer, Martin Z. Schwartz, Chief Compliance

Commission is rightly trying to increase investor confidence, current short sale regulations, including Rule 204 of Regulation SHO and Exchange Act Rule 10b-21, are sufficient to address the public's concerns about potentially abusive short selling.[93]

A significant number of commenters, however, continue to urge the Commission to reinstate some form of short sale price test restriction because these commenters believe that such a measure will help to restore investor confidence.[94] One commenter stated that "we

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Officer, Millennium Management LLC, dated June 19, 2009 ("Millennium"); letter from Citadel et al. (June 2009).

[93] See e.g., letter from Tim Belloto, dated May 5, 2009; letter from MFA (June 2009); letter from SIFMA (June 2009); letter from Pershing Square; letter from Paul M. Russo, Managing Director and Head of U.S. Equity Trading, Goldman, Sachs & Co., dated June 19, 2009 ("Goldman Sachs (June 2009)"); letter from CBOE (June 2009); letter from Allston Trading (June 2009); letter from STANY (June 2009); letter from Citadel et al. (June 2009); letter from STA (Sept. 2009); letter from BATS (Sept. 2009).

[94] See, e.g., letter from Herbert C. Roubidoux, dated May 4, 2009; letter from William K. Barnard, CEO, Equity Insight, Inc., dated May 4, 2009 ("Equity Insight"); letter from Henry J. Judd, CEO, Alethium Corp., dated May 6, 2009; letter from John Sook, dated May 6, 2009; letter from Boris Finkelstein, dated May 7, 2009; letter from John E. Detraz, dated May 8, 2009; letter from Joseph Giancola, dated May 8, 2009; letter from John W. Kozak, Chief Financial Officer, Park National Corporation, dated May 19, 2009 ("Park National"); letter from Robert S. Miloszewski, dated June 1, 2009; letter from Dr. George R. Arends, dated June 1, 2009; letter from Kent Hendrickson, dated June 4, 2009; letter from Dennis Nixon, Chairman and Chief Executive Officer, International Bancshares Corporation, dated June 9, 2009 ("IBC"); letter from Brian P. Hendey, dated June 9, 2009; letter from Catherine Mapen, dated June 15, 2009; letter from Jeffrey T. Brown, Senior Vice President, Office of Legislative and Regulatory Affairs, Charles Schwab & Co., Inc., dated June 18, 2009 ("Schwab"); letter from Michael Gitlin, Head of Global Trading, David Oestreicher, Chief Legal Counsel, Christopher P. Hayes, Sr. Legal Counsel, T. Rowe Price Associates, Inc., dated June 18, 2009 ("T. Rowe Price (June 2009)"); letter from Michael R. McAlevey, Vice President and Chief Corporate, Securities and Finance Counsel, General Electric Company, dated June 18, 2009 ("GE"); letter from Janet M. Kissane, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, dated June 19, 2009 ("NYSE Euronext (June 2009)"); letter from Ronald C. Long, Director, Regulatory Affairs, Wells Fargo Advisors, dated June 15, 2009 ("Wells Fargo (June 2009)"). In addition, prior to the Proposal, a number of commenters stated that they believe that reinstatement of some form of price test restriction would help restore investor confidence. See, e.g., letter from Richard F. Vulpi, dated Sept. 24, 2008; letter from Maureen Christensen, dated Oct. 9, 2008; letter from Peter B. Eckle, CEO Associate Arrangements, dated Oct. 11, 2008; letter from Joe Garrett, dated Oct. 15, 2008; letter from Jenna L. Spurrier, dated Oct. 24, 2008; letter from Scotland Settle, dated Oct. 27, 2008; letter from Patrick McQuaid, dated Oct. 29, 2008; letter from Lynn Miller, dated Nov. 13, 2008; letter from David Sheridan, dated Nov. 18, 2008; letter from W. Romain Spell, dated Nov. 19, 2008; letter from Phil Mason, dated Nov. 19, 2008; letter from Jeff Brower, dated Nov. 20, 2008; letter from Mike Abraham, dated Nov. 20, 2008; letter from Marvin Dingott, dated Nov. 20, 2008; letter from Josh Dodson, dated Nov. 21, 2008; letter from J. Geddes Parsons, dated Nov. 21, 2008; letter from Charles Rudisill, dated Nov. 21, 2008; letter from Mike Ryan, dated Nov. 21, 2008; letter from David B. Campbell and Natalie H. Win, dated Nov. 25, 2008; letter from Edward L. Yingling, American Bankers Association, dated Dec. 16, 2008; letter from Robert A. Lee, dated Feb. 10, 2009; letter from Robert Levine, dated Feb. 17, 2009; letter from Karl Findorff, dated Feb. 19, 2009; letter from Robert Lounsbury, dated Feb. 25, 2009; letter from Dr. Bill Daniel, dated Feb. 26, 2009; letter from Glenn A. Webster, dated Feb. 26, 2009; letter from Arleen Golden, dated Mar. 2, 2009; letter from Doug Cameron, dated Mar. 2, 2009; letter from Mike Rogers, dated Mar. 3, 2009; letter from George A. Flagg, dated Mar. 3, 2009; letter from

believe that a price test could have a real impact on investors' and issuers' confidence in the equities market."[95] Some commenters have stated that a lack of price test restrictions makes them question whether they should invest in the stock market.[96] Other commenters have stated that they believe a short sale price test will aid small investors.[97] In addition, some commenters have suggested that restricting the prices at which securities may be sold short will help address steep declines in securities' prices.[98] Some Members of Congress and representatives of one

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Kevin Girard, dated Mar. 4, 2009; letter from Briggs Diuguid, dated Mar. 5, 2009 ("Briggs Diuguid"); letter from Bob Young, dated Mar. 5, 2009; letter from Troy Williams, dated Mar. 6, 2009; letter from Paul Kent, dated Mar. 7, 2009; letter from Chris Baratta, dated Mar. 9, 2009 ("Chris Baratta"); see also letter from Professor Constantine Katsoris, Fordham University School of Law, dated Mar. 4, 2009 (stating that elimination of former Rule 10a-1 "hardly generates confidence on the part of a true investor who is entrusting his or her life's savings...to the current market").

95 Letter from NYSE Euronext (June 2009).

96 See, e.g., letter from Phil Koepke, dated May 5, 2009; letter from Joe Wells, dated May 29, 2009; letter from Michael Anderson, dated June 1, 2009 (noting "[i]f the SEC fails to act in the best interest of all investors, then peopel (sic) like myself, will look at other investment alternatives than the Stock Market."); letter from Anton Kleinschmidt, dated June 2, 2009 (noting that he "will not return to the equity markets" until he is "confident that the wide range of market predators such as unregulated short sellers are being effectively controlled"). In addition, prior to (and as cited in) the Proposal, commenters expressed similar concerns regarding a lack of price test restrictions. See, e.g., letter from Jeff Boyd, dated Feb. 10, 2009; letter from Tim Zanni, dated Feb. 19, 2009.

97 See, e.g., letter from Michael Anderson, dated June 1, 2009; letter from Carl H. Van Hoozier, Jr., dated June 3, 2009; letter from Kevin Adcock, dated June 3, 2009 (noting that "[w]ithout this reinstatement the market will never be judged as fair, balanced or worth the unfair risks created by the SEC removing a tried and tested 70+ year old rule"); letter from Fran Mazenko, dated June 4, 2009; letter from Daniel H. Owings, dated June 4, 2009 (noting "the elimination of the uptick rule...prevented the small investor from equal treatment in the market"); letter from Kathleen Jardine, dated June 4, 2009. In addition, prior to (and as cited in) the Proposal, commenters expressed similar statements regarding short sale price tests aiding small investors. See, e.g., letter from Chris Baratta (noting that while price test restrictions could not reasonably be expected to prevent market downturns, they would, in his opinion, "give the little investor a chance" in the current conditions); see also letter from Paul D. Mendelsohn, President, Windham Financial Services, Inc., dated Mar. 6, 2009 (stating that he believes former Rule 10a-1 "protected" the markets and that "suspension of the uptick rule has opened a security hole into our financial system"); letter from Bob Young, dated Mar. 5, 2009 (suggesting that reinstatement of the uptick rule "will not be a quick or total fix, but it will help").

98 See, e.g., letter from Grant D. Wieler, dated May 8, 2009; letter from John J. Piccitto, Managing Director, John Piccitto Consulting Ltd., dated May 7, 2009 (noting that "[b]ecause the decline of the value of a stock can be very steep and very fast indeed, the ensuing 'feeding frenzy'... should be addressed by regulators. Slowing the cascade of short selling would create both the fact and the appearance of regulatory control..."); letter from Mucho Balka, Esq., dated May 30, 2009; letter from George A. Mitchell, dated June 1, 2009; letter from Jason Sturm, dated June 1, 2009; letter from Erin Chieffi , dated June 2, 2009; letter from Paul Rivett, Vice President and Chief Legal Officer, Fairfax Financial Holdings Ltd., dated June 17, 2009 ("Fairfax Financial"); letter from GE; letter from Michael Lamanna, dated June 17, 2009; letter from Stanyarne Burrows, dated June 17, 2009; letter from William R. Harker, Senior Vice President, General Counsel and Corporate Secretary, Sears Holdings

SRO have also continued to express support for reinstatement of price test restrictions.[99] One such SRO representative noted that over 95% of its issuers who participated in a survey believed that the market would function better with one of the proposed short sale price test restrictions.[100]

As we noted in the Proposal, some researchers have also indicated that they believe that they have collected data that establishes a possible association between the recent market

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Corporation, dated June 19, 2009 ("Sears"); letter from Glen Shipway, dated Sept. 21, 2009 ("Glen Shipway (Sept. 2009)"). In addition, the American Bankers Association noted that its members, "both large and small, have told us that short sellers were taking advantage of the uptick rule's absence; that their stock prices were experiencing excessive downward pressure unrelated to actual conditions of the firm . . . ." and that its members expressed "that measures needed to be taken, including reinstating the uptick rule in some format, to reduce the avenues for abusive trading practices and to restore investor confidence." Letter from Sarah A. Miller, Senior Vice President, Center for Securities, Trust and Investments, American Bankers Association, dated July 1, 2009 ("Amer. Bankers Assoc."); see also letter from Paul Tudor Jones II, Tudor Investment Corporation, dated Oct. 10, 2008 (stating that he believes that one way to "immediately stem the decline" in the stock market would be to reinstate the uptick rule); letter from James F. Kane, Jr., dated Feb. 6, 2009 (stating that he believes that reinstating "the Up-tick Rule will go a long way in preventing speculators from ganging up on a particular stock and forcing it down"); letter from Briggs Diuguid (stating that while short sellers "make efficient markets," he is nonetheless concerned that short selling may be a tool of manipulators when short sales are "piled on" a particular company).

99 See e.g., letter to Mary Schapiro, Chairman, from Kirsten Gillibrand, United States Senator, dated June 5, 2009; joint statement of Ted Kaufman, United States Senator, and Johnny Isakson, United States Senator, dated Sept. 29, 2009. In addition, prior to (and as cited in) the Proposal, several current and former Members of Congress have called for reinstatement of short sale price test restrictions. See, e.g., letter to Christopher Cox, Chairman, from Hillary Rodham Clinton, former United States Senator, dated Sept. 17, 2008; letter to Christopher Cox, Chairman, from Bill Sali, Member of Congress, dated Oct. 1, 2008; letter to Christopher Cox, Chairman, from Peter T. King, Member of Congress, dated Oct. 7, 2008; letter to Mary Schapiro, Chairman, from Gary L. Ackerman, Member of Congress, dated Jan. 27, 2009; letter to Mary Schapiro, Chairman, from Rep. Barney Frank and other Members of the House Financial Services Committee, dated Mar. 11, 2009; Proposal, 74 FR at 18046-18047 (noting statements by a Member of Congress and a former U.S. Senator asking the Commission to reinstate former Rule 10a-1 or some other form of short sale price test restriction). See also letter to Mary Schapiro, Chairman, from Carolyn Maloney, Member of Congress and Chairman of the Joint Economic Committee, dated Mar. 23, 2009. We note, however, that other Members of Congress have expressed concerns regarding our adopting a short sale price test restriction. See, e.g., letter to Mary Schapiro, Chairman, from Michael Crapo, United States Senator, Jim Bunning, United States Senator, David Vitter, United States Senator, Michael Enzi, United States Senator, and Mel Martinez, former United States Senator, dated June 17, 2009.

With respect to comments by SRO representatives, see, e.g., letter from Janet M. Kissane, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, dated Sept. 21, 2009 ("NYSE Euronext (Sept. 2009)"); letter from NYSE Euronext (June 2009); statement of Larry Leibowitz, Group Executive Vice President and Head of Global Technology and US Executions, NYSE Euronext, dated May 5, 2009 ("NYSE Euronext (May 2009)"). In addition, prior to (and as cited in) the Proposal, one senior SRO representative endorsed the reinstatement of a short sale price test restriction. See Edgar Ortega, Short-Sale Rule Undermined as Bernanke Backs Review, Bloomberg News Service, Mar. 4, 2009 (noting comments by Duncan Niederauer, CEO, The NYSE Euronext Group, Inc., that imposing a measure such as former Rule 10a-1, "would go a long way to adding confidence" in our markets).

100 See letter from NYSE Euronext (June 2009).

downturn and the elimination of former Rule 10a-1.[101] Commenters also submitted data or referenced studies they believe support the contention that a price test restriction would have a positive impact on the market.[102] In addition, there have been reports of significant short selling in connection with the use of credit default swaps ("CDS"), particularly in the securities of significant financial institutions,[103] and it has been suggested that the interaction between and amplifying effects of CDS and short selling may be a reason to reinstate a short sale price test.[104]

Further, as we stated in the Proposal, questions and comments have been raised about the role that short selling, and in particular potentially abusive short selling, may have had in connection with the recent price fluctuations and disruption in our markets.[105] As such, prior to issuing the Proposal, in the latter part of 2008, we took a number of other short sale-related actions aimed at addressing these concerns. For example, due to our concerns that false rumors spread by short sellers regarding financial institutions of significance in the U.S. may have fueled market volatility in the securities of some of these institutions, on July 15, 2008, we issued an

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[101] See Proposal, 74 FR at 18047, n.64; see also letter from Yavni Bar-Yam, New England Complex Systems Institute, dated June 23, 2009 ("Yavni Bar-Yam"); Dion Harmon and Yaneer Bar-Yam, April 2009, Technical Report on SEC Uptick Rule Proposals, New England Complex Systems Institute.

[102] See, e.g., letter from NYSE Euronext (June 2009); letter from Schwab; letter from Richard J. Adler, Managing Director, European Investors, Inc., dated June 19, 2009 ("European Investors (June 2009)"); letter from Richard J. Adler, Managing Director, European Investors, dated Sept. 21, 2009 ("European Investors (Sept. 2009)"); letter from William Furber, High Street Advisors, L.P., dated June 18, 2009 ("High Street Advisors"); letter from Park National; letter from IBC; letter from Daniel P. Amos, Chairman and CEO, Aflac Incorporated, dated June 23, 2009 ("Aflac"); letter from J. Austin Murphy, Ph.D., Professor of Finance at Oakland University, School of Business Administration, dated Apr. 9, 2009 ("Prof. Murphy"); letter from Martin B. Napor, dated June 17, 2009 ("Martin Napor"); see also infra Section II.D. (discussing empirical data submitted in response to the Proposal and the Re-Opening Release).

[103] See Proposal, 74 FR at 18047, n.65 (referring to an article by George Soros, The Game Changer, available at http://www.ft.com/cms/s/0/49b1654a-cd60-11dd-bd60-0000779fd2ac.html). Similarly, in response to the Proposal, commenters raised concerns about CDS and short selling. See, e.g., letter from Edward D. Herlihy, Theodore A. Levine, Wachtell, Lipton, Rosen & Katz, dated June 17, 2009 ("Wachtell"); letter from GE.

[104] See Proposal, 74 FR at 18047, n.66 and accompanying text.

[105] See Proposal, 74 FR at 18047-18048.

emergency order ("July Emergency Order")[106] pursuant to Section 12(k)(2) of the Exchange Act[107] which imposed borrowing and delivery requirements on short sales of the equity securities of certain financial institutions. We noted in the July Emergency Order that false rumors can lead to a loss of investor confidence. Such loss of investor confidence can lead to panic selling, which may be further exacerbated by "naked" short selling. As a result, the prices of securities may artificially and unnecessarily decline well below the price level that would have resulted from the normal price discovery process.[108] If significant financial institutions are involved, this chain of events can threaten disruption of our markets.[109]

Due to our concerns regarding the impact of short selling on the prices of financial institution securities, on September 18, 2008, we issued another emergency order prohibiting short selling in the publicly traded securities of certain financial institutions.[110] Our concerns, however, were not limited to financial institutions, given the importance of confidence in our markets and the rapid and steep declines in the prices of securities that generally we were seeing at that time.[111] Such rapid and steep price declines can give rise to questions about the underlying financial condition of an institution, which in turn can erode confidence, even without

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106 See Exchange Act Release No. 58166 (July 15, 2008), 73 FR 42379 (July 21, 2008).

107 15 U.S.C. 78l(k)(2).

108 See July Emergency Order, 73 FR 42379.

109 See id.

110 See Exchange Act Release No. 58592 (Sept. 18, 2008), 73 FR 55169 (Sept. 24, 2008) ("Short Sale Ban Emergency Order").

111 See, e.g., July Emergency Order, 73 FR 42379; Short Sale Ban Emergency Order 73 FR 55169; Exchange Act Release No. 58572 (Sept. 17, 2008), 73 FR 54875 (Sept. 23, 2008) ("September Emergency Order").

an underlying fundamental basis.[112] This erosion of confidence can impair the liquidity and ultimate viability of an institution, with potentially broad market consequences.[113]

These concerns resulted in our issuance on September 17, 2008 of an emergency order under Section 12(k)(2) of the Exchange Act, in part targeting short selling in all equity securities.[114] Pursuant to the September Emergency Order we imposed enhanced delivery requirements on sales of all equity securities under Rule 204T of Regulation SHO.[115]

Rule 204T, among other things, required participants of a registered clearing agency to close-out fails to deliver resulting from short sales of any equity security by purchasing or borrowing the security by no later than the beginning of trading on the day after the fail to deliver occurred. We adopted the provisions of the September Emergency Order as an Interim Final Temporary Rule in October 2008 because of our continued concern about the potentially negative market impact of large and persistent fails to deliver.[116]

Our adoption of Interim Final Temporary Rule 204T followed a series of other steps aimed at reducing such fails to deliver and addressing potentially abusive short selling. These steps included eliminating the "grandfather" and options market maker exceptions to Regulation SHO's close-out requirement,[117] and proposing and subsequently adopting a "naked" short

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112 See Short Sale Ban Emergency Order, 73 FR 55169; September Emergency Order, 73 FR 54875.

113 See id.

114 See September Emergency Order, 73 FR 54875.

115 See id. In addition, we issued an emergency order, and subsequent Interim Final Temporary Rule, Rule 10a-3T, to require disclosure of short sales and short positions in certain securities. The temporary rule expired on August 1, 2009. See Exchange Act Release No 58591 (Sept. 18, 2008) 73 FR 55175 (Sept. 24, 2008); Exchange Act Release No. 58785 (Oct. 15, 2008), 73 FR 61678 (Oct. 17, 2008).

116 See Exchange Act Release No. 58773 (Oct. 14, 2008), 73 FR 61706 (Oct. 17, 2008) ("Interim Final Temporary Rule 204T").

117 See Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544 (Aug. 14, 2007) (eliminating the "grandfather" exception to Regulation SHO's close-out requirement); September Emergency Order, 73 FR 54875 (eliminating the options market maker exception to Regulation SHO's close-out requirement).

selling anti-fraud rule, Rule 10b-21.[118] Although we recognize that fails to deliver can occur for legitimate reasons, we remained concerned about the impact of large and persistent fails to deliver on market confidence. Results from Staff analysis indicate that our actions to further reduce fails to deliver are having their intended effect. For example, these results indicate that fails to deliver in all equity securities have declined significantly since the adoption of Interim Final Temporary Rule 204T.[119] To help further our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of Interim Final Temporary Rule 204T, as well as other actions taken by the Commission, we adopted the substance of Interim Final Temporary Rule 204T as a permanent rule, Rule 204, in July 2009.[120]

Despite the significant decline in fails to deliver and the more recent stability in the securities markets, concerns persist about rapid and steep price declines in securities and erosion of investor confidence in our markets. Thus, we continued to examine whether there are other actions that the Commission should take, including re-evaluating whether a short sale price test should be reintroduced or a circuit breaker rule should be imposed.

As we stated in the Proposal, when we eliminated all short sale price test restrictions in July 2007, we acknowledged that circumstances may develop that could warrant relief from the

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Following the issuance of the September Emergency Order, we adopted amendments making permanent the elimination of the options market maker exception. See Exchange Act Release No. 58775 (Oct. 14, 2008), 73 FR 61690 (Oct. 17, 2008) ("Options Market Maker Elimination Release").

118 See Exchange Act Release No. 58774 (Oct. 14, 2008), 73 FR 61666 (Oct. 17. 2008); September Emergency Order, 73 FR 54875; Exchange Act Release No. 57511 (Mar. 17, 2008), 73 FR 15376 (Mar. 21, 2008).

119 See Memorandum from the Staff Re: Impact of Recent SHO Rule Changes on Fails to Deliver, Nov. 4, 2009 at http://www.sec.gov/spotlight/shortsales/oeamemo110409.pdf (stating, among other things, that the average daily number of aggregate fails to deliver for all securities decreased from 2.21 billion to 0.25 billion for a total decline of 88.5% when comparing a pre-Rule to post-Rule period); Memorandum from the Staff Re: Impact of Recent SHO Rule Changes on Fails to Deliver, Nov. 26, 2008 at http://www.sec.gov/comments/s7-30-08/s73008-37.pdf; Memorandum from the Staff Re: Impact of Recent SHO Rule Changes on Fails to Deliver, Mar. 20, 2009 at http://www.sec.gov/comments/s7-30-08/s73008-107.pdf.

120 See Exchange Act Release No. 60388 (July 27, 2009), 74 FR 38266 (July 31, 2009) ("Rule 204 Adopting Release"). Rule 204 contained some modifications to address commenters' concerns. See id.

prohibition in Rule 201 of Regulation SHO for a short sale price test, including a short sale price test of an SRO, to apply to short sales in any security.[121] Thus, in determining whether or not to propose, and now adopt, a short sale price test rule or circuit breaker rule, we have considered the recent turmoil in the financial sector and steep declines and extreme volatility in securities prices.[122]

As discussed in this adopting release, we remain mindful that short selling provides benefits to the market. For example, legitimate short selling can play an important and constructive functional role in the markets, providing liquidity and price efficiency. Short sellers also play an important role in correcting upward stock price manipulation.[123] Because short sale price test restrictions may lessen some of these benefits, it is important that any short sale price test regulation is designed to limit any potentially unnecessary impact on legitimate short selling.

Thus, as discussed in detail below, we are adopting in Rule 201 a targeted short sale price test restriction that will be based on the current national best bid and that will apply only if the price of an individual security declines intra-day by 10% or more from that security's prior day's closing price on the listing market for that security. We are also amending Rule 200(g) of Regulation SHO to address when a broker-dealer may need to mark certain sell orders "short exempt."

D. Empirical Data Regarding Potential Market Impact of Short Sale Price Test Restrictions Submitted in Response to the Proposal and Re-Opening Release

In the Proposal, we requested that commenters provide empirical data to support their views and arguments with respect to the proposed short sale price test rules and the proposed

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121 See Proposal, 74 FR at 18048; see also 2007 Price Test Adopting Release, 72 FR at 36348.

122 See, e.g., Proposal, 74 FR at 18048 (noting the turbulence in the securities markets at the time we issued the Proposal and during the eighteen months prior thereto).

123 See, e.g., Staff's Summary Pilot Report at 9.

circuit breaker rules.[124] Overall, the interpretations and results of the analyses submitted were mixed and sometimes conflicted with each other. In addition, the methods used in the empirical analyses submitted ranged from simple plots of data points to carefully constructed econometrics. The Pilot Results, while dated, in our view should continue to inform our decision-making where relevant, and none of the empirical studies discussed below have given us reason to question the rigor or validity of the Pilot Results.

A number of commenters submitted data or referenced studies in support of their position that a short sale price test restriction would not have a positive impact on the market.[125] In contrast, and as we noted in the Proposal, some commenters have indicated that they believe that they have collected data that establishes a possible association between the recent market downturn and the elimination of former Rule 10a-1.[126] Commenters also submitted data or referenced studies in support of the contention that a price test restriction would have a positive

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124 See, e.g., Proposal, 74 FR at 18049.

125 See, e.g., letter from BATS (May 2009); Autore, Billingsley, and Kovacs, Short Sale Constraints, Dispersion of Opinion, and Market Quality: Evidence from the Short Sale Ban on U.S. Financial Stocks (June 19, 2009); letter from CBOE (June 2009); letter from CPIC (June 2009); letter from STANY (June 2009); letter from SIFMA (June 2009); letter from MFA (June 2009); letter from ICI (June 2009); letter from NSCP; letter from AIMA; letter from Credit Suisse (June 2009); letter from T.D. Pro Ex; letter from Citadel et al. (June 2009); letter from Allston Trading (June 2009); letter from Knight Capital (June 2009); letter from Wolverine; letter from Pershing Square; letter from GETCO (June 2009); letter from Dialectic Capital (June 2009); letter from Hudson River Trading; memorandum regarding meeting with Credit Suisse (July 2009); letter from CPIC (Sept. 2009); letter from STA (Sept. 2009); letter from SIFMA (Sept. 2009); letter from TD Asset Management; letter from Goldman Sachs (Sept. 2009); letter from EWT (Sept. 2009); letter from Prof. Jones; see also letter from NAAIM; letter from Prof. Werner; memorandum regarding meeting with TD Ameritrade; letter from Adam V. Reed, Julian Price Associate Professor of Finance, University of North Carolina at Chapel Hill, dated Sept. 21, 2009 ("Prof. Reed"); letter from RBC (Sept. 2009); letter from Daniel Mathisson, Managing Director, Credit Suisse Securities (USA), LLC. dated Mar. 30, 2009 ("Credit Suisse (Mar. 2009)"); Ana Avramovic, What Happened When Traders' Shorts Were Pulled Down?, Credit Suisse Market Commentary (Sept. 2008) ("Avramovic (Sept. 2008)").

126 See Proposal, 74 FR at 18047, n.64; see also letter from Yavni Bar-Yam; Dion Harmon and Yaneer Bar-Yam, April 2009, Technical Report on SEC Uptick Rule Proposals, New England Complex Systems Institute.

impact on the market.[127] We summarize below findings from these studies and discuss our views with respect to the studies.

Several commenters cited empirical evidence showing that short selling contributes to market liquidity, price discovery, and market efficiency and that restrictions on short selling, particularly bans on short selling, may impede liquidity, price discovery, and market efficiency.[128] While we agree with commenters that short selling contributes to market liquidity, price discovery and market efficiency and while these studies provide relevant information with respect to the effects of a short selling ban, they do not address the effects of a short sale price test restriction, or more specifically for purposes of Rule 201, a circuit breaker that, when triggered, imposes the alternative uptick rule.[129] In fact, because Rule 201 does not impose a ban

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[127] See, e.g., letter from Jeff Wang, dated May 7, 2009 ("Jeff Wang"); letter from NYSE Euronext (June 2009); letter from Schwab; letter from European Investors (June 2009); letter from European Investors (Sept. 2009); letter from High Street Advisors; letter from Park National; letter from IBC; letter from Aflac; letter from GE; letter from Michael R. Grupe, Executive Vice President, Research & Investor Outreach, National Association of Real Estate Investment Trusts, dated June 19, 2009 ("NAREIT"); letter from Kurt N. Schacht, Managing Director, Linda L. Rittenhouse, Director, Capital Markets Policy, CFA Institute Centre for Financial Market Integrity, dated Aug. 21, 2009 ("CFA"); letter from Martin Napor.

[128] See, e.g., letter from BATS (May 2009); letter from AIMA; letter from CBOE (June 2009); letter from CPIC (June 2009); letter from Credit Suisse (June 2009); letter from GETCO (June 2009); letter from ICI (June 2009); letter from NSCP; letter from TD Asset Management; letter from T.D. Pro Ex; letter from STANY (June 2009); letter from Hudson River Trading; letter from Allston Trading (June 2009); letter from Knight Capital (June 2009); letter from Pershing Square; letter from Wolverine; letter from Citadel et al. (June 2009) (referencing Lawrence E. Harris, Ethan Namvar and Blake Phillips, Price Inflation and Wealth Transfer during the 2008 SEC Short-Sale Ban, (Apr. 2009)); Matthew Clifton and Mark Snape, The Effect of Short-selling Restrictions on Liquidity: Evidence from the London Stock Exchange (Dec. 19, 2008); Recent Trends in Trading Activity, Short Sales and Failed Trades and Study on the Impact of the Prohibition on the Short Sale of Inter-Listed Financial Sector Issuers by Investment Industry Regulatory Organization of Canada (IIROC) (February 2009); See Autore, Billingsley, and Kovacs, Short Sale Constraints, Dispersion of Opinion, and Market Quality: Evidence from the Short Sale Ban on U.S. Financial Stocks (June 19, 2009); memorandum regarding meeting with Credit Suisse (July 2009); see also letter from Credit Suisse (Mar. 2009).

[129] See id. In addition, several commenters cited research showing that short selling may be beneficial to price discovery and market efficiency, but that did not address the effect of a short sale price test restriction on price discovery or market efficiency. See letter from CPIC (June 2009) (citing Jonathan Karpoff and Xiaoxia Lou, Do Short Sellers Detect Overpriced Firms? Evidence from SEC Enforcement Actions, Working paper, 2008); letter from Goldman Sachs (Sept. 2009) (citing Jonathan Karpoff and Xiaoxia Lou, Short Sellers and Financial Misconduct, Working paper, 2009); letter from Pershing Square (citing Jonathan Karpoff and Xiaoxia Lou, Do Short Sellers Detect Overpriced Firms? Evidence from SEC Enforcement Actions, Working paper, 2008); letter from CPIC (Sept. 2009) (citing Jonathan Karpoff and Xiaoxia Lou, Short Sellers and Financial Misconduct, Working paper, 2009). Another commenter submitted a study showing that short sellers trade after news stories

on short selling but instead continues to allow short selling (although at a price above the national best bid) when the short sale price test restriction has been triggered, the Rule's structure will help preserve the benefits of short selling.

Some commenters cited a study (the "Pre-Borrow Study") which did not find a relationship between changes in short interest and changes in trading volume, and which concluded that "short sales do not have a significant effect on market liquidity: Other factors drive liquidity."[130] We note, however, that the correlation between changes in short interest and changes in trading volume may not be an accurate measure of the impact of short sales on liquidity. Economic theory does not tend to support using changes in trading volume as a measure of liquidity.[131] Trading volume itself, as opposed to changes in trading volume, is considered a measure of liquidity, though other measures, such as effective spreads and price impact, are considered by many to be better measures of liquidity and are more commonly used for measuring the liquidity of equities.[132] In addition, changes in short interest do not necessarily measure the volume of short selling. In fact, short interest is a "snapshot" variable, so the change

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and that short sellers effectively process publicly available information. See letter from Prof. Reed. While this study uses short selling volume data to support its conclusion that short sellers do not disproportionately engage in information-based manipulation, it does not directly examine the impact of a short sale price test restriction, and, therefore, has limited utility for purposes of evaluating the potential market impact of Rule 201.

130 See, e.g., letter from Patrick M. Byrne, Chairman and CEO, Overstock.com, Inc., dated May 29, 2009 ("Overstock.com (May 2009)") (citing Robert J. Shapiro and Nam D. Pham, The Impact of a Pre-Borrow Requirement for Short Sales on Failures-to-Deliver and Market Liquidity, Apr. 2009; letter from Brian D. Pardo, Chairman and CEO, Life Partners Holding, Inc., dated May 28, 2009 ("Life Partners Holding") (citing the Pre-Borrow Study).

131 The reason why we cannot interpret a change in trading volume as a measure of liquidity can be illustrated by the following example: A less liquid stock can experience an increase (positive change) in trading volume and a more liquid stock can experience a decrease in trading volume. Measuring liquidity by changes in trading volume will mischaracterize the less liquid stock as more liquid and the more liquid stock as less liquid.

132 See, e.g., Tarun Chordia, Richard Roll, and Avanidhar Subrahmanyam, 2001, Market Liquidity and Trading Activity," Journal of Finance, 34: 501-530; Joel Hasbrouck and Duane J. Seppi, 2001, Common Factors in Prices, Order Flows and Liquidity, Journal of Financial Economics, 59: 383-411; Yakov Amihud, 2002, Illiquidity and stock returns: cross-section and time-series effects," Journal of Financial Markets, 5: 31-56.

in short interest does not necessarily measure correctly the volume of short selling, which is what the Pre-Borrow Study is trying to examine. Thus, we do not believe that the results in the Pre-Borrow Study cited by commenters should be interpreted to suggest that short sales are unimportant for liquidity. We also note that the Pre-Borrow study does not reconcile its results to a large body of conflicting evidence, including (but not restricted to) analyses in the comments mentioned above, showing that short selling contributes to market liquidity and that restrictions on short selling, particularly bans on short selling, may impede liquidity.[133]

Several commenters provided analyses showing that short interest initially fell immediately after the repeal of former Rule 10a-1 and that either short interest or short selling volume fell for specific stocks over periods leading up to the Short Sale Ban Emergency Order.[134] Overall, these analyses show that the negative returns of financial securities in the weeks both before and during the Short Sale Ban Emergency Order are unlikely to be the result of short selling activities.[135] We note that, although these studies create some doubt about whether certain price declines during that time period were caused by short sellers, because the analyses provided are specific to the Short Sale Ban Emergency Order and to a time period during which there was significant market turmoil, the analyses are less relevant regarding the potential impact on returns of the circuit breaker approach of Rule 201.

Several other commenters stated that the absence of a short sale price test restriction has been detrimental to prices and provided information on share prices, volume and/or short interest

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133 See supra note 128 (referencing, among others, empirical evidence cited by commenters as showing that short selling contributes to market liquidity).

134 See, e.g., letter from Dialectic Capital (June 2009); letter from MFA (June 2009); letter from STA (Sept. 2009); Avramovic (Sept. 2008).

135 See Avramovic (Sept. 2008); letter from Credit Suisse (June 2009).

that they believe support this statement.[136] We note that, while some of the noted price changes coincide with changes in short selling activity, some do not.[137] Moreover, because these studies look at a long horizon (e.g., months instead of minutes), it is not clear that the evidence provided is relevant to support such conclusion. Thus, it is difficult to conclude from these analyses that the absence of a short sale price test restriction and the actions of short sellers resulted in issuer prices falling below their fundamental values.

One commenter cited a study that used intra-day short selling transaction data to examine the impact of short selling on volatility and found that the removal of former Rule 10a-1 did not exacerbate volatility.[138] We note that, while the study analyzed a period prior to and after the removal of former Rule 10a-1, it analyzed only a six-week period following the elimination of former Rule 10a-1, which may minimize the study's statistical significance. We also note that although the Staff found, in the Staff's Summary Pilot Report presenting the Staff's analysis of the data made public during the Pilot, that short sale price tests in effect at that time did not have a significant impact on daily volatility, the Staff also found some evidence that the short sale price tests dampened intra-day volatility for smaller stocks.[139]

In contrast, other commenters submitted data showing an increase in volatility from July 2007 through November 2008 to support the conclusion that the absence of a short sale price test

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[136] See, e.g., letter from Park National; letter from GE; letter from Aflac; letter from IBC; letter from Jeff Wang; letter from Martin Napor.

[137] For example, some of the noted price declines coincide with increases in short interest. See letter from Aflac; letter from IBC. Other noted price changes do not correlate with changes in short interest or short selling activity. See letter from Dialectic Capital (June 2009); letter from MFA (June 2009); letter from Peter J. Driscoll, Chairman, John C. Giesea, President and CEO, Security Traders Association, dated June 19, 2009 ("STA (June 2009)"); Avramovic (Sept. 2008).

[138] See letter from Citadel et al. (June 2009) (citing Ekkehart Boehmer, Charles M. Jones, and Xioayan Zhang, Unshackling Short Sellers: The Repeal of the Uptick Rule (Nov. 2008)).

[139] See Staff's Summary Pilot Report at 55.

restriction caused an increase in market volatility.[140] As discussed above and in the Proposal,[141] concurrent with the subprime mortgage crises and credit crisis in 2007, U.S. markets experienced increased volatility and steep price declines, particularly in the stocks of certain financial issuers. We are not aware, however, of any empirical evidence that the elimination of short sale price test restrictions contributed to the increased volatility in the U.S. markets. In addition, the data showing an increase in volatility since the elimination of former Rule 10a-1 submitted by commenters in response to the Proposal does not address the extent to which other factors may have influenced the increased volatility. Moreover, because these studies look at a long horizon (e.g., months instead of minutes), it is not clear that the evidence provided is relevant to support such conclusion. Thus, the relationship between the elimination of short sale price test restrictions and the increased volatility remains unclear.

Several commenters submitted data on the percentage of short sales that might be affected by a short sale price test restriction.[142] One commenter submitted data indicating that the alternative uptick rule, adopted on a permanent, market-wide basis, could affect up to 37% of short sale orders.[143] As acknowledged by this commenter, however, this number does not indicate how severely the short sellers would be affected, how the number might change in different market conditions, or whether the number would result in changes in market quality.[144]

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140 See, e.g., letter from NAREIT; letter from High Street Advisors; letter from European Investors (June 2009); letter from European Investors (Sept. 2009).

141 See Proposal, 74 FR at 18043.

142 See letter from Prof. Jones; letter from BATS (May 2009) (stating that, on its own market during May, June, September and October 2008, 12% to 13% of all executions were short sellers trading at a price less than the last execution price).

143 See letter from Prof. Jones (stating that, during the period from July 6, 2007 through the end of August 2007, an average of 37% of submitted short sale orders in NYSE-listed Russell 3000 stocks were either market orders or marketable limit orders).

144 See id.

In addition, as acknowledged by the commenter, the number also does not account for how order submission strategies would differ based on the alternative uptick rule.[145]

In addition, as discussed in more detail below,[146] in response to our request for comment on an appropriate threshold at which to trigger the proposed circuit breaker short sale price restrictions, commenters submitted estimates of the number of securities that would trigger a circuit breaker rule at a 10% threshold.[147] While commenters' analyses (including the facts and assumptions used) and their resulting estimates varied,[148] commenters' estimates reflect that a 10% circuit breaker threshold, on average, should affect a limited percentage of covered securities.[149] Given the variations in the facts and assumptions underlying the estimates submitted by commenters, the Staff also looked at trading data to confirm the reasonableness of those estimates. The Staff found that, during the period covering April 9, 2001 to September 30, 2009,[150] the price test restrictions of Rule 201 would have been triggered, on an average day, for approximately 4% of covered securities.[151] The Staff also found that for a low volatility period, covering January 1, 2004 to December 31, 2006, the 10% trigger level of Rule 201 would have, on an average day, been triggered for approximately 1.3% of covered securities.[152] Thus, we believe that the short sale price test restriction of Rule 201 is structured so that generally it will not be triggered for the majority of covered securities at any given time and, thereby, will not

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145 See id.

146 See infra Section III.A.5. (discussing the circuit breaker trigger level).

147 See supra note 21.

148 See infra note 306.

149 See infra note 307.

150 See infra note 309.

151 See infra note 310.

152 See infra note 311.

interfere with the provision of market benefits such as liquidity and price efficiency for those securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising.

Several commenters submitted data on indexes of investor confidence to argue that investor confidence has been restored and, therefore, short sale price test restrictions are not necessary.[153] In addition, one commenter submitted preliminary data, drawn in part from investor confidence indexes, on the relationship between short selling and investor confidence and stated that "[w]hile it is too early to draw conclusions from this data, the evidence presented . . . does not suggest that there is a negative relationship between short selling activity and investor confidence."[154] Another commenter submitted a survey showing that its clients put more money into the markets between Fall 2008 and Spring 2009 and that many of its clients do not believe that an overhaul of financial services regulation would restore investor confidence.[155]

We also note that some other commenters submitted surveys showing that reinstituting a short sale price test restriction would improve investor confidence.[156] One commenter submitted a survey showing that over 95% of the issuers participating in the survey believed that the market would function better with a short sale price test restriction and stated that this data "suggests that a price test would boost confidence."[157]

While the analyses of investor confidence indexes submitted by commenters do contain measures of investor confidence, we believe that the investor confidence indexes cited are

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[153] See, e.g., letter from RBC (Sept. 2009); letter from EWT (Sept. 2009); letter from CPIC (June 2009); see also letter from NAAIM (citing press articles as evidence of increased investor confidence).

[154] Letter from Prof. Werner.

[155] See memorandum regarding meeting with TD Ameritrade.

[156] See, e.g., letter from NYSE Euronext (June 2009); letter from CFA; see also letter from Schwab.

[157] Letter from NYSE Euronext (June 2009).

designed to capture elements of investor confidence not directly affected by regulatory changes. Investor confidence indexes often capture measures of systematic risk or optimism about the economy, as opposed to measures of investor confidence related to regulation designed to provide investor protections. In addition, in light of the surveys that were submitted in support of a short sale price test restriction as a means to restore investor confidence,[158] we do not believe that the surveys submitted to argue that a short sale price test restriction would not improve investor confidence[159] provide strong evidence on this point.

Although in recent months there has been an increase in stability in the securities markets, we remain concerned that excessive downward price pressure on individual securities accompanied by the fear of unconstrained short selling can undermine investor confidence in our markets generally. Further, we are concerned about potential future market turmoil, including significant increases in market volatility and significant price declines, and the impact of any such future market turmoil on investor confidence. Thus, we believe it is appropriate to adopt the targeted short sale price test restrictions contained in Rule 201.

In summary, we have reviewed the empirical data, analyses and studies submitted and carefully considered them in connection with our determination that it is appropriate at this time to adopt in Rule 201 a short sale price test restriction combined with a circuit breaker approach.

III. Discussion of Rule 201 of Regulation SHO

In the Proposal, we proposed two approaches to restrictions on short selling: one that would apply on a market-wide and permanent basis and one that would apply only to a particular security during a significant market decline in the price of that security (i.e., a circuit breaker

158 See, e.g., letter from Schwab; letter from NYSE Euronext (June 2009); letter from CFA.

159 See, e.g., memorandum regarding meeting with TD Ameritrade.

approach).[160] With respect to the permanent, market-wide approach, we proposed two alternative short sale price tests: the proposed modified uptick rule, based on the current national best bid, and the proposed uptick rule, based on the last sale price. With respect to the circuit breaker approach, we proposed two alternative circuit breaker tests: one that would temporarily prohibit short selling in a particular security when there is a significant decline in the price of that security and one that would temporarily impose either the proposed modified uptick rule or the proposed uptick rule on short sales in a particular security when there is a significant decline in the price of that security.

In addition, in the Proposal we inquired whether a short sale price test restriction that would permit short selling at a price above the current national best bid, i.e., the alternative uptick rule, would be preferable to the proposed modified uptick rule and the proposed uptick rule.[161] We sought comment regarding the application of the alternative uptick rule as a market-wide permanent price test restriction or in conjunction with a circuit breaker.[162] We received two comment letters regarding applying the alternative uptick rule on a permanent, market-wide basis[163] and seven comment letters with respect to applying the alternative uptick rule in combination with a circuit breaker.[164] To allow us to further consider the alternative uptick rule,

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160 See Proposal, 74 FR 18042.

161 See Proposal, 74 FR at 18072, 18081, 18082.

162 See id.

163 See letter from William Hartley, dated May 8, 2009; letter from Glen Shipway, dated June 19, 2009 ("Glen Shipway (June 2009)").

164 See letter from BATS (May 2009); letter from Johnny Peters, ChFC, dated May 20, 2009; letter from Credit Suisse (June 2009); letter from SIFMA (June 2009); letter from Goldman Sachs (June 2009); letter from NYSE Euronext (June 2009); letter from Eric W. Hess, General Counsel, Direct Edge Holdings LLC, dated June 23, 2009 ("Direct Edge (June 2009)"). In addition, in connection with the May 2009 Roundtable, panelists expressed support for the alternative uptick rule. See statement from NYSE Euronext (May 2009); opening remarks of James J. Angel, Ph.D., CFA, Associate Professor of Finance, McDonough School of Business, Georgetown University, dated May 5, 2009. We also note that prior to the Proposal, four exchanges, NYSE Euronext, Nasdaq OMX Group, BATS, and National Stock Exchange, submitted a comment letter

on August 20, 2009, we re-opened the comment period to the Proposal.[165] In addition, on May 5, 2009, we held the May 2009 Roundtable[166] at which panelists discussed the proposed short sale price test restrictions and circuit breaker rules.

As noted above, we received over 4,300 unique comment letters in response to the Proposal and Re-Opening Release.[167] In discussing the provisions of Rule 201, we highlight and address below the main issues, concerns, and suggestions raised by commenters.

A. Operation of the Circuit Breaker Plus Alternative Uptick Rule

We are adopting in Rule 201 a circuit breaker approach combined with the alternative uptick rule. Specifically, Rule 201(b)(1) provides that "[a] trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to: (i) Prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day; and (ii) Impose the requirements of paragraph (b)(1)(i) of this section for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan."[168]

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recommending a circuit breaker combined with a price test that would allow short selling only at an increment above the current national best bid. See letter from National Stock Exchange, NYSE Euronext, Nasdaq OMX Group, and BATS, dated Mar. 24, 2009 ("National Stock Exchange et al."). NYSE Euronext, in its subsequent comments, stated that it supported the proposed modified uptick rule applied on a permanent and market-wide basis rather than the position expressed in the earlier March 24, 2009 letter. See statement from NYSE Euronext (May 2009); letter from NYSE Euronext (June 2009).

165 See Re-Opening Release, 74 FR 42033.

166 See supra note 14.

167 See supra note 78.

168 Rule 201(b).

Thus, Rule 201 will require a trading center[169] to have policies and procedures reasonably designed to prevent it from executing or displaying any short sale order, absent an exception, at a price that is equal to or below the national best bid if the price of that security decreases by 10% or more from the security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[170] As discussed in more detail below, we believe that such a Rule will help prevent short sellers from using short selling as a tool to exacerbate a declining market in a security.

1. Covered Securities

Consistent with the proposed permanent, market-wide short sale price test restrictions and proposed circuit breaker rules, Rule 201 will apply to any "covered security." As proposed and as adopted, Rule 201 defines "covered security" to mean any "NMS stock" as defined under Rule 600(b)(47) of Regulation NMS.[171] Rule 600(b)(47) of Regulation NMS defines an "NMS stock" as "any NMS security other than an option."[172] Rule 600(b)(46) of Regulation NMS defines an "NMS security" as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options."[173] Thus,

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169 Consistent with the Proposal, Rule 201(a)(9) states that the term "trading center" shall have the same meaning as in Rule 600(b)(78). Rule 600(b)(78) of Regulation NMS defines a "trading center" as "a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent." See 17 CFR 242.600(b)(78). The definition encompasses all entities that may execute short sale orders. Thus, Rule 201 will apply to any entity that executes short sale orders.

170 Any such execution or display will also need to be in compliance with applicable rules regarding minimum pricing increments. See 17 CFR 242.612. See also infra Section III.A.2.

171 See Rule 201(a)(1).

172 17 CFR 242.600(b)(47).

173 17 CFR 242.600(b)(46).

Rule 201 will apply to any security or class of securities, except options, for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan. As a result, Rule 201 generally will cover all securities, except options, listed on a national securities exchange whether traded on an exchange or in the OTC market.[174] As discussed further below, it will not include non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market.

In response to our requests for comment, some commenters stated that any short sale price test adopted by the Commission for NMS stocks should also apply to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market.[175] One commenter indicated that failure to apply a short sale price test restriction applicable to NMS stocks to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market would cause investors to have inappropriately negative views about the OTC market and the firms whose securities are quoted there.[176] This commenter and another commenter also stated that not including non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market in a short sale price test restriction could have a negative impact on the ability of firms whose securities are quoted OTC to raise capital.[177] Commenters noted that many issuers of securities

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[174] We note that there may be securities that are listed on a national securities exchange but that are not NMS stocks because they do not meet the definition of "NMS stock." Thus, these securities will not be subject to the short sale price test restrictions of Rule 201.

[175] See letter from Peter J. Chepucavage, General Counsel, Plexus Consulting LLC, The International Association of Small Broker Dealers and Advisors, dated Apr. 21, 2009; letter from R. Cromwell Coulson, Chief Executive Officer, Pink OTC Markets, Inc., dated May 26, 2009 ("Pink OTC"); letter from STANY (June 2009); letter from Michael L. Crowl, Managing Director and Global General Counsel, Barclays Global Investors, dated June 19, 2009 ("Barclays (June 2009)").

[176] See letter from Pink OTC.

[177] See letter from Pink OTC; letter from STANY (June 2009).

that are quoted OTC are "small, emerging growth companies,"[178] that may have a particular need to raise capital in the equity markets.[179] One commenter noted that "less liquid stocks and the stock of less capitalized firms that trade in the OTC markets are in need of as much, if not more, protection from manipulative behavior than NMS stocks"[180] while another stated that "OTC Bulletin Board and Pink Sheet securities would appear to be prime targets for manipulative shorting practices."[181] Commenters also noted that applying a price test rule uniformly to NMS stocks and to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market could reduce the costs of such a rule because market participants would need only one set of programs and systems designed to ensure compliance with the rule, rather than different programs and systems for securities covered by the rule and securities not covered by the rule.[182]

Several commenters, however, expressed support for the application of a price test only to NMS stocks.[183] Several commenters noted that the current national best bid and offer are not currently collected, consolidated and disseminated for non-NMS stocks quoted on the OTC

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178 Letter from Pink OTC.

179 See letter from Pink OTC; letter from Alan F. Eisenberg, Executive Vice President, Emerging Companies and Business Development, Biotechnology Industry Organization, dated June 29, 2009 ("BIO"). BIO requested that biotechnology companies, many of which BIO stated are emerging companies that are "very dependent on capital, including using the public markets as a source of financing," be covered by any short sale price test restriction. Letter from BIO. We also note that one commenter requested that the Commission adopt a short sale price test or circuit breaker halt restriction specifically applicable to financial sector stocks. See letter from IBC. However, another commenter stated, "Restrictions on short selling in only the issues of financial services providers is perhaps the least valuable of all the ideas to be discussed during the short sale debate." See letter from STA (June 2009). Another commenter noted that it is not possible to anticipate which industry sectors may be impacted by potentially manipulative short selling in the future. See letter from T. Rowe Price (June 2009). Given the lack of a widespread call for industry specific short selling restrictions, and the additional complexities that an industry specific restriction would raise, such as identifying and defining the industry or sector to be covered, we have determined not to apply an industry specific short selling restriction at this time.

180 Letter from STANY (June 2009).

181 Letter from T. Rowe Price (June 2009).

182 See letter from Pink OTC; letter from STANY (June 2009).

183 See, e.g., letter from Wells Fargo (June 2009); letter from T. Rowe Price (June 2009); letter from STA (June 2009); letter from Credit Suisse (Sept. 2009).

Bulletin Board or elsewhere in the OTC market.[184] Further, although one commenter indicated that the Commission should plan to phase in application of a price test rule to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market,[185] another commenter expressed concerns that the OTC market is not "robust enough to withstand" such regulation.[186]

At this time, we are not applying Rule 201 to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market because a national best bid and offer currently is not required to be collected, consolidated, and disseminated for such securities.[187] Rule 201 is based on the current national best bid and its implementation requires that the national best bid is collected, consolidated and disseminated to market participants. Although several commenters indicated that it would be possible for non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market to join or create a national plan for disseminating consolidated national best bid information for such stocks,[188] we are concerned that this would be a significant undertaking that would add greatly to the implementation time and cost of Rule 201, particularly in light of comments that the implementation process may be complex even for those securities for which the national best bid is currently collected, consolidated, and disseminated.[189]

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184 See letter from Pink OTC; letter from T. Rowe Price (June 2009).

185 See letter from T. Rowe Price (June 2009).

186 Letter from STA (June 2009).

187 As noted above, former Rule 10a-1 also did not apply to non-exchange listed securities quoted on the OTC Bulletin Board or elsewhere in the OTC market. See supra note 43.

188 See, e.g., letter from Pink OTC; letter from STANY (June 2009); letter from T. Rowe Price (June 2009). The comment letter from Pink OTC indicates that it "would be willing to join the current Tape C UTP network or work with FINRA to create an OTC/UTP Plan including the best bid and offer prices for securities quoted on OTCBB and our Pink Quote Inter-Dealer Quotation System." Letter from Pink OTC.

189 See infra Section VII. (discussing implementation time) and Sections X.B.1.b. and X.B.2.b. (discussing implementation costs).

We recognize commenters' concerns, however, regarding not applying Rule 201 to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market. Thus, at a later time, we may reconsider whether applying Rule 201 to non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market may be appropriate.

In response to our requests for comment, a number of commenters expressed concerns about the application of a short sale price test to equity securities without also addressing derivative securities.[190] Several commenters indicated that the ability of market participants to create "synthetic" short positions that are the economic equivalent of a short sale through the use of derivative securities would undermine the effectiveness of a short sale price test[191] and/or result in an increased use of derivative products to create "synthetic" short positions.[192] Some commenters indicated that the Commission should apply some sort of restriction to derivative

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190 See, e.g., letter from Gregory Bloom, dated Apr. 10, 2009; letter from Peter J. Driscoll, Chairman, John C. Giesea, President and CEO, Security Traders Association, dated Apr. 16, 2009 ("STA (Apr. 2009)"); letter from Jeffrey D. Morgan, President and CEO, National Investor Relations Institute, dated May 29, 2009 ("NIRI"); letter from Douglas Engmann, President, Engmann Options, Inc., dated June 1, 2009 ("Engmann Options"); letter from Dale W.R. Rosenthal, Assistant Professor of Finance, College of Business Administration, University of Illinois at Chicago, dated June 2, 2009 ("Prof. Rosenthal"); letter from Leslie Seff, President, Matthew B. Management, Inc., dated June 5, 2009 ("Matthew B. Management"); letter from Patrick J. Healy, Issuer Advisory Group, dated June 30, 2009 ("IAG"); letter from Barclays (June 2009); letter from Jesse J. Greene, Jr., Vice President, Financial Management and Chief Financial Risk Officer, International Business Machines Corporation, dated June 19, 2009 ("IBM"); letter from Katherine Tew Darras, General Counsel, Americas, International Swaps and Derivatives Association, Inc., dated June 19, 2009 ("ISDA"); letter from STA (June 2009); letter from George U. Sauter, Managing Director and Chief Investment Officer, The Vanguard Group, Inc., dated June 19, 2009 ("Vanguard (June 2009)"); letter from GE; letter from Knight Capital (June 2009); letter from Wachtell; letter from Keith F. Higgins, Chair, Committee on Federal Regulation of Securities, American Bar Association, dated July 8, 2009 ("Amer. Bar Assoc. (July 2009)"); letter from Jeffrey S. Wecker, CEO, Lime Brokerage LLC, dated Sept. 21, 2009 ("Lime Brokerage (Sept. 2009)"); letter from Jonathan E. Johnson III, President, Overstock.com, dated Sept. 24, 2009 ("Overstock.com (Sept. 2009)"); letter from Kevin Holley, dated Sept. 29, 2009 ("Kevin Holley"); see also letter from Eric W. Hess, General Counsel, Direct Edge Holdings LLC, dated Mar. 30, 2009 ("Direct Edge (Mar. 2009)").

191 See, e.g., letter from Prof. Rosenthal; letter from STA (Apr. 2009); letter from Overstock.com (Sept. 2009); letter from Lime Brokerage (Sept. 2009).

192 See, e.g., letter from Matthew B. Management; letter from Prof. Rosenthal; letter from Barclays (June 2009); letter from STA (June 2009); letter from Vanguard (June 2009); letter from Lime Brokerage (Sept. 2009).

securities with respect to "synthetic" short sales,[193] while others suggested that the Commission should require disclosure of "synthetic" short positions created with derivative securities.[194] Several commenters noted concerns with respect to practical difficulties related to addressing derivative securities and short selling issues, and that the Commission may not have the necessary legislative authority to address certain areas.[195]

As indicated in the Proposal and our requests for comment,[196] we recognize that the ability to obtain a short position through the use of derivative products such as options, futures, contracts for differences, warrants, CDS or other swaps (so-called "synthetic short sales") or other instruments (such as inverse leveraged exchange traded funds) may undermine our goals for adopting short sale price test restrictions. We are also concerned that synthetic short positions may increase as a result of the adoption of Rule 201. Rule 201, however, like former Rule 10a-1 and NASD's former bid test, which also did not apply to derivative securities, is formulated with the specific structure of the equity markets in mind and not for the substantially different market structure applicable to many derivatives securities. In addition, we believe that applying a Rule 201-type rule to derivatives securities would significantly complicate the implementation process. Thus, we have determined at this time not to modify the definition of "covered security" from that proposed and, therefore, the scope of securities to which Rule 201 will apply.

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193 See, e.g., letter from IAG; letter from ISDA; letter from STA (June 2009); letter from Wachtell; letter from Matthew B. Management; letter from James L. Rothenberg, dated Sept. 20, 2009 ("James Rothenberg").

194 See, e.g., letter from IAG; letter from GE; letter from Wachtell; see also letter from Direct Edge (Mar. 2009).

195 See letter from Barclays (June 2009); letter from GE; letter from NIRI; letter from Amer. Bar Assoc. (July 2009). Two commenters stated that the Commission should seek authority from Congress to regulate derivative securities where authority is currently lacking. See letter from GE; letter from NIRI.

196 See Proposal, 74 FR at 18071, 18078.

We note, however, that short sales in the equity markets to hedge derivatives transactions are subject to Rule 201. In addition, because we are concerned that the ability to create a short position through the use of derivative securities may undermine the goals of short sale price test restrictions, we may reconsider, at a later time, whether additional regulation of derivative securities and the use of "synthetic" short positions may be appropriate.

The securities covered by Rule 201 will overlap with the securities covered by former Rule 10a-1. Former Rule 10a-1 applied to securities registered on, or admitted to unlisted trading privileges on, a national securities exchange, if trades of the security were reported pursuant to an effective transaction reporting plan and information regarding such trades was made available in accordance with such plan on a real-time basis to vendors of market transaction information. All securities that would have been subject to former Rule 10a-1 will also be subject to Rule 201. In addition, certain securities, i.e., securities traded on Nasdaq prior to its regulation as an exchange, that were not subject to former Rule 10a-1 will be subject to Rule 201.[197]

As we discussed in the Proposal,[198] market information for NMS stocks, including quotes, is disseminated pursuant to three different national market system plans.[199] The national

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197 When Nasdaq became a national securities exchange in 2006, absent an exemption from former Rule 10a-1, all Nasdaq securities would have been subject to former Rule 10a-1. The Commission provided Nasdaq with an exemption from the application of the provisions of former Rule 10a-1 to securities traded on Nasdaq because the Pilot was already in progress, and the Commission believed it was necessary and appropriate to maintain the status quo for short sale price tests during the Pilot and to ensure that market participants would not be burdened with costs associated with implementing a price test that might be temporary. See Exchange Act Release No. 53128 (Jan. 13, 2006), 71 FR 3550 (Jan. 23, 2006) (order approving application of Nasdaq for registration as a national securities exchange); see also letter from James A. Brigagliano Acting Associate Director, Division of Market Regulation, SEC, to Marc Menchel, Executive Vice President and General Counsel, NASD, Inc., dated June 26, 2006.

198 See Proposal, 74 FR at 18050 – 18051.

199 The three joint-industry plans are (1) the Consolidated Tape Association Plan ("CTA Plan"), which disseminates transaction information for securities primarily listed on an exchange other than Nasdaq, (2) the Consolidated Quotation Plan ("CQ Plan"), which disseminates consolidated quotation information for securities

securities exchanges and FINRA participate in these joint-industry plans ("Plans").[200] The Plans establish three separate networks to disseminate market information for NMS stocks.[201] These networks are designed to ensure that, among other things, consolidated bids from the various trading centers that trade NMS stocks are continually collected and disseminated on a real-time basis, in a single stream of information. Thus, all market participants will have access to the consolidated bids for all the securities that will be subject to Rule 201.[202] As discussed in further detail below, however, we note that the national best bid can change rapidly and repeatedly and potentially there might be latencies in obtaining data regarding the national best bid.[203]

2. Pricing Increment

Rule 201(b) provides that a trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In Rule 201 we have determined not to specify at what price a trading center may execute or display a short sale order of a covered security provided it is not at a price

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primarily listed on an exchange other than Nasdaq, and (3) the Nasdaq UTP Plan, which disseminates consolidated transaction and quotation information for securities primarily listed on Nasdaq.

200 Rule 603(b) of Regulation NMS provides that every national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, for NMS stocks. See 17 CFR 242.603(b).

201 These networks can be categorized as follows: (1) Network A — securities primarily listed on the NYSE; (2) Network B — securities listed on exchanges other than the NYSE and Nasdaq; and (3) Network C — securities primarily listed on Nasdaq.

202 See Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37503 (June 29, 2005) ("Regulation NMS Adopting Release").

203 See infra Section III.A.7.

that is less than or equal to the current national best bid. As we stated in the Proposal, however, any such execution or display must be in compliance with applicable rules regarding minimum pricing increments.[204]

In the Proposal and Re-Opening Release, we did not propose a specific increment above the national best bid or last sale price at which short selling would be permissible. In response to our requests for comment regarding pricing increments, however, a number of commenters stated that any increment should be greater than one cent in order to make a price test more restrictive or effective or to address decimal pricing concerns.[205] Several commenters noted, however, that the higher the increment, the more restrictive such an increment could be on short selling and, if high enough, could even be tantamount to a ban on short selling.[206] A study by the Staff found that even moderate changes in bid increments can have a big impact on the constraints imposed on short selling activity and that, for practical purposes, high bid increments, such as five or ten cents, might be equivalent to a ban on short selling in some stocks, especially during periods when prices are not changing rapidly.[207]

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204 See Proposal, 74 FR at 18050, n.99, 101 (referencing 17 CFR 242.612).

205 See, e.g., letter from Franco A. Mortarotti, Managing Director, Zermatt Capital Management, dated Apr. 10, 2009 ("Zermatt"); letter from Neal E. Schear, President, Schear Capital, Inc.. dated Apr. 28, 2009 ("Schear"); letter from Dale T. Forte, dated Apr. 14, 2009; letter from Arthur Colman, dated May 4, 2009; letter from Joseph Leegan, dated Mar. 25, 2009; letter from John H. Happke, dated May 7, 2009; letter from Louis G. Marozsan, Jr., dated May 8, 2009; letter from S. Buford Scott, Chairman, Walter S. Robertson, III, President and CEO, John Sherman, Jr., Past President and CEO, William P. Schubmehl, Past President and CEO, Scott & Stringfellow LLC, dated May 14, 2009 ("Scott & Stringfellow"); letter from Martin Napor; letter from Michael Sigmon, Chairman, Sigmon Wealth Management, dated June 10, 2009 ("Sigmon Wealth Management (June 2009)"); letter from Christopher Ailman, Chief Investment Officer, California State Teachers' Retirement System, dated June 17, 2009; letter from IBM; letter from Stan Ryckman, dated June 19, 2009.

206 See, e.g., letter from Citadel et al. (June 2009); letter from SIFMA (June 2009); letter from STA (June 2009)); see also letter from Credit Suisse (Mar. 2009).

207 See Staff Analysis (Dec. 17, 2008).

Several commenters supported an increment of one trading unit, or one cent,[208] while another commenter suggested that the increment should be consistent with the minimum pricing increments specified in Rule 612 of Regulation NMS.[209] One commenter stated that the Commission should not specify a minimum increment and should permit trades to be executed at the mid-point between the best bid and best offer, even if the price were less than one cent above the best bid.[210] Another commenter expressed concerns that a short sale price test might advantage subpenny executions if, for example, certain trading venues were permitted to comply with the test by executing transactions at less than one cent above the national best bid.[211]

After considering the comments, we have determined at this time to not specify in Rule 201 a particular increment above the national best bid at which a covered security may be sold short. We believe that the goals we are seeking to advance by adopting Rule 201 will be achieved by requiring that when a covered security becomes subject to the short sale price test restrictions of Rule 201, all short selling must be at a price above the current national best bid. As discussed above, a goal of Rule 201 is to help prevent short selling from being used as a tool to exacerbate a declining market in a security. Thus, the price test restriction of Rule 201 does not permit short selling at or below the current national best bid. In addition to achieving this goal, however, we also recognize the need to minimize market disruption as well as the need for the price test restriction in Rule 201 to not be unduly restrictive. We believe that restricting short selling to a price above the current national bid for a particular security when the circuit breaker

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[208] See, e.g., letter from Citadel et al. (June 2009); letter from STA (June 2009).

[209] 17 CFR 242.612. See letter from NYSE Euronext (Sept. 2009).

[210] See letter from Howard Meyerson, General Counsel, Liquidnet, Inc., dated June 18, 2009 ("Liquidnet").

[211] See letter from Alec Hanson, dated Sept. 19, 2009.

has been triggered for that security, without specifying at what price such short sales may occur, will best achieve these goals.[212]

3. Alternative Uptick Rule

We have determined to adopt in Rule 201(b) the alternative uptick rule such that when triggered, short selling will be permitted only at a price above the current national best bid. Specifically, Rule 201(b) will require a trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[213] As noted above, we have determined to adopt in Rule 201(b) a circuit breaker trigger combined with the alternative uptick rule. Thus, while this Section III.A.3. focuses on the alternative uptick rule in the context of comments received about the different price tests that we proposed, the alternative uptick rule operates in conjunction with the circuit breaker approach and should not be considered as an isolated provision.

In the Proposal and the Re-Opening Release, we sought comment on three alternative types of short sale price test restrictions that could be applied on a permanent, market-wide basis or in combination with a circuit breaker: the proposed uptick rule, the proposed modified uptick rule, and the alternative uptick rule.[214] The alternative uptick rule is similar to the proposed modified uptick rule in that it will use the current national best bid, rather than the last sale price,

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212 As noted above, any execution or display of a short sale order must be in compliance with applicable rules of Regulation NMS regarding minimum pricing increments. See supra note 204 and accompanying text.

213 See Rule 201(b).

214 See Proposal, 74 FR 18042; Re-Opening Release, 74 FR 42033.

as a reference point for short sale orders. Unlike the proposed modified uptick rule and the proposed uptick rule, the alternative uptick rule will not allow short selling at the current national best bid or last sale price. Instead, the alternative uptick rule will only permit short selling at an increment above the current national best bid, unless an applicable exception applies.

In response to the Proposal and the Re-Opening Release, we received a number of comment letters supporting and opposing the alternative uptick rule. Those that opposed the alternative uptick rule stated, among other things, that because it will allow short selling only at a price above the current national best bid or last sale price, rather than at the current national best bid or last sale price, it will be more disruptive to the market than the proposed modified uptick rule or proposed uptick rule.[215] Some commenters stated that the alternative uptick rule will decrease liquidity, widen bid-ask spreads, decrease pricing efficiency, create inefficiencies in the routing and execution of short sale orders, increase intra-day volatility, and result in higher costs to investors.[216] Some commenters expressed concerns that the alternative uptick rule will exacerbate downward price movements because market participants may perceive the presence of short limit orders as a negative view of a security, causing buyers to withdraw their bids.[217]

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215 See, e.g., letter from William E. McDonnell, Jr., Chief Compliance Officer, Atherton Lane Advisers, LLC, dated Sept. 9, 2009 ("Atherton Lane"); letter from Michael J. Simon, Secretary, International Securities Exchange LLC, dated Sept. 21, 2009 ("ISE (Sept. 2009)"); letter from John Nagel, Managing Director and Deputy General Counsel, Citadel Investment Group, L.L.C., John Liftin, Managing Director and General Counsel, The D.E. Shaw Group, Mark Silber, Executive Vice President, Renaissance Technologies, dated Sept. 21, 2009 ("Citadel et al. (Sept. 2009)"); letter from Bingham McCutchen; letter from Vanguard (Sept. 2009); letter from STA (Sept. 2009).

216 See, e.g., letter from Karrie McMillan, General Counsel, Investment Company Institute, dated Sept. 21, 2009 ("ICI (Sept. 2009)"); letter from CPIC (Sept. 2009); letter from STA (Sept. 2009); letter from Kimberly Unger, Executive Director, Security Traders Association of New York, Inc., dated Sept. 21, 2009 ("STANY (Sept. 2009)"); letter from RBC (Sept. 2009); letter from EWT (Sept. 2009); letter from MFA (Oct. 2009); letter from Knight Capital (Sept. 2009).

217 See, e.g., letter from John Gilmartin, Co-CEO and Ben Londergan, Co-CEO, Group One Trading, L.P., dated Sept. 14, 2009 ("Group One Trading (Sept. 2009)"); letter from STANY (Sept. 2009); letter from Glen Shipway (Sept. 2009); letter from Michael L. Crowl, Managing Director, Global General Counsel, Barclays Global Investors, dated Sept. 21, 2009 ("Barclays (Sept 2009)"); letter from Knight Capital (Sept. 2009); letter from MFA (Oct. 2009).

Other commenters stated that, although easier to implement, the alternative uptick rule would have a more disruptive effect on the market than the proposed modified uptick rule or the proposed uptick rule.[218]

The alternative uptick rule, like former Rule 10a-1 and the proposed uptick rule and proposed modified uptick rule, when triggered will affect all short selling, including some legitimate short selling, as well as abusive or manipulative short selling. The alternative uptick rule is by definition more restrictive than the proposed modified uptick rule, but differences between the operation of the proposed uptick rule and the alternative uptick rule mean that one approach or the other would be more restrictive in particular circumstances.[219] The empirical evidence regarding former Rule 10a-1 tends to demonstrate that it did not have a negative effect on market liquidity and price efficiency.[220] We similarly believe that the alternative uptick rule will have a minimal, if any, negative effect on market liquidity or price efficiency.[221]

In contrast to those commenters opposed to the alternative uptick rule, several commenters expressed support for the alternative uptick rule, stating that the alternative uptick rule is preferable to the proposed modified uptick rule or the proposed uptick rule because it will eliminate sequencing issues, will be easier and less costly to implement, will be more effective in decreasing price pressure on a security,[222] and will reduce the ability of market participants to

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218 See, e.g., letter from ISE (Sept. 2009); letter from ICI (Sept. 2009).

219 See, e.g., infra note 242 and accompanying text (discussing automated trade matching systems).

220 See, e.g., the Pilot Results.

221 See infra Section X.B.1.a. (discussing the impact of Rule 201 on market liquidity and price efficiency).

222 See, e.g., letter from Direct Edge (Sept. 2009); letter from BATS (Sept. 2009); letter from Ronald C. Long, Director, Regulatory Affairs, Wells Fargo Advisors, dated Sept. 17, 2009 ("Wells Fargo (Sept. 2009)"); see also letter from SIFMA (Sept. 2009) (stating that a circuit breaker coupled with the alternative uptick rule "would limit instances where a security is the subject of severe downward pressure"); letter from Hudson River Trading (expressing support for the alternative uptick rule in conjunction with a circuit breaker as opposed to other proposed price tests in conjunction with a circuit breaker).

use short selling as a market manipulation tool.[223] Some commenters stated that because the alternative uptick rule will most effectively prevent short selling from proactively driving the price of a security lower, it will also be the most effective of the proposed short sale price test restrictions at achieving the Commission's goal of helping to restore investor confidence.[224] In discussing the alternative uptick rule, one commenter stated that "[n]ot only does it faithfully replicate the old uptick rule it improves upon it by making each and every short sale a liquidity providing transaction."[225] Another commenter, in supporting the alternative uptick rule, stated that it will "likely be more restrictive on short selling than the original Rule 10a-1 'uptick rule'."[226]

We have determined to adopt the alternative uptick rule in combination with a circuit breaker because we believe the alternative uptick rule will be more effective at meeting our goals than the other proposed rules. Because the alternative uptick rule, when triggered, will generally permit short selling only at a price above the current national best bid, the alternative uptick rule will not allow short sales to get immediate execution at the bid.[227] In other words, short sellers will not be permitted to act as liquidity takers when the alternative uptick rule applies, but will participate, if at all, as liquidity providers (unless an exception applies), adding depth to the market. Put another way, short sale orders will be executed only when purchasers arrive willing

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223 See letter from BATS (Sept. 2009); letter from Wells Fargo (Sept. 2009); letter from Glen Shipway (Sept. 2009).

224 Letter from Michael Gitlin, Head of Global Trading, David Oestreicher, Chief Legal Counsel, Christopher P. Hayes, Sr. Legal Counsel, T. Rowe Price Associates, Inc., dated Sept. 21, 2009 ("T. Rowe Price (Sept. 2009)").

225 Letter from Glen Shipway (Sept. 2009).

226 Letter from Virtu Financial.

227 As noted by some commenters, there may be situations in which a short seller could get immediate execution, such as where an order is executed in a facility that provides executions at the mid-point of the national best bid and offer. See, e.g., letter from ISE (Sept. 2009); see also letter from BATS (Sept. 2009).

to buy at prices above the national best bid. In addition, by not allowing short sellers to sell at the current national best bid, the alternative uptick rule will generally allow long sellers, by selling at the bid, to sell first and, thereby, take liquidity in a declining market for a security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of such restrictions is to allow long sellers to sell first in a declining market.[228] A short seller that is seeking to profit quickly from market moves may find it advantageous to be able to short sell at the current national best bid. By placing long sellers ahead of short sellers in the execution queue under certain circumstances, Rule 201 will help promote capital formation, since investors should be more willing to hold long positions if they know that they may have a preferred position over short sellers when they wish to sell.

In addition, by making bids accessible only by long sellers when a security's price is undergoing significant downward price pressure, Rule 201 will help to facilitate and maintain stability in the markets and help ensure that they function efficiently. It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors.

As we stated in the Proposal, short sale price test restrictions, whether a permanent, market-wide restriction or in combination with a circuit breaker, might help prevent short sellers from accelerating a declining market by exhausting all remaining bids at one price level, and causing successively lower prices to be established by long sellers.[229] Because the alternative

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[228] See supra note 17.

[229] See Proposal, 74 FR at 18050, 18053, 18059, 18061, 18065, 18069; see also Securities and Exchange Commission, Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., at 251 (1963).

uptick rule will only permit short selling at a price above the current national best bid, unless an exception applies, we believe it will be more effective than the proposed uptick rule or the proposed modified uptick rule at helping to prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to exacerbate a decline in the price of a security by exhausting all remaining bids at one price level.

A number of commenters favored the proposed circuit breaker halt rule, stating, among other things, that they believe it would be the least disruptive of the proposed rules with respect to market functioning, while still achieving the Commission's underlying goals;[230] and would be the easiest of the proposed rules to implement.[231] We are concerned, however, that, as expressed by other commenters, the proposed circuit breaker halt rule could harm the market by preventing short sellers from being able to provide benefits such as liquidity and price efficiency to the impacted security during the duration of the halt or that it could harm investor confidence.[232] We note that in severe conditions, stocks tend to be less liquid. Thus, as a rule that permits short

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[230] See, e.g., letter from Lime Brokerage (Sept. 2009); see also letter from Lime Brokerage (June 2009) (stating that "[i]mplementing a "cooling off" period after a steep decline in a given security's price will give market participants a chance to absorb the situation and possibly reassess their desire to continue short selling"); letter from Credit Suisse (June 2009); letter from T.D. Pro Ex.

[231] See, e.g., letter from SIFMA (June 2009); letter from Credit Suisse (June 2009); letter from Liquidnet; letter from Manisha Kimmel, Executive Director, Financial Information Forum, dated June 19, 2009 ("FIF (June 2009)"); letter from Lime Brokerage (Sept. 2009). Some commenters also stated that they believe that the proposed circuit breaker halt rule would be effective at preventing bear raids, reducing volatility in the market, and helpful in restoring investor confidence. See, e.g., letter from Matthew Samelson, Principal, Woodbine Associates, dated May 15, 2009 ("Woodbine"); letter from Credit Suisse (June 2009); letter from IBC; letter from Sigmon Wealth Management (June 2009); letter from Wachtell.

[232] See, e.g., letter from BATS (May 2009); letter from Citadel et al. (June 2009); letter from Direct Edge (June 2009); letter from Wolverine; letter from Amer. Bankers Assoc.. Other commenters viewed the proposed circuit breaker halt rule as too restrictive. See, e.g., letter from BATS (May 2009); letter from Direct Edge (June 2009). Some commenters argued that the proposed circuit breaker halt rule could harm investor confidence, by reducing volume and increasing bid-ask spreads during the effective period of the halt. See, e.g., letter from ICI (June 2009); letter from Amer. Bankers Assoc.; letter from Citadel et al. (June 2009). Other commenters expressed opposition to the concept of short sale halts and bans as a general matter, perceiving such actions as harmful to the markets, citing prior regulatory halts and short sale bans as evidence. See, e.g., letter from Josh Galper, Managing Principal, Finadium LLC, dated Apr. 13, 2009 ("Finadium); letter from Barclays (June 2009); letter from Citadel et al. (June 2009); letter from Dialectic Capital (June 2009); letter from Knight Capital (June 2009); letter from MFA (June 2009).

selling only at a price above the national best bid, the alternative uptick rule will require that during the period of time when a covered security is subject to the rule, short sellers in the security must act as liquidity providers, not liquidity takers, in that security.[233] In addition, by restricting the ability of short sellers to take liquidity when a covered security is undergoing significant price pressure, it will allow long sellers to access available liquidity by being able to sell at the current national best bid. This, in turn, may result in an increase in investor confidence during times of crisis as long sellers will have preferred access to bids for a security because when the circuit breaker has been triggered for a covered security, Rule 201 generally will allow only long sellers to sell at the bid.[234]

We have also determined to adopt the alternative uptick rule because, unlike the proposed uptick rule, it will be based on the current national best bid rather than the last sale price. As we stated in the Proposal, we believe that a short sale price test based on the national best bid is more suitable to today's markets than a short sale price test based on the last sale price.[235]

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233 See supra note 29 (discussing the terms "liquidity provider" and "liquidity taker").

234 Too much investor confidence may also be detrimental to investors because it can lead to investors making inappropriate decisions. Investor over-confidence, however, is less likely during times of crisis. See, e.g., Brad M. Barber and Terrance Odean, 2000, Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors, Journal of Finance, 55: 773-806.

235 See Proposal, 74 FR at 18053. In response to our requests for comment in the Proposal and the Re-Opening Release, a number of commenters to the Proposal and Re-Opening Release expressed support for a price test restriction based on the national best bid rather than the last sale price, stating that it would be more suitable to today's markets. See, e.g., letter from BATS (May 2009); letter from SIFMA (June 2009); letter from NYSE Euronext (June 2009); letter from Goldman Sachs (June 2009); letter from Direct Edge (June 2009); letter from GE; letter from Bingham McCutchen; letter from Citadel et al. (June 2009); letter from Amer. Bar Assoc. (July 2009); letter from Barry Friedman, Llewellyn Jones, and Derrick Kaiser, Founding Members, Qtrade Capital Partners LLC, dated Sept. 21, 2009 ("Qtrade"); letter from MFA (Oct. 2009). We also note supporting statements made by Larry Leibowitz, Group Executive Vice President at NYSE Euronext, at our May 5, 2009 Roundtable, stating that the proposed uptick rule would be ineffective in today's market "due to improper price sequencing caused by permitted reporting delays and the potential for manipulation." Statement of NYSE Euronext (May 2009). Available at: http://www.sec.gov/comments/4-581/4581-86.pdf.

We note, however, that a number of commenters offered support for a price test restriction based on the last sale price. See, e.g., letter from Zermatt; letter from Bruce Lueck, Managing Partner, Zephyr Unicorn Funds, dated Apr. 10, 2009; letter from Walter Cruttenden, Cruttenden Partners, dated Apr. 14, 2009; letter from Larry Chlebina, President, Chlebina Capital Management, LLC, dated Apr. 15, 2009 ("Chlebina (Apr. 2009)"); letter

Although we recognize that a quotation proposes a transaction, whereas the last trade price reflects an actual trade, we note that pursuant to Commission and SRO rules, quotations for all covered securities must be firm.[236] By requiring that quotations be firm, the Commission intended to ensure that quotations provide reliable information to the marketplace to assist broker-dealers in satisfying their best execution obligations to their customers and to assist customers in making informed investment decisions.[237] Moreover, quotation information has significant value to the marketplace because it reflects the various factors affecting the market, including current levels of buying and selling interest.[238] Both retail and institutional investors rely on quotation information to understand the market forces at work at a given time and to assist in the formulation of investment strategies.[239]

Further, we believe that bids generally are a more accurate reflection of current prices for a security because changes in bids are more accurately timed than transactions. Transactions may be reported within a 90 second window, which can easily result in "stale" reports. Even transactions that are executed and reported automatically may be out of sequence if they occur in different trading centers, which can detract from the accuracy and reliability of the last sale. For example, trade reporting for covered securities can involve multiple trading centers reporting

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from Chad McCurdy, Managing Partner, Marlin Capital Partners, dated Apr. 20, 2009; letter from David Wagner, CEO, Active Investment Management, LLC, dated Apr. 22, 2009; letter from Bradley Kelly, President, Magnum Opus Financial, dated Apr. 29, 2009; letter from Equity Insight; letter from Tony Wyan, CEO, Tony Wyan and Company, dated May 5, 2009; letter from Aaron Shafter, President, Great Mountain Capital Management, LLC, dated May 5, 2009; letter from Richard Casey, Chairman and CEO, Casey Securities, LLC, dated May 8, 2009; letter from Scott & Stringfellow; letter from Donald Rembert Sr., President, Rembert Pendelton and Jackson, dated May 28, 2009; letter from Sigmon Wealth Management (June 2009); letter from Sears.

[236] See, e.g., 17 CFR 242.602.

[237] See, e.g., Exchange Act Release No. 43085 (July 28, 2000), 65 FR 47918, 47924 – 47925 (Aug. 4, 2000).

[238] See id. at 47925.

[239] See id.

trades in the same stock from different locations using different means of reporting. Thus, for those covered securities for which a significant amount of trading occurs manually, or in multiple trading centers, a price test based on the national best bid will be a more accurate and effective means of regulating short selling than a test based on the last sale price because the manner in which trades are reported may create up-ticks and down-ticks that may not accurately reflect actual price movements in the security for the purpose of a test based on the last sale price.

We also note that the national best bid is nearly always a protected bid for the trade-through rule of Rule 611 of Regulation NMS,[240] with which every trading center must comply. Because trading centers' execution procedures must incorporate protected bids, they will also usually include the national best bid. Market participants will also be familiar with using the current national best bid as a reference point because NASD's former bid test, which was in existence from 1994 to mid-2007, was based on the current national best bid.[241]

In addition, another advantage of the alternative uptick rule is that it accommodates trading systems and strategies used in the marketplace today, such as the automated trade matching systems that offer price improvement based on the national best bid and offer. These passive pricing systems often effect trades at an independently-derived price, such as at the mid-point of the bid-offer spread. Such pricing would often not satisfy the tick test of former Rule 10a-1 because matches could potentially occur at a price below the last reported sale price.

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[240] See 17 CFR 242.611.

[241] NASD's former bid test referenced the national best bid and was designed to help prevent short selling at or below the current national best bid in a declining market. See supra note 43 (discussing NASD's former bid test).

Thus, we provided a limited exception from former Rule 10a-1 for these trading systems.[242] In response to the Proposal and Re-Opening Release, commenters noted that a short sale price test restriction based on the current national best bid is preferable to a restriction based on the last sale price because it would not impede mid-point and similar derived price trading.[243] One such commenter noted that mid-point trading is beneficial to the markets because it provides price improvement to both sides of the trade.[244] The short sale price test restrictions of Rule 201 will accommodate matching systems that execute trades at an independently-derived price because such systems are designed so that matches occur above the current national best bid.

We have also determined to adopt the alternative uptick rule rather than the proposed uptick rule or the proposed modified uptick rule because it will not require monitoring of the sequence of bids or last sale prices (i.e., whether the current national best bid or last sale price is above or below the previous national best bid or last sale price) and, therefore, will likely be easier to implement and monitor. As we noted in the Re-Opening Release, commenters had stated that the alternative uptick rule would likely be easier to monitor, could likely be implemented more quickly and with less cost, and would be easier to program into trading and surveillance systems than the proposed modified uptick rule or the proposed uptick rule because it would not require bid sequencing.[245] In response to the Re-Opening Release, several

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242 See, e.g., supra note 42; letter from James A. Brigagliano, Acting Associate Director, Division of Market Regulation, SEC, to Alan J. Reed, Jr., First Vice President and Director of Compliance, Instinet Group, LLC, dated June 15, 2006 (granting Instinet modified exemptive relief from Rule 10a-1 for certain transactions executed through Instinet's Intra-day Crossing System).

243 See letter from Liquidnet; letter from GE.

244 See letter from Liquidnet.

245 See Re-Opening Release, 74 FR at 42034.

commenters made similar statements in comparing the alternative uptick rule to the proposed modified uptick rule and proposed uptick rule.[246]

The requirements of Rule 201 will also not result in the type of disparate short sale regulation that existed under former Rule 10a-1.[247] Rule 201 will apply a uniform rule to trades in the same securities that can occur in multiple, dispersed, and diverse markets. To further this goal of having a uniform short sale price test, consistent with the Proposal, subsection (e) of Rule 201 provides that no SRO shall have any rule that is not in conformity with, or conflicts with, Rule 201.[248] One of the reasons for the elimination of former Rule 10a-1 and the prohibition on any SRO from having a short sale price test in July 2007 was that the application of short sale price tests had become disjointed, with different price tests applying to the same securities trading in different markets. One commenter noted that a rule that does not cover all market centers would result in an unlevel playing field,[249] while another stated that the Commission should not adopt a rule that would create an opportunity for regulatory arbitrage.[250] For this same reason, this commenter supported a prohibition on any SRO having a rule that is not in conformity with or conflicts with Rule 201.[251] We believe that a uniform rule will reduce

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[246] See, e.g., letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from John McCarthy, General Counsel, Global Electronic Trading Company, dated Sept. 21, 2009 ("GETCO (Sept. 2009)"); letter from Hudson River Trading. Some commenters, however, expressed disagreement that a price test restriction that will require sequencing of bids or last sale prices is not technologically feasible. See, e.g., letter from Bingham McCutchen; letter from ISE (Sept. 2009); letter from EWT (Sept. 2009); letter from Vincent Florack and Steve Crutchfield, Matlock Capital LLC, dated Sept. 18, 2009 ("Matlock Capital (Sept. 2009)"); letter from Gary E. Shugrue, President, Ascendant Capital Partners, dated May 11, 2009 ("Ascendant Capital"); letter from Robert P. Porter, President, Paladin Investment LLC, dated May 8, 2009 ("Paladin Investment").

[247] See Proposal, 74 FR at 18044 – 18045 (discussing the history of short sale price test restrictions).

[248] See Rule 201(e).

[249] See letter from Wells Fargo (June 2009).

[250] See letter from STA (June 2009).

[251] See id.

compliance and surveillance costs because systems and surveillance mechanisms will have to be programmed to consider a single price test based on the national best bid, rather than different tests for different markets. In addition, a uniform test will reduce opportunities for regulatory arbitrage. Accordingly, under Rule 201, all covered securities, wherever traded, will be subject to one short sale price test, the alternative uptick rule.

4. Circuit Breaker Approach Generally

Under Rule 201(b), the alterative uptick rule will apply only if the price of a covered security has declined by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[252] In the Proposal, we proposed a permanent, market-wide approach to short sale price test restrictions that would result in the proposed uptick rule or proposed modified uptick rule applying to all covered securities all the time.[253] We also proposed a circuit breaker approach, either as an addition or an alternative to a permanent, market-wide approach, which would temporarily result in either a halt on short selling in a specific security or the proposed modified uptick rule or the proposed uptick rule applying to a specific security if there was a significant decline in the price of that security.[254] In addition, in the Re-Opening Release, we stated that the alternative uptick rule could be implemented market-wide or in combination with a short selling circuit breaker.[255]

A number of commenters stated that if we determined to adopt a short sale price test restriction, it should be in combination with a circuit breaker rather than on a permanent, market-

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[252] See Rule 201(b).

[253] See Proposal, 74 FR 18042.

[254] See id.

[255] See Re-Opening Release, 74 FR 42033.

wide basis.[256] For example, one commenter urged us to adopt a circuit breaker approach because it would be more narrowly-tailored to address our concerns about the effects of short selling in a market subject to a significant downturn.[257] This commenter noted that in such a market, circuit breakers likely would be triggered for a large number of securities.[258] Another commenter stated that a circuit breaker is preferable because it "permits normal market activity while a stock is trading in a natural range and short selling is more likely to benefit the market (by, for example, increasing price discovery and liquidity). Conversely, a Circuit Breaker will restrict short selling when prices begin to decline substantially and short selling becomes more likely to be abusive and potentially harmful."[259] One commenter stated that "[a] circuit breaker would better target situations that could result from . . . potential bear raids and other forms of manipulation that may be used to drive down or accelerate the decline in the price of a stock."[260]

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256 See, e.g., statement of Justin Schack, Vice President, Market Structure Analysis, Rosenblatt Securities, Inc., at SEC Roundtable on Short Selling (May 5, 2009) ("Rosenblatt Securities"); letter from Richard T. Chase, Managing Director and General Counsel, RBC Capital Markets Corporation, dated June 19, 2009 ("RBC (June 2009)"); letter from Michael J. Simon, Secretary, International Securities Exchange LLC, dated June 19, 2009 ("ISE (June 2009)"); memorandum of a meeting between representatives of Penson Worldwide, Inc., and the Division of Trading and Markets, dated July 21, 2009, and written materials submitted at the meeting ("Penson"); letter from Direct Edge (June 2009); letter from BATS (May 2009); letter from SIFMA (June 2009); letter from MFA (June 2009); letter from ICI (June 2009); letter from Barclays (June 2009); letter from Vanguard (June 2009); letter from Goldman Sachs (June 2009); letter from Credit Suisse (June 2009); letter from Dialectic Capital (June 2009); letter from Allston Trading (June 2009); letter from Knight Capital (June 2009); letter from GETCO (June 2009); letter from Citadel et al. (June 2009); letter from William Connell, President and CEO, Allston Trading, LLC, dated Sept. 21, 2009 ("Allston Trading (Sept. 2009)"); letter from GETCO (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from ICI (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from RBC (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from BATS (Sept. 2009); letter from SIFMA (Sept. 2009); letter from MFA (Oct. 2009); letter from AIMA; letter from IAG; letter from Fidelity; letter from T.D. Pro Ex; letter from Finadium; letter from Matthew B. Management; letter from Millennium; letter from Liquidnet; letter from Qtrade; letter from Hudson River Trading; letter from Virtu Financial; see also letter from Credit Suisse (Mar. 2009).

257 See letter from Citadel et al. (Sept. 2009).

258 See id.

259 Letter from Nasdaq OMX Group (Oct. 2009); see also letter from Goldman Sachs (June 2009); letter from MFA (June 2009); letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Virtu Financial.

260 Letter from Hudson River Trading; see also letter from MFA (June 2009).

Other commenters stated that implementing price test restrictions on a permanent, market-wide basis, rather than in combination with a circuit breaker, would substantially diminish the benefits that short sellers bring to the markets.[261] One commenter stated that a price test restriction should be adopted with a circuit breaker because prior empirical studies did not necessarily include times of severe market events.[262] One commenter stated that a circuit breaker approach was preferable because it would be easier to implement than a permanent, market-wide rule.[263]

Other commenters were not supportive of a circuit breaker approach.[264] One such commenter stated that a permanent, market-wide price test restriction would be preferable to a circuit breaker approach because it is "more predictable for market participants and issuers alike, would raise fewer implementation complexities, and is less likely to have a 'magnet effect' on the pricing of a security as it approaches a circuit breaker trigger point."[265] This commenter stated that a circuit breaker is "unlikely to be perceived as a timely or effective remedy against abusive short selling, since restrictions would only take effect after there had already been a significant intraday price decline in a security."[266] Further, this commenter stated that "[c]ircuit breakers may also undermine investor confidence because they introduce an element of uncertainty in the pricing of securities: at a certain point, the price of a declining security would begin to reflect not the fundamental value of the security, but rather the likelihood that a security

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261 See, e.g., letter from Direct Edge (Sept. 2009); letter from Credit Suisse (Sept. 2009).

262 See letter from Virtu Financial.

263 See letter from SIFMA (June 2009).

264 See, e.g., letter from Glen Shipway (June 2009); letter from T. Rowe Price (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from EWT (Sept. 2009).

265 Letter from NYSE Euronext (Sept. 2009).

266 Id.

will trigger the circuit breaker. This 'magnet effect' could undermine investor confidence, resulting in less buying interest in securities nearing the circuit breaker if there is a perception that professional traders could use sophisticated pricing models to profit from this anomaly while public investors, lacking access to such tools, could not."[267]

Another commenter stated that it believes that a circuit breaker approach is unworkable because it "may exacerbate market dislocations by suddenly and unexpectedly altering the regulatory regime and liquidity characteristics of a particular security, precisely when it is under duress."[268] One commenter stated that it did not support a circuit breaker approach because it "would still allow abusive short sellers to drive down the price of a stock at least 10% on any given day even before the circuit breaker would kick in."[269] This commenter also stated that it was concerned that during periods of extreme volatility, "circuit breakers could potentially impact far too many stocks on any given day and damage the benefits of short selling."[270] Another commenter stated that it did not support a circuit breaker approach because, among other things, it would add "an additional element of trading risk that could result in a decrease in certain market participant's [sic] willingness to supply liquidity in securities perceived to be potentially subject to triggering of a circuit breaker."[271]

In line with the Commission's position that market impediments should be minimized, we believe the short selling circuit breaker approach of Rule 201 will benefit the market as a narrowly-

[267] Id.; see also letter from Amer. Bankers Assoc. (referencing the "stigmatizing effect" on stocks subject to a circuit breaker); letter from T. Rowe Price (Sept. 2009) (expressing support for the alternative uptick rule that would apply on a permanent, market-wide basis).

[268] Letter from EWT (Sept. 2009).

[269] Letter from Atherton Lane.

[270] Id.

[271] Letter from NYSE Euronext (June 2009).

tailored response to severe circumstances.[272] As discussed above, due to the changes in market conditions and erosion of investor confidence that occurred recently, investors have become increasingly concerned about sudden and excessive declines in prices that appear to be unrelated to issuer fundamentals.[273] We believe that a circuit breaker that is triggered by a significant intra-day decline in price of an individual security is a targeted response to address these concerns. Although a permanent, market-wide approach that would apply to all covered securities all the time may, as one commenter stated,[274] provide an element of predictability, we believe that the circuit breaker approach of Rule 201 is appropriate because it provides a balance between achieving our goals for adopting a short sale price test restriction and limiting impediments to the normal operations of the market.

As noted above, some commenters expressed concerns regarding the effectiveness and workability of a circuit breaker approach because the price test restriction will apply only after there has already been a significant intra-day price decline in a security, and because it may exacerbate market dislocations when a security is under duress. The Commission has previously noted that circuit breakers may benefit the market by allowing participants an opportunity to re-evaluate circumstances and respond to volatility.[275] Unlike a price test restriction that would apply on a permanent, market-wide basis, Rule 201 will restrict short selling for an individual covered security for a specified period of time. As we stated in the Proposal, in discussing a short selling circuit breaker, one commenter noted that such a measure could address the issue of "bear raids"

272 See Exchange Act Release No. 39846 (Apr. 9, 1998), 63 FR 18477 (Apr. 15, 1998) (order approving proposals by Amex, BSE, CHX, NASD, NYSE, and Phlx) ("1998 Release").

273 See supra Section II.C. (discussing investor confidence); see also Proposal, 74 FR at 18046 – 18049.

274 See letter from NYSE Euronext (Sept. 2009).

275 See 1998 Release, 63 FR 18477.

while limiting the market impact that may arise from other forms of short sale price test restrictions.[276] In addition, although we agree that a circuit breaker combined with a halt on short selling may cause or exacerbate market dislocations, we do not believe that the circuit breaker approach of Rule 201 will have the same impact because it will continue to allow short selling, although at a price above the national best bid, even when the price test restriction is in effect. Further, to the extent that the circuit breaker approach results in market dislocations, we believe any such dislocations are justified by the benefits provided by the Rule.

We have designed the alternative uptick rule implemented through a circuit breaker to strike the appropriate balance between our goal of preventing potential short sale abuse and the need to limit impediments to the normal operations of the market. The Commission has long held the view that circuit breakers may help restore investor confidence during times of substantial uncertainty.[277] We believe that the requirements of Rule 201 will produce similar benefits. By imposing the alternative uptick rule once a security's price is experiencing a significant intra-day price decline, the short selling circuit breaker rule in Rule 201(b) is designed to target only those securities that experience such declines and, therefore, will help to prevent short selling from being used as a tool to exacerbate a declining market in a security. This approach establishes a narrowly-tailored Rule that will target only those securities experiencing such a decline. We believe that addressing short selling in connection with such a decline in an individual security will help restore investor confidence in the markets generally.

As discussed above, short selling is an important tool in price discovery and the provision of liquidity to the market, and we recognize that imposition of a short selling circuit breaker that when

[276] See Proposal, 74 FR at 18067, n.252 (noting a letter from Peter Brown, dated Dec. 12, 2008).

[277] See, e.g., 1998 Release, 63 FR 18477; see also Proposal, 74 FR at 18067.

triggered imposes the alternative uptick rule could restrict otherwise legitimate short selling activity during periods of significant volatility. To the extent that the alternative uptick rule may negatively impact the ability of short sellers to provide liquidity to the markets and contribute to price efficiency, we believe any such negative impact is justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from driving down further the price of a security that has already experienced a significant intra-day price decline.

In addition, we believe that any such negative impact will be limited both in duration and reach. First, the circuit breaker will apply for a limited period of time, that is, through the end of the day on which it is triggered and the following day. Second, because the restrictions of Rule 201 will apply only when the price of a covered security has experienced a significant intra-day price decline, the circuit breaker approach of Rule 201 will preserve the potential benefits of short selling, such as the provision of liquidity and price efficiency, for those securities for which prices are undergoing minimal downward pressure, or are stable or rising.[278] To the extent that the markets are experiencing periods of extreme volatility, we expect that the circuit breaker will be triggered for more securities than during periods of low volatility. We believe this is an appropriate result of Rule 201 because it is designed to impose restrictions on short selling when individual securities are undergoing significant intra-day price declines. Because Rule 201 does not impose a halt on short selling, however, short selling will be possible even when the circuit breaker has been triggered, although it will be limited to a price above the current national best bid. A circuit breaker approach will also allow regulatory, supervisory and compliance resources

[278] In addition, as discussed above, based on the empirical evidence regarding former Rule 10a-1 that tends to demonstrate that it did not have an effect on market liquidity and price efficiency, we similarly believe that the alternative uptick rule will have a minimal, if any, effect on market liquidity or price efficiency. See supra note 220 and accompanying text.

to focus on, and address, those situations where a specific security is experiencing significant downward price pressure.[279]

As we stated in the Proposal, we understand that there are concerns about a potential "magnet effect" that could arise as an unintended consequence of a circuit breaker that imposes a short selling price test restriction.[280] This "magnet effect" could result in short sellers driving down the price of an equity security in a rush to execute short sales before the circuit breaker is triggered. We are also concerned about short selling demand building until the circuit breaker is lifted. In response to our requests for comments, several commenters stated that a short sale circuit breaker could exacerbate downward pressure on stocks as their value reached the threshold level.[281] Commenters also discussed the possibility that short selling demand could be built up until the short selling restriction is lifted.[282] Other commenters, however, discounted the possibility or impact of a "magnet effect,"[283] including some commenters who cited empirical studies that question whether a circuit breaker would result in artificial pressure on the price of individual securities.[284]

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[279] See letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

[280] See, e.g., Proposal, 74 FR at 18067.

[281] See, e.g., letter from Vincent Florack and Steve Crutchfield, Matlock Capital LLC, dated May 26, 2009 ("Matlock Capital (May 2009)"); letter from Schwab; letter from Lime Brokerage (June 2009); letter from STA (June 2009); letter from Glen Shipway (June 2009); letter from NYSE Euronext (June 2009); letter from Wolverine; letter from Direct Edge (June 2009); letter from Amer. Bankers Assoc.; letter from NYSE Euronext (Sept. 2009); see also letter from SIFMA (June 2009) (indicating that an "on/off" circuit breaker trigger could dampen any magnet effect); letter from Direct Edge (Mar. 2009).

[282] See letter from STA (June 2009); letter from Wolverine.

[283] See letter from BATS (May 2009); letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); letter from Hudson River Trading; letter from Virtu Financial; see also letter from Credit Suisse (Mar. 2009).

[284] See letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); see also letter from Credit Suisse (Mar. 2009); letter from Nasdaq OMX Group (Oct. 2009).

After considering the comments, including studies cited by commenters, we do not believe that the evidence is clear regarding a "magnet effect." In fact, many academic studies that have analyzed circuit breakers in other contexts found no evidence of such trading patterns.[285] We recognize, however, that some of these studies were conducted in markets dissimilar from the highly automated markets currently existing in the United States and, therefore, that limits their utility in this context. Overall, however, the most relevant studies fail to demonstrate a magnet effect and we believe that adopting the circuit breaker approach best serves our goals.

5. Circuit Breaker Trigger Level and Duration

In the Proposal, we proposed that if the price of a covered security declined by at least 10% from the prior day's closing price for that covered security, as measured by the closing price of the covered security on the consolidated system, then all short selling in the covered security would be subject to a halt or a price test restriction for the remainder of the trading day.[286] To avoid market disruption that might occur if a circuit breaker were triggered late in the trading day, the circuit breaker rules, as proposed, would not have been triggered if the specified market decline threshold was reached in a covered security within thirty minutes of the end of regular trading hours.[287]

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285 See, e.g., letter from Credit Suisse (June 2009); see also David Abad and Roberto Pascual, On the Magnet Effect of Price Limits, European Financial Management, 13:833 – 852 (2007) (studying the Spanish stock exchange); Chan et al., Price limit performance: Evidence from transactions data and the limit order book, Journal of Empirical Finance, 12: 269 – 290 (2005) (studying the Kuala Lumpur Stock Exchange); Anthony D. Hall and Paul Korfman, Limits to linear price behavior: futures prices regulated by limits, Journal of Futures Markets, 21: 463 – 488 (2001) (studying five agriculture futures contracts); Henk Berkman and Onno Steenbeek, The influence of daily price limits on trading in Nikkei futures, Journal of Futures Markets, 18: 265 – 279 (1998) (studying futures contracts on the Osaka Securities Exchange); Marcelle Arak and Richard E. Cook, Do daily price limits act as magnets? The case of treasury bond futures, Journal of Financial Services Research, 12: 5 – 20 (1997) (studying treasury bond futures).

286 See Proposal, 74 FR at 18066.

287 See id.

In Rule 201(b), we are adopting a 10% trigger level measured from the closing price determined by the covered security's listing market as of the end of regular trading hours on the prior day.[288] This differs from the Proposal, under which the price decline would have been measured from the covered security's last price reported in the consolidated system during regular trading hours on the prior day.[289] In addition, we are modifying the proposed duration of the price test restriction once the circuit breaker is triggered. Under Rule 201(b), as adopted, once the circuit breaker has been triggered, the price test restriction will remain in place for the remainder of the day and for the following day.[290] In addition, as discussed in more detail below, because the price test restriction will remain in place for the remainder of the day and for the following day, we are not adopting in Rule 201 a provision that the short sale price test restriction of the Rule will not be triggered if the 10% trigger level is reached in a covered security within thirty minutes of the end of regular trading hours.

In the Proposal, we noted our preliminary belief that a 10% decline in a security's price from the prior day's closing price would be an appropriate level at which to trigger the proposed circuit breaker rules.[291] We also noted that a 10% threshold would be consistent with current SRO rules that restrict or halt trading if key market indexes fall by specified amounts ("SRO Circuit

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288 "Regular trading hours" is defined in Rule 201 to have the same meaning as in Rule 600(b)(64) of Regulation NMS. See Rule 201(a)(7). Rule 600(b)(64) provides that "Regular trading hours means the time between 9:30 a.m. and 4:00 p.m. Eastern Time, or such other time as is set forth in the procedures established pursuant to §242.605(a)(2)." 17 CFR 242.600(b)(64).

289 See Proposal, 74 FR at 18066.

290 Rule 201(b). We note that if the price of a covered security declines intra-day by at least 10% on a day on which the security is already subject to the short sale price test restriction of Rule 201, the restriction will be re-triggered and, therefore, will continue in effect for the remainder of that day and the following day. For example, if on Monday, the price of XYZ security declines intra-day by at least 10%, XYZ security will be subject to the alternative uptick rule for the remainder of Monday and for the following day, Tuesday. If then on Tuesday, the price of XYZ security again declines intra-day by at least 10%, the circuit breaker will be re-triggered for that security such that the alternative uptick rule will apply for the following day, i.e., Wednesday, as well as for the remainder of the day on Tuesday.

291 See Proposal, 74 FR at 18066, 18069.

Breakers")[292] and had been recommended by certain commenters.[293] The Commission solicited comment on whether a 10% decline from the prior day's closing price would be an appropriate threshold at which to trigger the proposed circuit breaker short sale price restrictions.[294] We noted that the threshold level would affect the balance of the costs and benefits of the Rule; a low trigger level could result in more securities being subject to the proposed short sale price test restrictions, or subject to them more frequently, and a high trigger level could result in securities facing more significant declines before the benefits of the short sale price test restrictions applied.[295]

In response to our request for comment, several commenters expressed support for a 10% trigger level.[296] One commenter did not specifically object to the 10% threshold, but stated that 10% should be the minimum trigger level considered.[297] One commenter expressed support for a lower, 5% trigger level.[298]

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[292] See Proposal, 74 FR at 18065-18066. To protect investors and the markets, the Commission has approved proposals to restrict or halt trading if key market indexes fall by specified amounts. Currently, all stock exchanges and FINRA have rules or policies to implement coordinated circuit breaker halts. See 1998 Release, 63 FR 18477; see also NYSE Rule 80B. The circuit breaker procedures call for cross-market trading halts when the Dow Jones Industrial Average ("DJIA") declines by 10%, 20%, and 30% from the previous day's closing value. See, e.g., BATS Exchange Rule 11.18. The options markets also have rules applying circuit breakers. See Amex Rule 950 (applying Amex Rule 117, Trading Halts Due to Extraordinary Market Volatility, to options transactions); CBOE Rule 6.3B; ISE Rule 703; NYSE Arca Options Rule 7.5; and Phlx Rule 133. The futures exchanges that trade index futures contracts have adopted circuit breaker halt procedures in conjunction with their price limit rules for index products. See, e.g., CME Rule 35102.1. The CME will implement a trading halt on S&P 500 Index futures contracts if a NYSE Rule 80B trading halt is imposed in the primary securities market. Trading of S&P 500 Index futures contracts will resume upon lifting of the NYSE Rule 80B trading halt. Finally, security futures products are required to have cross-market circuit breaker regulatory halt procedures in place. See Exchange Act Release No. 45956 (May 17, 2002), 67 FR 36740 (May 24, 2002).

[293] See Proposal, 74 FR at 18066.

[294] See Proposal, 74 FR at 18066, 18069, 18070.

[295] See Proposal, 74 FR at 18079, 18081.

[296] See, e.g., letter from BATS (May 2009); letter from Allston Trading (June 2009); letter from IBC.

[297] See letter from Direct Edge (June 2009).

[298] See letter from James J. Angel, Ph.D., CFA, Associate Professor of Finance, McDonough School of Business, Georgetown University, dated Sept. 21, 2009 ("Prof. Angel (Sept. 2009)").

Several commenters expressed support for a trigger level higher than 10%.[299] Several of these commenters stated that a circuit breaker threshold of 10% would be too narrow or restrictive.[300] Other commenters indicated that a circuit breaker should only be triggered in extraordinary circumstances and asked that we consider a trigger level higher than 10% due to concerns that a 10% trigger level would capture "normal" trading activity.[301] Several commenters indicated that a higher trigger level would be particularly important for lower priced securities because a 10% trigger level would likely be reached frequently even in the absence of abnormal activity for such securities.[302] Other commenters indicated that, in addition to price, the trigger level should factor in other characteristics of individual securities, such as volume and volatility.[303] One commenter stated that a higher trigger level would be especially important for a circuit breaker in conjunction with the alternative uptick rule because the alternative uptick rule is more restrictive than the other proposed price tests.[304]

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[299] See, e.g., letter from MFA (June 2009); letter from Goldman Sachs (June 2009); letter from ISDA; letter from ISE (June. 2009); letter from SIFMA (June 2009); letter from Citadel et al. (June 2009); letter from Dialectic Capital (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from ISE (Sept. 2009); letter from SIFMA (Sept. 2009); letter from Virtu Financial; letter from Nasdaq OMX Group (Oct. 2009).

[300] See, e.g., letter from MFA (June 2009); letter from ISDA; letter from ISE (June 2009); letter from Virtu Financial; letter from Jordan & Jordan; letter from Credit Suisse (June 2009).

[301] See, e.g., letter from MFA (June 2009); letter from Citadel et al. (June 2009); letter from Goldman Sachs (June 2009); letter from ISDA; letter from ISE (June 2009); letter from SIFMA (June 2009); letter from Dialectic Capital (Sept. 2009); letter from SIFMA (Sept. 2009); letter from Virtu Financial.

[302] See, e.g., letter from Barclays (June 2009); letter from ISDA; letter from SIFMA (June 2009); letter from SIFMA (Sept. 2009).

[303] See letter from Direct Edge (June 2009); letter from Barclays (June 2009); letter from Goldman Sachs (June 2009); letter from Lime Brokerage (June 2009); letter from Direct Edge (Sept. 2009); letter from Goldman Sachs (Sept. 2009).

[304] See letter from ISE (Sept. 2009).

In addition, several commenters submitted estimates of the number of securities that would trigger a circuit breaker rule at a 10% threshold.[305] While commenters' analyses (including the facts and assumptions used) and their resulting estimates varied,[306] commenters' estimates reflect that a 10% circuit breaker threshold, on average, should affect only a limited percentage of covered securities.[307] For example, one commenter submitted an estimate that slightly more than 5% of a universe of 4,800 NMS common stocks would have "tripped the 10% threshold on average each day" during roughly the first half of 2009.[308] In determining that a 10% threshold is appropriate, we considered other thresholds and the data presented by commenters regarding the numbers of securities that they believed would be subject to a short sale price test restriction at those different thresholds. Given the variations in the facts and assumptions underlying the estimates submitted by commenters, the Staff also looked at trading data to confirm the reasonableness of those estimates. The Staff found that, over the period covering April 9, 2001 to September 30, 2009,[309] the 10% trigger level of Rule 201 would have,

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305 See, e.g., letter from Jordan & Jordan; letter from Citadel et al. (June 2009); letter from MFA (June 2009); letter from SIFMA (June 2009); letter from Credit Suisse (Sept. 2009).

306 See, e.g., letter from Jordan & Jordan (providing estimated percentages of exchange listed stocks impacted by a 10% circuit breaker threshold on sample days); letter from MFA (June 2009) (providing the average daily number and percentage of Russell 3000 stocks impacted by a 10% circuit breaker threshold over a ten year period); letter from Credit Suisse (Sept. 2009) (providing the number of times, by month, a circuit breaker with a 10% threshold would have been triggered for S&P 500 stocks and for Russell 2000 stocks); letter from SIFMA (June 2009) (referencing two member firms' estimates, one that provided the average number of stocks out of 4,800 NMS common stocks that would have triggered the 10% threshold during roughly the first half of 2009 and another that measured the average number of Russell 3000 stocks per day that declined by 10% from their opening price from November 2008 to March 2009).

307 See, e.g., letter from MFA (June 2009) (reflecting that approximately 5% of Russell 3000 stocks would have been impacted at any one time by a circuit breaker with a 10% threshold during the period of October 1998 to September 2008); letter from SIFMA (June 2009) (reflecting that approximately 3% of Russell 3000 stocks trading above $10 and 16.5% of Russell 3000 stocks trading below $10 would have been impacted by a 10% threshold measured from the security's opening price during the period of November 2008 through March 2009); but cf letter from Jordan & Jordan. We note that the sample of days in the data reflected in the letter from Jordan & Jordan is not representative of typical trading.

308 Letter from SIFMA (June 2009).

309 This time period constitutes the period after full implementation of decimal increments.

on an average day, been triggered for approximately 4% of covered securities.[310] The Staff also found that for a low volatility period, covering January 1, 2004 to December 31, 2006, the 10% trigger level of Rule 201 would have, on an average day, been triggered for approximately 1.3% of covered securities.[311]

After considering the comments, we believe that a 10% decline in a security's price, as measured from the security's closing price on the prior day, is an appropriate level at which to trigger a circuit breaker. As discussed in the Proposal, the circuit breaker short sale price test restrictions were designed to target a security experiencing a significant intra-day price decline, where the concerns about the potential harmful effects of short selling would be greatest. In this way, they would be tailored to help prevent short selling, including potentially abusive or manipulative short selling, from being used as a tool to exacerbate the declining market in those securities experiencing a significant intra-day decline and, thereby, help stabilize the market in those securities and help address concerns about the erosion in investor confidence.[312] At the same time, we explained, the proposed circuit breaker price test restrictions would not impact

310 The Staff estimates that on the average day during this period, approximately 6.0% of stocks would have been impacted by the Rule, which is comprised of 3.4% of stocks that would have triggered the circuit breaker on a given day, plus an additional 2.6% of stocks that would have been affected as a result of having triggered the circuit breaker on the previous day. We note that the actual percentage of stocks affected by the Rule in the future could be different from the historical average, particularly under different market conditions. In particular, the percentage of stocks affected by the Rule is likely to be higher under crisis conditions. For example, the Staff estimates that on October 10, 2008 approximately 68.1% of stocks would have traded under a short sale price test during part or all of the day while on November 24, 2006 approximately 0.6% of stocks would have traded under a short sale price test during part or all of the day. The S&P 500 Index was down nearly 15% on October 10, 2008 from the closing price two days earlier while the S&P 500 Index was nearly flat on November 24, 2006 from the closing price two days earlier. The estimates are calculated based on data from CRSP US Stock Database ©2009 Center for Research in Security Prices (CRSP), The University of Chicago Booth School of Business.

311 The period from 2004 to 2006 exhibited low daily volatility as measured by the S&P 500 index. The estimates are calculated based on data from CRSP US Stock Database ©2009 Center for Research in Security Prices (CRSP), The University of Chicago Booth School of Business.

312 See, e.g., Proposal, 74 FR at 18065, 18069.

trading in the majority of securities, and so would preserve the benefits of legitimate short selling, such as the provision of liquidity and price efficiency, in those securities.[313]

Although we recognize commenters' concerns that a 10% trigger level may capture some "normal" trading activity, commenters' estimates and the Staff's analysis show that a 10% circuit breaker threshold generally should affect only a limited percentage of covered securities. This supports the conclusion that Rule 201 provides a tailored approach that reaches a limited subset of covered securities that are experiencing a significant intra-day price decline, while generally not restricting short selling in the majority of covered securities. Thus, by including a 10% trigger level in Rule 201, the Rule will not interfere with trading in the majority of securities most of the time, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising. In addition, we note that a circuit breaker approach is more targeted than applying a short sale price test restriction on a permanent, market-wide basis, and that any circuit breaker approach needs to have a line drawn.

Further, we are concerned that setting a trigger level higher than 10% would undermine our goals of helping to prevent short selling from being used as a tool to exacerbate a price decline in a particular security and of increasing investor confidence because so few securities would, on average, trigger a threshold higher than 10%.[314] The 10% threshold for a circuit breaker that, when triggered, results in all short selling in a covered security being subject to the alternative uptick rule strikes a balance between the need to restrict short selling in moments of significant intra-day price declines in a covered security and the market participant's expectation that its short selling strategy will normally be available in an efficient and open marketplace. Thus,

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313 See, e.g., Proposal, 74 FR at 18065, 18069; see also Proposal, 74 FR at 18104 ("By targeting only those securities that experience severe intraday declines, all three proposed circuit breaker rules would be narrowly tailored so that most stocks would not fall under any new short sale restrictions.").

314 See supra notes 305 to 311 (discussing the limited number of securities that would, on an average day, trigger a circuit breaker with a 10% threshold).

we have determined that a 10% trigger level strikes the right balance among our goals of facilitating the smooth functioning of the markets, preserving investor confidence, and preventing abusive market practices.

Although we recognize commenters' concerns that a 10% trigger level may be reached more frequently for lower priced securities, at this time we have determined not to set a higher trigger level for lower priced securities, or to base the trigger on other characteristics of a security. Varying the trigger level according to characteristics of individual securities would complicate and increase costs with respect to implementation of, compliance with, and regulatory oversight of, Rule 201. Moreover, contrary to the concerns of commenters, we believe that having a trigger level that is reached more frequently for lower priced stocks may be beneficial. As stated in the Staff's Summary Pilot Report, during the Pilot, the Staff found some evidence that short sale price tests dampened intra-day volatility in the smallest market capitalization stocks, which tend to have lower share prices than larger market capitalization stocks.[315] Thus, a trigger level that is reached more frequently for lower priced stocks may impose the alternative uptick rule in those situations where it is more likely to dampen volatility and achieve our goals in adopting short sale price test restrictions.

In response to our request for comment,[316] some commenters asked that we clarify how to determine the official price from which to measure a price decline and to designate from where that price will come.[317] In addition, a number of commenters expressed concerns that measuring the trigger level from the prior day's closing price for a security would result in a short selling restriction being applied as the result of a price change caused by the overnight

315 See Staff's Summary Pilot Report at 55-56, 81.

316 See Proposal, 74 FR at 18066, 18079.

317 See, e.g., letter from SIFMA (June 2009).

release of material news or other significant events outside of trading hours.[318] Several commenters asked that the percentage decline be measured from the covered security's opening price rather than the prior day's closing price.[319] One commenter specified that the opening price should be the official opening price distributed by a SIP,[320] while other commenters stated that it should be the opening price on the covered security's primary market.[321] One commenter stated that the opening print should not be included in the measurement of the trigger level.[322] Other commenters, however, supported our proposal to measure the decline from the previous day's closing price.[323] One commenter noted that measuring the trigger level from the previous day's closing price might be easier to implement in connection with a policies and procedures approach.[324]

As discussed in more detail in Section III.A.6. below, Rule 201(b)(3) provides that the listing market for each covered security must determine whether a covered security's price has declined by 10% or more such that it is subject to the short sale price test restrictions of Rule 201

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318 See, e.g., letter from Citadel et al. (June 2009); letter from GETCO (June 2009); letter from Goldman Sachs (June 2009); letter from Lime Brokerage (June 2009); letter from SIFMA (June 2009); letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); letter from Hudson River Trading; letter from Virtu Financial; see also letter from CBOE (June 2009) (stating that the opening price would take into account after hours news and avoid disorderly openings, particularly on options settlement dates).

319 See, e.g., letter from Knight Capital (June 2009); letter from Citadel et al. (June. 2009); letter from GETCO (June 2009); letter from Goldman Sachs (June 2009); letter from Lime Brokerage (June 2009); letter from SIFMA (June 2009); letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from Hudson River Trading.

320 See letter from Virtu Financial.

321 See, e.g., letter from Goldman Sachs (June 2009); letter from SIFMA (June 2009).

322 See letter from SIFMA (June 2009).

323 See, e.g., letter from IBC; letter from Nasdaq OMX Group (Oct. 2009).

324 See letter from SIFMA (June 2009); see also letter from Glen Shipway (June 2009) (noting that basing the trigger level on the previous day's closing price "certainly would be a price mechanism easier to track and to comprehend by market participants").

and such information must be disseminated to the trading centers via the applicable single plan processor.[325]

As set forth in Rule 201(b)(1), we have determined that it is appropriate to measure the price decline from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In the proposed circuit breaker rules, we proposed that the decline in a covered security's price would be measured from the security's last price as reported in the consolidated system during regular trading hours on the prior day.[326] After considering the comments, we believe that the closing price as determined by the covered security's listing market as of the end of regular trading hours on the prior day will provide a more accurate price from which to measure a decline in price than the last price reported in the consolidated system. We believe that the last price reported in the consolidated system is more likely to reflect an anomalous trade, e.g, a trade that is not consistent with the current market due to, for example, the 90 second reporting window, or an uncorrected error. Listing markets generally have in place specific procedures designed to ensure the accuracy and reliability of their closing prices.[327] Thus, we believe it is appropriate to use the more accurate closing price as determined by the covered security's listing market rather than the last price reported in the consolidated system.

We also believe that the price decline in a covered security under Rule 201(b)(1)(i) should be measured from the covered security's closing price reported on the prior day rather

[325] See Rule 201(b)(3); see also infra Section III.A.6. Rule 201(a)(6) provides that "[t]he term plan processor shall have the same meaning as in §242.600(b)(55)." Rule 600(b)(55) of Regulation NMS states: "Plan processor means any self-regulatory organization or securities information processor acting as an exclusive processor in connection with the development, implementation and/or operation of any facility contemplated by an effective national market system plan." The single plan processors are "exclusive processors" as defined under Section 3(a)(22) of the Exchange Act. 17 CFR 242.600(b)(55). See 15 U.S.C. 78c(a)(22).

[326] See Proposal, 74 FR at 18110 – 18113.

[327] See, e.g., NYSE Rule 116.40; NYSE Rule 123C(3).

than from each day's opening price for the covered security because the closing price provides a clearly discernible price and time from which to measure the decline. The closing price of a covered security will be known by or shortly after the end of regular trading hours such that the listing markets will have a price on the following day from which to determine if a covered security is subject to the short sale price test restrictions of Rule 201. An opening price, on the other hand, is established only if there is opening interest for a security, which, for thinly traded securities, may present issues. In addition, as noted by one commenter, we believe that measuring the price decline from the closing price on the prior day is preferable because it should be easier to implement than a requirement to measure the decline from the covered security's opening price.[328] For example, should any uncertainties in price occur, using the closing price as a measurement will provide time to resolve any such uncertainties before the requirements of Rule 201 will potentially apply. If the Rule required that the decline must be measured from the opening price, any uncertainties would have to be resolved in real time, so that if a 10% or more price decline were to occur, the short sale price test restrictions of Rule 201 could be applied that day in accordance with the Rule.

As noted above, under Rule 201(b), once the circuit breaker has been triggered, the price test restriction will remain in place for the remainder of the day and for the following day. This requirement differs from the proposed circuit breaker rules that would have applied a short selling halt or short sale price test restriction for the remainder of the day only.

In response to our request for comment on the duration of the proposed circuit breaker rules, comments were mixed. For example, one commenter suggested that the Commission should consider extending the duration of the short selling restriction through the close of trading

[328] See letter from SIFMA (June 2009).

on the trading day following the triggering of the circuit breaker to allow sufficient time to achieve the Commission's intended purpose of "halting or slowing a price decline in a security."[329] Some commenters supported the proposed period for the circuit breaker of the remainder of the trading day[330] for various reasons, including that the limited duration would mitigate the potential adverse impact of a short selling restriction.[331] In addition, several commenters supported a circuit breaker with a duration of less than the remainder of the trading day.[332]

One commenter, however, stated that the circuit breaker should not be in effect for multiple days, but also that it should not be in effect for a matter of hours because "frequent changes in the status of a security would create more disruption."[333] Several commenters who supported a circuit breaker with a duration of less than the remainder of the trading day stated that the circuit breaker should be lifted if the security's price has recovered and the price decline is less than 10% before the end of the trading day.[334] These commenters stated, among other things, that such a recovery may be a common occurrence[335] and that lifting the circuit breaker

329 See letter from RBC (June 2009); see also letter from Credit Suisse (Mar. 2009).

330 See, e.g., letter from Direct Edge (June 2009) (stating that the circuit breaker should be limited in duration to the end of the trading day with respect to the proposed circuit breaker halt rule); letter from AIMA; letter from Goldman Sachs (June 2009).

331 See, e.g., letter from AIMA; see also letter from Direct Edge (June 2009) (opposing a circuit breaker duration beyond one trading day specifically with respect to a circuit breaker triggering a short selling halt); letter from Barclays (June 2009); letter from Goldman Sachs (June 2009).

332 See letter from Barclays (June 2009); letter from Citadel et al. (June 2009); letter from SIFMA (June 2009); see also letter from Jordan & Jordan (providing data regarding the extent to which securities with an "on/off" trigger recovered by the end of trading).

333 Letter from Goldman Sachs (June 2009).

334 See letter from Barclays (June 2009); letter from SIFMA (June 2009).

335 See letter from SIFMA (June 2009).

would take into account the resilience of the markets.[336] Another commenter stated that the circuit breaker should only be in effect long enough to re-establish equilibrium between buying and selling interests and further noted that the duration of the circuit breaker should depend on the time of day when the threshold is triggered.[337]

Some commenters supported the Commission's proposal that a circuit breaker would not be triggered if the 10% trigger level were reached in a covered security within thirty minutes of the end of regular trading hours.[338] Other commenters, however, stated that the last thirty minutes of the day has become the most volatile part of the day and that this is exactly the time that a rule that would slow short selling and reduce volatility would be most needed.[339]

After considering the comments, we believe it is appropriate to apply the alternative uptick rule, when triggered, for the remainder of the day and the day following the day on which the circuit breaker is triggered. We believe that a circuit breaker that is in effect for the remainder of the day and the following day will have the advantage of being more effective at preventing short selling from being used as a tool to exacerbate a security's decline in price. As we, and several commenters, have noted, because the alternative uptick rule will permit short selling only at a price above the current national best bid, it will likely be the most effective of the proposed price tests at preventing short selling from driving down further a security's price or from exacerbating a price decline.[340] A circuit breaker that will impose a short selling

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336 See letter from Barclays (June 2009).

337 See letter from Citadel et al. (June 2009).

338 See letter from Barclays (June 2009); letter from Citadel et al. (June 2009).

339 See, e.g., letter from Jibralta Merrill, dated May 5, 2009; letter from Arthur Porcari, dated May 11, 2009; letter from IBC; letter from STA (June 2009).

340 See letter from Wells Fargo (Sept. 2009); letter from STA (Sept. 2009); letter from Glen Shipway (Sept. 2009); letter from BATS (Sept. 2009).

restriction for only the remainder of the trading day, or as some commenters suggested, for less than the remainder of the trading day, may not allow sufficient time for the short selling restriction to have its desired effect. To the extent that short selling is causing or contributing to downward price pressure, a longer duration will provide additional time during which the security will be subject to reduced downward price pressure from short selling. In addition, we note that the circuit breaker could be triggered at any point during regular trading hours. Further, as noted by one commenter, we are concerned that if the circuit breaker is triggered late in the day, such that it would be in effect for only a short period of time, this would in fact create more disruption rather than achieving our goals with respect to short sale price test restrictions for that security.[341] By applying the short sale price test restriction for the day following the day on which it is triggered, the time period will help ensure that there is not unnecessary disruption caused by the triggering of the circuit breaker.

As discussed above, the Commission has previously noted that circuit breakers may benefit the market by allowing participants an opportunity to re-evaluate circumstances and respond to volatility.[342] We believe that imposing a short selling restriction for the remainder of the day and the following day will help ensure that market participants have a reasonable opportunity to become aware of, and respond to, a significant decline in a security's price, and will provide sufficient time to re-establish market efficiency in the individual security. Although, for the reasons discussed above, we believe it is necessary to impose the short sale price test restriction of Rule 201 for longer than the remainder of the day, we do not believe it is appropriate to extend the duration beyond the time period specified in Rule 201 because we believe that the duration specified in Rule 201 strikes

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341 See supra note 333 and accompanying text.

342 See supra note 275 and accompanying text.

the appropriate balance between achieving our goals in adopting Rule 201 and not causing unnecessary market disruption.

In the Proposal, we stated that to avoid market disruption that may occur if a circuit breaker is triggered late in the trading day, the proposed circuit breaker rules would not be triggered if the specified market decline threshold is reached in a covered security within thirty minutes of the end of regular trading hours.[343] As noted above, because the short sale price test restriction of Rule 201 will remain in place for the remainder of the day and the following day, we have determined not to include a provision in Rule 201 stating that the Rule's restrictions will not be triggered if the 10% trigger level is reached in a covered security within thirty minutes of the end of regular trading hours. We believe it is appropriate to apply Rule 201 during the last thirty minutes of regular trading hours because, due to potential volatility during this period, it is a time period when a covered security's price may experience a significant decline.

Consistent with the Proposal, we have determined to apply the price test restriction, if triggered, during periods when the national best bid is calculated and disseminated on a current and continuing basis by a plan processor.[344] As discussed above and as we discussed in the Proposal,[345] market information for quotes in covered securities is disseminated pursuant to two different national market system plans, the CQ Plan and Nasdaq UTP Plan.[346] Quotation information is made available pursuant to the CQ Plan between 9:00 a.m. and 6:30 p.m. ET,

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[343] See Proposal, 74 FR at 18066.

[344] See Rule 201(b).

[345] See Proposal, 74 FR at 18060, 18064-18065.

[346] See supra note 199 and accompanying text. See also 17 CFR 242.603(b). Rule 603 of Regulation NMS requires that every national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, on quotations for and transactions in NMS stocks.

while one or more participants is open for trading. In addition, quotation information is made available pursuant to the CQ Plan during any other period in which any one or more participants wish to furnish quotation information to the Plan.[347] Quotation information is made available by the Nasdaq UTP Plan between 9:30 a.m. and 4:00 p.m. ET. The Nasdaq UTP Plan also collects, processes, and disseminates quotation information between 4:00 a.m. and 9:30 a.m. ET, and after 4:00 p.m. when any participant is open for trading, until 8:00 p.m. ET.[348] During the time periods in which these Plans do not operate, real-time quote information is not collected, calculated and disseminated.

In response to our request for comment,[349] one commenter stated that any price test restriction should be applied during regular trading hours only because the period when the current national best bid is calculated, collected and disseminated "can vary depending on whether a participant in the particular national market system governing quote consolidation for a security decides to pay the consolidator to extend the hours of the calculation of the bid."[350] In contrast, other commenters stated that the proposed price test restrictions should apply at all times during after-hours trading.[351] Because the short sale price test restrictions of Rule 201 are based on the current national best bid, we believe that the restrictions should apply at all times when the current national best bid is collected, calculated and disseminated even though this period can vary depending on whether a participant in the particular national market system

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347 See http://www.nyxdata.com/cta.

348 See http://www.utpdata.com/docs/UTP_PlanAmendment.pdf.

349 See, e.g., Proposal, 74 FR at 18060.

350 Letter from Credit Suisse (Sept. 2009); see also letter from SIFMA (June 2009); letter from Goldman Sachs (June 2009); letter from T. Rowe Price (June 2009).

351 See, e.g., letter from Michael Sigmon, Chairman, Sigmon Wealth Management, dated Apr. 14, 2009; letter from IBC.

governing quote consolidation for a security decides to pay the consolidator to extend the hours of the calculation of the bid.[352] Thus, the price test restrictions of Rule 201 will apply at times when quotation information and, therefore, the national best bid, is collected, processed, and disseminated pursuant to a national market system plan. We note, however, that at a later time we may reconsider whether any changes to Rule 201 would be necessary to also apply the Rule to short selling during times when the national best bid is not collected, calculated and disseminated, in light of any new information on short selling activity during these times.

6. Determination Regarding Securities Subject to Rule 201 and Dissemination of Such Information

In the Proposal, we requested comment regarding who should be responsible for monitoring the price declines of individual securities to determine if they trigger the short selling circuit breaker, such as broker-dealers or SROs, how such information should be disseminated to the market, and who should be responsible for disseminating the information.[353] In response to our request for comment, some commenters stated that if we were to adopt a circuit breaker rule, securities subject to the Rule should be tracked and disseminated by the SIP for the covered security in question, noting that SIPs currently track and disseminate percentage moves[354] and that such a role would be consistent with the responsibilities of a SIP to collect, process, distribute and publish information with respect to transactions in, or quotations for, any security for which it acts as a SIP

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352 We note that currently, the period during which the current national best bid is collected, calculated and disseminated can vary depending on whether a participant in the particular national market system governing quote consolidation for a security has decided to pay the consolidator to extend the hours of the calculation of the bid.

353 See Proposal, 74 FR at 18078.

354 See, e.g., letter from Virtu Financial (also stating that the SIPs would add a flag to their data feeds that would announce when the circuit breaker is in effect).

on a current and continuing basis.[355] One commenter stated that it would be inappropriate to allow each market to perform its own calculation or to impose the responsibility on a particular market due to the importance of ensuring that triggering of a circuit breaker is communicated to all markets and market participants on a fair, impartial and timely basis.[356] Other commenters stated that the listing market for a covered security should communicate the triggering of the circuit breaker to the SIP for the covered security, which would then redistribute such information to the market.[357] Another commenter stated that the exchanges should be required to develop and maintain "a centralized real-time list of all securities subject to the circuit breaker price test."[358] This commenter stated that it believes this centralization "would ensure consistent treatment of orders and help reduce the costs of compliance for market participants."[359] One commenter stated that as an alternative to the listing market notifying the SIP for a covered security when the circuit breaker has been triggered, trading centers could arrange to receive this information directly from the listing market.[360]

After considering the comments, we have determined that the listing market for each covered security must determine whether that covered security is subject to Rule 201.[361] Rule 201(a)(3) defines the term "listing market" to have the same meaning as the term "listing

355 See letter from NYSE Euronext (Sept. 2009); see also letter from SIFMA (June 2009) (stating that some of its member firms "believe that exchange-controlled SIPs should monitor prices and disseminate information flags when a security is in short sale mode . . .").

356 See letter from NYSE Euronext (Sept. 2009).

357 See, e.g., letter from Direct Edge (June 2009); letter from Liquidnet; letter from FIF (June 2009); letter from Manisha Kimmel, Executive Director, Financial Information Forum, dated Sept. 23, 2009 ("FIF (Sept. 2009)").

358 Letter from RBC (June 2009).

359 Id.

360 See letter from Liquidnet.

361 See Rule 201(b)(3).

market" as defined in the effective transaction reporting plan for the covered security.[362] Because the definition of "listing market" is a currently-used definition, we believe users of the Rule will not have difficulty identifying for a security which entity is its listing market.

Currently, there are two effective transaction reporting plans, the CTA Plan, which disseminates transaction information for securities primarily listed on an exchange other than Nasdaq, and the Nasdaq UTP Plan, which disseminates consolidated transaction and quotation information for securities primarily listed on Nasdaq.[363] Each of these Plans includes a definition of "listing market," which definitions we are incorporating by reference into Rule 201. We have determined to incorporate by reference into Rule 201 the definition of "listing market," as that term is defined in the CTA Plan and the Nasdaq UTP Plan,[364] to provide the markets with uniformity with respect to decisions regarding trading restrictions for individual NMS stocks because the listing markets are already familiar with making determinations regarding, and imposing trading restrictions on, individual NMS stocks. For example, listing markets already

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362 Rule 201(a)(2). Rule 201(a)(2) provides that "[t]he term effective transaction reporting plan for a covered security shall have the same meaning as in §242.600(b)(22)." Rule 201(a)(2).

363 See supra note 199 (discussing the joint-industry plans).

364 We note that although the definition of a "listing market" in the CTA Plan and Nasdaq UTP Plan is similar, the Plans differ with respect to how they treat dually listed securities. The CTA Plan states that "the 'listing market' for any Eligible Security shall be that exchange Participant on which the Eligible Security is listed. If an Eligible Security is dually listed, 'listing market' shall be that exchange Participant on which the Eligible Security was originally listed." The Nasdaq UTP Plan states that "'Listing Market' for an Eligible Security means the Participant's Market on which the Eligible Security is listed. If an Eligible Security is dually listed, Listing Market shall mean the Participant's Market on which the Eligible Security is listed that also has the highest number of the average of the reported transactions and reported share volume for the preceding 12-month period. The Listing Market for dually-listed Eligible Securities shall be determined at the beginning of each calendar quarter." Although there are differences between how each of the Plans determines the listing market for dually listed securities, we do not believe this difference will impact the rule operationally because participants are already familiar with determining the applicable listing market for a covered security.

have rules or policies in place to coordinate trading suspensions or halts in individual NMS stocks.[365]

In addition, requiring the listing market for a covered security to determine whether the security has become subject to the short sale price test restrictions of Rule 201 will help ensure consistency for each covered security with respect to such determinations as only the listing market for that covered security will be making the determination. In addition, we believe that listing markets will be in the best position to respond to anomalous or unforeseeable events that may impact a covered security's price, such as an erroneous trade, because the listing markets generally have in place specific procedures designed to address such events.

As discussed above, in response to our request for comment,[366] some commenters provided comments regarding how information that a covered security has become subject to the short sale price test restrictions of Rule 201 should be disseminated to the markets.[367] In order that all market participants receive information regarding when a security has become subject to Rule 201 on a fair, impartial and timely basis, after considering the comments we have determined to provide in Rule 201(b)(3) that once the listing market has determined that a security has become subject to the requirements of Rule 201, the listing market shall immediately notify the single plan processor responsible for consolidation of information for the covered security in accordance with Rule 603(b) of Regulation NMS[368] of the fact that a covered

[365] See, e.g., Nasdaq Rule 4120 (relating to trading halts in Nasdaq-listed securities); NYSE Rule 123D (relating to delayed openings and trading halts in NYSE-listed securities).

[366] See supra note 353 and accompanying text.

[367] See, e.g., letter from Direct Edge (June 2009); letter from FIF (June 2009); letter from Liquidnet; letter from RBC (June 2009); letter from SIFMA (June 2009); letter from FIF (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from Virtu Financial.

[368] Rule 603(b) of Regulation NMS provides that "Every national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, on

security has become subject to the short sale price test restriction of Rule 201. The plan processor must then disseminate this information.[369]

As discussed above, the CTA Plan disseminates transaction information for securities primarily listed on an exchange other than Nasdaq and the Nasdaq UTP Plan disseminates consolidated transaction and quotation information for securities primarily listed on Nasdaq. In accordance with Rule 603(b) of Regulation NMS, these plans, together with the CQ Plan, provide for the dissemination of all consolidated information for individual NMS stocks through a single plan processor. The single plan processors currently receive information from listing markets regarding trading restrictions (i.e., Regulatory Halts as defined in those plans) on individual securities and disseminate such information. Thus, the requirements of Rule 201(b)(3) are similar to existing obligations on plan processors pursuant to the requirements of Regulation NMS, the CTA and CQ Plans and the Nasdaq UTP Plan.

We recognize that the requirements of Rule 201(b)(3) may require changes to systems currently supported by the single plan processors.[370] Thus, in considering the appropriate implementation period for Rule 201, we have factored into our considerations time to allow the single plan processors to determine any changes to their systems requirements and to make any necessary changes.

7. Policies and Procedures Approach

In the Proposal, we stated that the proposed price test restrictions could be applied in combination with a policies and procedures approach, a prohibition approach, or a combination

quotations for and transactions in NMS stocks. Such plan or plans shall provide for the dissemination of all consolidated information for an individual NMS stock through a single plan processor." 17 CFR 242.603(b).

[369] See Rule 201(b)(3); 17 CFR 242.603(b).

[370] See letter from FIF (June 2009).

thereof.[371] We have determined to adopt a policies and procedures approach in Rule 201(b). Rule 201(b) will require trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of the security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[372] In addition, such policies and procedures must be reasonably designed to impose the short sale price test restriction in Rule 201(b)(1) for the remainder of the day on which it is triggered and on the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[373]

Several commenters stated that any short sale price test restriction should be implemented through a policies and procedures approach.[374] One such commenter stated that a policies and procedures approach "would help promote compliance by all affected parties, distribute compliance and monitoring responsibility, allow flexibility to address inadvertent violations (thus likely resulting in fewer cancellations and trade breaks), and conserve the enforcement resources of agencies and other self-regulatory organizations."[375] Another commenter noted the

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371 See Proposal, 74 FR at 18049.

372 See Rule 201(b)(1)(i).

373 See Rule 201(b)(1)(ii).

374 See, e.g., letter from SIFMA (June, 2009); letter from Goldman Sachs (June 2009); letter from NYSE Euronext (June 2009); letter from T. Rowe Price (June 2009); letter from RBC (June 2009); letter from Schwab; letter from BATS (Sept. 2009); letter from SIFMA (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Virtu Financial; letter from Goldman Sachs (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from Otrade; letter from Citadel et al. (Sept. 2009); letter from MFA (Oct. 2009).

375 Letter from Citadel et al. (Sept. 2009); see also letter from AIMA.

"smooth implementation" and "successful operation" of Regulation NMS, which also uses a policies and procedures approach, and stated that a policies and procedures approach for Rule 201 will "allow for a smoother transition into full implementation as well as a more flexible rule where triggers based on circuit breakers are being contemplated."[376]

Some commenters stated that any short sale price test restriction should be implemented with a policies and procedures approach as well as a straight prohibition approach.[377] In supporting this combination approach, one such commenter noted that a policies and procedures approach would be consistent with Regulation NMS, permit trading centers the flexibility to tailor such policies and procedures to their particular markets, and permit broker-dealers to manage their order flow. At the same time, this commenter stated that a prohibition approach would be familiar to market participants and will give the Commission direct enforcement authority over violations.[378]

In contrast, some commenters stated that a short sale price test restriction, if adopted, should be implemented with a straight prohibition approach only. For example, one commenter stated that a straight prohibition approach is preferable because "[v]ariations in policies and procedures would lead some to believe certain market participants are less vigilant than others."[379] Another said a straight prohibition approach would be easier for market participants

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376 Letter from Virtu Financial; see also letter from MFA (Oct. 2009) (stating that it believes that "implementation concerns would be minimized if executing market centers (or any broker using an intermarket sweep order) surveil for compliance as they could leverage existing architecture developed to comply with the order protection rule in Reg. NMS (Rule 611)").

377 See, e.g., letter from GE; letter from Wachtell; letter from Amer. Bankers Assoc.

378 See letter from GE; see also letter from Wachtell.

379 Letter from Wells Fargo (Sept. 2009).

to implement and understand.[380] In addition, several commenters expressed support for a rule that would "prohibit" short selling on a down-bid (or down-tick)[381] or expressed that they did not support a policies and procedures approach.[382]

We recognize some commenters' preference that a short sale price test restriction be adopted with a straight prohibition approach or in combination with a straight prohibition approach because it is the approach taken under former Rule 10a-1 and, therefore, is familiar to market participants. Further, some commenters noted there can be variations in policies and procedures. As discussed in more detail below, however, we have determined to adopt in Rule 201(b)(1) a policies and procedures approach rather than a straight prohibition approach (or a combination thereof) because this alternative is similar to the policies and procedures approach under Regulation NMS and, therefore, market participants are familiar with a policies and procedures approach and can build on such policies and procedures in implementing Rule 201. In addition, a policies and procedures approach provides flexibility to trading centers and their customers in managing order flow because it allows trading centers, together with their customers, to determine how to handle orders that are not immediately executable or displayable by the trading center because the order is impermissibly priced. This flexibility potentially allows for the more efficient functioning of the securities markets than a rule that applies a straight prohibition approach.

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380 See, e.g., letter from Amer. Bankers Assoc. We note that this commenter also expressed support for a policies and procedures requirement for trading centers.

381 See, e.g., letter from Sigmon Wealth Management (June 2009); letter from James V. Kelly, President, Kelly Capital Management, LLC, dated June 2, 2009 ("Kelly Capital"); letter from Larry Chlebina, President, Ryan Stine, VP Portfolio Strategist, Chlebina Capital Management, LLC, dated May 29, 2009.

382 See, e.g., letter from Theresa Kinley, dated May 14, 2009; see also letter from James Rothenberg.

In addition, we note that the Commission and SROs will carefully monitor whether trading centers' policies and procedures are reasonably designed to prevent short selling in violation of Rule 201. To the extent that a trading center's policies and procedures permit any execution or display of a short sale order not in accordance with the requirements of the Rule, such trading center's policies and procedures may not be reasonable and could subject the trading center to enforcement action. Further, any conduct by trading centers, or other market participants, that facilitates short sales in violation of Rule 201 could also lead to liability for aiding and abetting or causing a violation of Regulation SHO, as well as potential liability under the anti-fraud and anti-manipulation provisions of the federal securities laws, including Sections 9(a), 10(b), and 15(c) of the Exchange Act, and Rule 10b–5 thereunder.

Under Rule 201(b)(1), a trading center will be required to have written policies and procedures reasonably designed to prevent the execution or display of short sale orders at a price that is less than or equal to the current national best bid when the price of a covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In addition, such policies and procedures must be reasonably designed to impose the short sale price test restriction of Rule 201(b)(1)(i) for the remainder of the day and the following day. Thus, a trading center's policies and procedures must require that a trading center be able to determine when a covered security is subject to the short sale price test restriction of Rule 201. As discussed above, due to the importance of ensuring that the triggering of the requirements of Rule 201 is communicated to all market participants on a fair, impartial and timely basis, we believe it is appropriate for the listing market for the covered security to determine whether that security is subject to the requirements of Rule 201 and, if it is, for such information to be disseminated to the market by the single plan processor. Thus, a trading center's policies and procedures must be reasonably designed so that the trading center is able to obtain such information from the single plan processor if the covered security becomes subject to the Rule's requirements.

Upon receipt of a short sale order for a covered security that is subject to the Rule's requirements, a trading center's policies and procedures must ensure that the trading center is able to determine whether or not the short sale order can be executed or displayed in accordance with the provisions of Rule 201(b)(1). If the order is marketable at a permissible price, the trading center may present the order for immediate execution or, if not immediately marketable, hold it for execution later at its specified price.

Rule 201(b)(1) permits a trading center to display an order provided it is permissibly priced at the time the trading center displays the order. If an order is impermissibly priced, the trading center could, in accordance with policies and procedures reasonably designed to prevent the execution or display of a short sale order at a price that is less than or equal to the current national best bid, re-price the order upwards to the lowest permissible price and hold it for later execution at its new price or better.[383] As quoted prices change, in accordance with Rule 201(b)(1), a trading center may repeatedly re-price and display an order at the lowest permissible price down to the order's original limit order price (or, if a market order, until the order is filled).

In addition, paragraph (b)(1)(iii)(A) of Rule 201 requires a trading center's policies and procedures to be reasonably designed to permit a trading center to execute a displayed short sale order at a price that is less than or equal to the current national best bid provided that, at the time the order was initially displayed by the trading center it was permissibly priced, i.e., not at a

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[383] For example, if a trading center receives a short sale order priced at $47.00 when the current national best bid in the security is $47.00, the trading center could re-price the order at the permissible offer price of $47.01, and display the order for execution at this new limit price.

price that was less than or equal to the then-current national best bid.[384] As discussed in the Proposal, this exception for properly displayed short sale orders will help avoid a conflict between Rule 201 and the "Quote Rule" under Rule 602 of Regulation NMS.[385] The Quote Rule requires that, subject to certain exceptions, the broker-dealer responsible for communicating a quotation shall be obligated to execute any order to buy or sell presented to him, other than an odd lot order, at a price at least as favorable to such buyer or seller as the responsible broker-dealer's published bid or published offer in any amount up to his published quotation size.[386] Thus, pursuant to this exception, a trading center will be able to comply with the "firm quote" requirement of Rule 602 of Regulation NMS by executing a presented order to buy against its displayed offer to sell as long as the displayed offer to sell was permissibly priced under Rule 201 at the time it was first displayed, even if the execution of the transaction will be at a price that is less than or equal to the current national best bid at the time of execution.[387]

Because a trading center can re-price and display a previously impermissibly priced short sale order, the policies and procedures approach of Rule 201, as noted by one commenter,[388]

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[384] See Rule 201(b)(1)(iii)(A).

[385] See Proposal, 74 FR at 18051.

[386] See 17 CFR 242.602(b)(2). We note that to the extent that a short sale order is un-displayed, Rule 201 will prevent the trading center from executing the order unless at the time of execution, the execution price complies with the Rule.

[387] We note that such a conflict between the Quote Rule and Rule 201 should be relatively infrequent. If a displayed order to sell shares is at a price that is less than or equal to the national best bid, this would result in a crossed or locked market. In accordance with Rule 610(d) of Regulation NMS, each national securities exchange and national securities association must establish, maintain, and enforce written rules that require its members reasonably to avoid: displaying quotations that lock or cross any protected quotation in an NMS stock, displaying manual quotations that lock or cross any quotation in an NMS stock disseminated pursuant to an effective national market system plan; are reasonably designed to assure reconciliation of locked or crossed quotations in an NMS stock; and prohibit its members from engaging in a pattern or practice of displaying quotations that lock or cross any protected quotation, or other quotation, in an NMS stock, unless an exception in such rules applies. See 17 CFR 242.610(d).

[388] See, e.g., letter from Citadel et al. (Sept. 2009) (noting that a policies and procedures approach is favorable to a strict prohibition approach in that it "would help promote compliance" and "address inadvertent violations" of Rule 201).

potentially allows for the more efficient functioning of the markets than a rule that applies a straight prohibition approach. Another commenter noted that while a prohibition approach could provide "bright lines" as to the acceptability of trades, such an approach would result in an "inordinate number" of trades being cancelled by trading centers.[389] Because trading centers will not have to reject or cancel impermissibly priced orders unless instructed to do so by the trading center's customer submitting the short sale order, we believe that the policies and procedures approach of Rule 201 will provide more flexibility to trading centers and their customers and result in more efficient markets. We recognize, however, that some trading centers might not want to re-price an impermissibly priced short sale order. Thus, re-pricing is not a requirement under Rule 201.

In addition, as noted by commenters, Rule 201 will provide trading centers and their customers with flexibility in determining how to handle orders that are not immediately executable or displayable by the trading center because the order is impermissibly priced. For example, trading centers can offer their customers various order types regarding the handling of impermissibly priced orders such that a trading center can either reject an impermissibly priced order or re-price the order upwards to the lowest permissible price until the order is filled.

As proposed and as adopted, Rule 201(b)(2) requires trading centers to regularly surveil to ascertain the effectiveness of the policies and procedures required by Rule 201(b)(1) and to take prompt action to remedy deficiencies in such policies and procedures.[390] As one commenter noted, this provision places trading centers in the position of determining whether an execution complies with the requirements of Rule 201(b)(1).[391] Thus, short sale orders executed or

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389 Letter from STA (June 2009).

390 See Rule 201(b)(2).

391 See letter from Wolverine.

displayed at impermissible prices will require the trading center that executed or displayed the short sales to take prompt action to remedy any deficiencies.

The policies and procedures requirements of Rule 201(b)(1) are similar to those set forth under Regulation NMS.[392] In accordance with Regulation NMS, trading centers must have in place written policies and procedures in connection with that Regulation's Order Protection Rule.[393] Thus, as we stated in the Proposal, trading centers are already familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.[394] Several commenters agreed with the Commission's view that this familiarity should reduce the implementation time and costs of the Rule on trading centers.[395]

As discussed in the Proposal,[396] similar to the requirements under Regulation NMS in connection with the Order Protection Rule, at a minimum, a trading center's policies and procedures must enable a trading center to monitor, on a real-time basis, the national best bid, so as to determine the price at which the trading center may execute or display a short sale order. In addition, as proposed, a trading center must have policies and procedures reasonably designed to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national

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392 See Regulation NMS Adopting Release, 70 FR 37496; see also 17 CFR 242.611.

393 See id.

394 See Proposal, 74 FR at 18051 – 18052.

395 See, e.g., letter from Amer. Bankers Assoc.; letter from Schwab; letter from Credit Suisse (Sept. 2009); letter from GE; letter from Goldman Sachs (June 2009); letter from NYSE Euronext (June 2009); letter from SIFMA (June 2009); letter from T. Rowe Price (June 2009); letter from Virtu Financial (noting familiarity with the policies and procedures approach of Regulation NMS should reduce the implementation costs of Rule 201).

396 See Proposal, 74 FR at 18052.

best bid.[397] A trading center's policies and procedures will not, however, have to include mechanisms to determine on which provision a broker-dealer is relying in marking an order "short exempt" in accordance with paragraph (c) or (d) of Rule 201.[398] We note that we did not receive comments that specifically discussed a trading center's policies and procedures with respect to the monitoring, on a real-time basis, of the national best bid, or its policies and procedures related to orders marked "short exempt."

As discussed in the Proposal,[399] a trading center must also take such steps as will be necessary to enable it to enforce its policies and procedures effectively. For example, trading centers may establish policies and procedures that include regular exception reports to evaluate their trading practices. If a trading center's policies and procedures include exception reports, any such reports will need to be examined by the trading center to affirm that a trading center's policies and procedures have been followed by its personnel and properly coded into its automated systems and, if not, promptly identify the reasons and take remedial action. In addition, we note that one commenter stated, and we agree, that as a means for developing an effective set of policies and procedures for compliance with the provisions of Rule 201, trading centers should conduct "regular post-trade analysis."[400] Another commenter stated that significant oversight of policies and procedures is necessary to prevent trades from being directed toward venues that become known for lax supervision regarding compliance with Rule 201.[401]

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397 See Rule 201(b)(1)(iii)(B); see also infra Section III.B. (discussing short sale orders marked "short exempt").

398 See infra Section III.B.; see also Rules 201(c) and 201(d)

399 See Proposal, 74 FR at 18052.

400 See letter from Jordan & Jordan.

401 See letter from STA (June 2009). We note that to the extent that a trading center is lax with respect to its supervision regarding Rule 201, such trading center could be subject to enforcement action. In addition, the

To help ensure compliance with Rule 201, as discussed in the Proposal,[402] trading centers may also have policies and procedures that will enable a trading center to have a record identifying the current national best bid at the time of execution or display of a short sale order. Such "snapshots" of the market will aid SROs in evaluating a trading center's written policies and procedures and compliance with Rule 201. In addition, such snapshots will aid trading centers in verifying that a short sale order was priced in accordance with the provisions of proposed Rule 201(b)(1) if bid "flickering," i.e., rapid and repeated changes in the current national best bid during the period between identification of the current national best bid and the execution or display of the short sale order, creates confusion regarding whether or not the short sale order was executed or displayed at a permissible price. Snapshots of the market at the time of execution or display of an order will also aid trading centers in dealing with time lags in receiving data regarding the national best bid from different data sources. A trading center's policies and procedures will be required to address latencies in obtaining data regarding the national best bid. In addition, to the extent such latencies occur, a trading center's policies and procedures will need to implement reasonable steps to monitor such latencies on a continuing basis and take appropriate steps to address a problem should one develop.

Some commenters requested clarification regarding whether, in determining the current national best bid, trading centers and/or broker-dealers, as applicable, may rely on the current national best bid as disseminated by proprietary feeds as well as the current national best bid disseminated by SIPs.[403] In addition, several commenters indicated that trading centers and/or

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Commission and SROs will monitor whether trading centers adequately monitor their compliance with Rule 201 as part of their examinations.

[402] See Proposal, 74 FR at 18052.

[403] See, e.g., letter from Glen Shipway (Sept. 2009); see also letter from Credit Suisse (June 2009); letter from FIF (June 2009); letter from Goldman Sachs (June 2009); letter from Lime Brokerage (June 2009); letter from RBC

broker-dealers should be required to rely on one source of the national best bid,[404] such as the current national best bid disseminated by SIPs.[405] One commenter stated that "[s]uch centralization would ensure consistent treatment of orders,"[406] and another commenter stated that it would "eliminate redundant effort across broker-dealers and maintain uniformity across exchanges."[407] Other commenters, however, questioned whether a unitary data feed would be beneficial, stating that "[e]ven utilizing a unitary data feed would be problematic, however, given the 'flickering' that occurs,"[408] and that latencies in the receipt of data by market participants is of concern, "even if they are working with the same SIP or exchange feed."[409] Another commenter noted concerns with respect to market disruption as a result of a single mandated data feed, stating that "the entire market could be disrupted significantly by a single point of failure at the aggregator."[410]

We recognize commenters' concerns regarding the potential impact that receiving national best bid information from different data feeds might have on the application of Rule 201, including latencies that may occur in receiving such information from different data feeds.[411] We do not believe, however, that it is appropriate to mandate that the receipt of the

(June 2009); letter from SIFMA (June 2009); letter from Direct Edge (June 2009); letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Lime Brokerage (Sept. 2009); letter from Qtrade.

404 See, e.g., letter from FIF (June 2009); letter from RBC (June 2009); letter from NYSE Euronext (Sept. 2009).

405 See, e.g., letter from FIF (June 2009); letter from NYSE Euronext (Sept. 2009); see also letter from Direct Edge (June 2009).

406 Letter from RBC (June 2009).

407 Letter from FIF (June 2009).

408 Letter from Direct Edge (June 2009).

409 Letter from Lime Brokerage (June 2009); see also letter from Lime Brokerage (Sept. 2009).

410 Letter from Credit Suisse (June 2009).

411 See infra Section X.B.1.b.i. and Section X.B.1.b.ii. (discussing the potential impact of not mandating receipt of the current national best bid from one particular data feed on the implementation costs of Rule 201).

current national best bid must be from any one particular data feed because a policies and procedures approach that provides for a "snapshot" of the applicable current national best bid will allow trading centers to deal with time lags in receiving data regarding the national best bid from different data sources. Thus, Rule 201 does not require modifications to how data feeds are currently received.

As discussed in the Proposal, trading centers will be required to conduct regular surveillance of their policies and procedures under Rule 201. Specifically, Rule 201(b)(2) provides that a trading center must regularly surveil to ascertain the effectiveness of the policies and procedures required under the Rule and must take prompt action to remedy deficiencies in such policies and procedures.[412] This provision will reinforce the requirement of Rule 201(b)(1) to maintain and enforce policies and procedures by explicitly assigning an affirmative responsibility to trading centers to surveil to ascertain the effectiveness of their policies and procedures.[413] Thus, under the Rule, trading centers may not merely establish policies and procedures that may be reasonable when created and assume that such policies and procedures will continue to satisfy the requirements of Rule 201(b). Rather, trading centers will be required to regularly assess the continuing effectiveness of their policies and procedures and take prompt action when needed to remedy deficiencies. In particular, trading centers will need to engage in regular and periodic surveillance to determine whether executions or displays of short sale orders on impermissible bids are occurring without an applicable exception and whether the trading center has failed to implement and maintain policies and procedures that would have reasonably prevented such impermissible executions or displays of short sale orders. We note that, although

[412] See Rule 201(b)(2).

[413] We note that Rule 611(a)(2) of Regulation NMS contains a similar provision for trading centers. See 17 CFR 242.611(a)(2).

discussed in the Proposal, we did not receive comments that specifically addressed the requirement that trading centers must conduct regular surveillance of their policies and procedures under Rule 201.

B. "Short Exempt" Provisions of Rule 201

In the Proposal, we proposed that a trading center's policies and procedures must be reasonably designed to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order otherwise met the short sale price test restrictions.[414] In addition, we included provisions in the Proposal that set out circumstances under which a broker-dealer could mark a sale order as "short exempt."[415]

After considering the comments and consistent with the Proposal, we have determined to include in Rule 201(b)(1)(iii)(B) a requirement that a trading center's policies and procedures must be reasonably designed to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.[416] We have also determined to include in Rule 201(c) and (d) provisions that specify the circumstances under which a broker-dealer may mark certain sale orders as "short exempt" so that a trading center may execute or display such orders without regard to whether they are priced in accordance with the requirements of Rule 201(b).[417] The

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[414] See, e.g., Proposal, 74 FR at 18107, 18111.

[415] See, e.g., Proposal, 74 FR at 18108, 18111-18112. We note that we proposed provisions relating to when a broker-dealer may mark a sale order as "short exempt." In discussing the "short exempt" marking provisions in paragraphs (c) and (d) of Rule 201, we set forth below how and why the provisions, as adopted, differ from the provisions as set forth in the proposed circuit breaker with modified uptick rule because that rule most closely resembles Rule 201, as adopted. To that end, we note that the circumstances under which a sale order may be marked as "short exempt" are contained in paragraphs (c) and (d) of Rule 201, as adopted, whereas such circumstances were contained in paragraphs (d) and (e) of the proposed circuit breaker with modified uptick rule.

[416] See Rule 201(b)(1)(iii)(B).

[417] See Rule 201(c); 201(d).

provisions contained in paragraphs (c) and (d) of Rule 201 are designed to promote the workability of the Rule, while at the same time furthering the Commission's goals.

The provisions contained in paragraph (d) of Rule 201 parallel exceptions to former Rule 10a-1 and exemptive relief granted pursuant to that rule.[418] These exceptions and exemptions from former Rule 10a-1 had been in place for several years. As we noted in the Proposal, we believe that the rationales underlying these exceptions and exemptions from former Rule 10a-1 still hold true today.[419] Moreover, due to the limited scope of these exceptions and exemptions, we do not believe that including them will undermine the Commission's goals for adopting Rule 201. To the extent that commenters addressed our inclusion of these exceptions and exemptions, we discuss such comments below.

A number of commenters stated that if we were to adopt a form of short sale price test restriction, it should include exceptions beyond those that we proposed in the Proposal and Re-Opening Release, particularly if we were to adopt a short sale price test restriction based on the alternative uptick rule.[420] Some commenters stated that the exceptions included in the Proposal and the Re-Opening Release were insufficient, stating that broader and/or additional exceptions would be necessary to, among other things, provide stability and liquidity to the market[421] and so as not to impair price discovery.[422] For example, commenters requested exceptions for activity

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418 See Proposal, 74 FR at 18054 (discussing how the "short exempt" marking provisions of the proposed modified uptick rule would parallel exceptions to former Rule 10a-1 and exemptive relief granted pursuant to that rule).

419 See Proposal, 74 FR at 18054-18059.

420 See, e.g., letter from SIFMA (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from EWT (Sept. 2009); letter from GETCO (Sept. 2009).

421 See, e.g., letter from SIFMA (June 2009); letter from NYSE Euronext (June 2009).

422 See, e.g., letter from NYSE Euronext (June 2009).

excepted from, or necessary to comply with, Regulation NMS.[423] Commenters also requested an exception for exchange traded funds ("ETFs") and similar broad-based indices and baskets of stocks.[424] Some commenters requested exceptions for short sales in connection with the facilitation of capital raising transactions, through stock issuances and convertible instruments, by issuers and selling shareholders.[425] In connection with convertible instruments, commenters stated that there needs to be an exception from any short sale price test restriction to allow investors purchasing a convertible instrument to hedge their long exposure.[426] Other exceptions requested relate to automated electronic buy-side trading,[427] bona fide hedging generally,[428] "exchange for physicals" transactions,[429] index expirations,[430] and market on open[431] and market on close orders.[432]

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423 See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009); letter from Goldman Sachs (June 2009). We note that where a broker-dealer is routing an inter-market sweep order ("ISO") solely to facilitate its execution of a customer's long sale in compliance with Rule 611, such ISOs may be marked as "short exempt." This will allow the destination trading centers to execute the orders against better-priced protected quotations without regard to the short sale price test restrictions of Rule 201. Such ISOs must not be marked as "long."

424 See, e.g., letter from SIFMA (June 2009); letter from NYSE Euronext (June 2009); letter from MFA (June 2009); letter from RBC (June 2009); letter from ICI (June 2009); letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from ISDA; letter from NYSE Euronext (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from Knight Capital (Sept. 2009); letter from Virtu Financial; letter from EWT (Sept. 2009).

425 See, e.g., letter from SIFMA (June 2009); see also letter from ISDA.

426 See, e.g., letter from SIFMA (June 2009).

427 See, e.g., letter from MFA (June 2009).

428 See, e.g., letter from MFA (June 2009); letter from Credit Suisse (June 2009); letter from ISDA; letter from John K. Robinson, General Counsel, P. Schoenfeld Asset Management LP, dated July 2, 2009 ("P. Schoenfeld Asset Management").

429 See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009).

430 See, e.g., letter from SIFMA (June 2009).

431 See, e.g., letter from RBC (June 2009); letter from Goldman Sachs (June 2009); letter from Goldman Sachs (Sept. 2009).

432 See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009); letter from Credit Suisse (June 2009); letter from EWT (Sept. 2009); letter from Goldman Sachs (June 2009); letter from Goldman Sachs (Sept. 2009). We also note that some commenters stated that we should include a marking error exception in connection with

In addition, as discussed in more detail in Section III.B.9. below, commenters requested an exception for short sales by market makers engaged in bona fide market making activities, including market makers in OTC and listed derivatives, options, convertibles and ETFs, and block positioners.[433]

Several commenters, however, stated that the Commission should be cautious of adopting numerous exceptions and discussed problems that may arise from adopting a short sale price test restriction with many or complex exceptions, such as additional implementation difficulties, greater compliance costs, lack of uniformity that may cause unfair application of the rule, increased opportunities for gaming and abuse, and, overall, a less effective rule that only applies

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any short sale price test restriction we adopt. See, e.g., letter from RBC (June 2009); letter from SIFMA (June 2009). In connection with the proposed uptick rule, we proposed an exception for any sale by a broker-dealer of a covered security for an account in which it has no interest, pursuant to an order marked "long." See Proposal, 74 FR at 18109. This exception would have applied where a broker-dealer effects a sale of an order marked "long" by another broker-dealer, but the order was mis-marked such that it should have been marked as a short sale order. We do not believe that a similar exception is necessary under Rule 201 because Rule 201, unlike the proposed uptick rule, is based on a policies and procedures approach rather than a straight prohibition approach. Thus, if a trading center's written policies and procedures are reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid, it is unlikely that such trading center's participation in any violation of the Rule due to a mis-marking by a broker-dealer could be knowing or reckless. See Proposal, 74 FR at 18063. As we stated in the Proposal, knowledge may be inferred where a broker-dealer has previously accepted orders marked "long" from the same counterparty that required borrowed shares for delivery or that resulted in a "fail to deliver." See Proposal, 74 FR at 18063 n.212; see also 2004 Regulation SHO Adopting Release, 69 FR at 48019, n.111 (stating that "[i]t may be unreasonable for a broker-dealer to treat a sale as long where orders marked 'long' from the same customer repeatedly require borrowed shares for delivery or result in 'fails to deliver.' A broker-dealer also may not treat a sale as long if the broker-dealer knows or has reason to know that the customer borrowed shares being sold.").

433 See, e.g., letter from SIFMA (June 2009); letter from NYSE Euronext (June 2009); letter from Knight Capital (June 2009); letter from EWT (June 2009); letter from STANY (June 2009); letter from Credit Suisse (June 2009); letter from CBOE (June 2009); letter from RBC (June 2009); letter from Citadel et al. (June 2009); letter from NYSE Euronext (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from Virtu Financial; letter from EWT (Sept. 2009); letter from Credit Suisse (Sept. 2009). Some commenters also asked for an exception for, or clarification that, a short sale price test restriction would not apply to short sales pursuant to all options assignments and exercises. See, e.g., letter from SIFMA (June 2009); letter from CBOE (June 2009); letter from Boston Options Exchange, Chicago Board Options Exchange, International Securities Exchange, Nasdaq Options Market, Nasdaq OMX PHLX, NYSE Amex, NYSE Arca and The Options Clearing Corporation, dated June 22, 2009 ("Boston Options Exchange et al. (June 2009)"); letter from RBC (June 2009). We note that because short sales pursuant to options exercises and assignments (whether or not automatic) are unrelated to the current national best bid, Rule 201 does not apply to such sales.

to a limited numbers of short sales.[434] Commenters stated that a short sale price test restriction with numerous exceptions will create loopholes and a rule that is easy to circumvent, thus resulting in a rule that applies to little trading activity and fails to serve the purpose for which it was adopted.[435] One commenter stated that emphasis should first be placed on "a sales price restriction on short sales, its possible effects on helping restore a measure of price continuity, and its possible deleterious effects on informational efficiency . . . with exceptions to be evolved as time goes by and as the industry petitions for them."[436] Another commenter noted that a short sale price test restriction with many exceptions will impose additional burdens on the Commission's inspection staff, which will be tasked with "retracing transactions to discern which were eligible for exceptions, which were not, and if any were disguised."[437]

In addition, one commenter noted that the exceptions that accompany any price test restriction will be driven by the approach adopted.[438] This commenter noted that a permanent, market-wide approach may necessitate more exceptions than one triggered by a temporary circuit

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434 See, e.g., letter from Paladin Investment; letter from Douglas M. Branson, W. Edward Sell Professor of Business Law, University of Pittsburgh School of Law, dated June 10, 2009 ("Prof. Branson"); letter from Wells Fargo (June 2009); letter from CPIC (June 2009); letter from IAG; letter from IBC; letter from Jordan & Jordan; letter from Kelly Capital; letter from Lime Brokerage (June 2009); letter from Millennium; letter from Hudson River Trading; letter from Lime Brokerage (Sept. 2009); letter from Glen Shipway (Sept. 2009); letter from Qtrade.

435 See, e.g., letter from Paladin Investment; letter from Prof. Branson; letter from CPIC (June 2009); letter from Wells Fargo (June 2009); letter from IBC (June 2009); letter from Jordan & Jordan; letter from Lime Brokerage (June 2009); letter from Millennium.

436 Letter from Prof. Branson.

437 Letter from CPIC (June 2009).

438 See, e.g., letter from ICI (June 2009).

breaker.[439] This commenter further noted that "a circuit breaker short sale ban may necessitate more or different exceptions than a circuit breaker that still permits short selling to occur."[440]

Although, as noted above, commenters requested a variety of exceptions in addition to those set forth in the Proposal, at this time, we have determined to include in Rule 201(c) and (d) only the "short exempt" marking provisions that we proposed. We believe that these limited provisions will help ensure the smooth functioning of the markets while at the same time not undermining our goals for adopting Rule 201.

In addition, we note that a number of commenters that discussed the need for additional and/or broader exceptions referenced the absence of some of the requested exceptions during the Short Sale Ban Emergency Order[441] and the effect on market quality of the Short Sale Ban Emergency Order in the absence of such exceptions.[442] These commenters noted the absence from the Short Sale Ban Emergency Order of exceptions for certain convertible arbitrage or hedging activities[443] and for automated electronic buy-side trading.[444] We note, however, that unlike the Short Sale Ban Emergency Order, which halted all short selling in the securities subject to the emergency order for its three-week duration, the short sale restrictions of Rule 201 will apply for a limited duration and will only apply to a covered security if such security has experienced a significant intra-day price decline (of 10% or more). Thus, Rule 201 will not

439 See letter from ICI (June 2009).

440 Letter from ICI (June 2009).

441 See supra Section II.C. (discussing the Short Sale Ban Emergency Order).

442 See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009); letter from CPIC (June 2009); letter from Goldman Sachs (June 2009); letter from MFA (June 2009).

443 See, e.g., letter from RBC (June 2009) (attaching and discussing letter from Philip Taylor and Scott DeCanio, Directors, RBC Capital Markets Corp., dated Sept. 25, 2008); letter from CPIC (June 2009); letter from Goldman Sachs (June 2009); letter from SIFMA (June 2009); letter from MFA (June 2009).

444 See, e.g., letter from MFA (June 2009).

impact trading in the vast majority of covered securities on an average day.[445] If a covered security becomes subject to the short sale price test restrictions of Rule 201 it will occur because that security's price is experiencing extreme downward price pressure and it is these securities that Rule 201 is designed to address by helping to prevent short selling from being used as a tool to exacerbate its price decline. If, as requested by commenters, we were to expand the scope of short selling activities that would not be subject to Rule 201, we are concerned such exceptions could undermine this goal of Rule 201.

In addition, although short selling will be restricted if the price of a covered security decreases by 10% or more, in contrast to securities subject to the Short Sale Ban Emergency Order, Rule 201 will still permit short selling in the covered security even when the restriction is in place, although at a price above the current national best bid. Thus, short sellers engaged in the various activities for which commenters are requesting additional or expanded exceptions will continue to be able to sell short even when the price test restriction is in effect. In addition, the restriction on short selling will be in place for a limited duration, that is, the remainder of the day on which the circuit beaker level is triggered and the following day, further reducing the need for additional exceptions.

We also note that with respect to ETFs, although under former Rule 10a-1 the Commission issued limited exemptive relief for certain ETFs via authority delegated to the Staff, that relief was issued on a case-by-case basis for a permanent, market-wide short sale price test rule.[446] Since the elimination of former Rule 10a-1, there has been a significant growth in ETF

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[445] See supra Section III.A.5. (discussing analyses regarding the number of securities that will trigger the circuit breaker on an average day).

[446] See, e.g., letter from Racquel L. Russell, Esq., Branch Chief, Office of Trading Practices and Processing, Division of Market Regulation, to George T. Simon, Esq., Foley & Lardner LLP, dated June 21, 2006; letter from James A. Brigagliano, Assistant Director, Division of Market Regulation, to Claire P. McGrath, Vice President and Special Counsel, Amex, dated Aug. 17, 2001. We note that each of the approvals for relief under

trading volume and an expansion in different structures of ETF products.[447] Commenters who opposed an exception for these products noted the growth in ETF trading volume and new ETF products among the reasons not to provide an exception for ETFs from any short sale price test restriction.[448] We do not believe that a general ETF exception is necessary because the circuit breaker approach of Rule 201 will generally result in the majority of ETFs not being subject to its short sale price test restrictions because ETFs are generally diversified, whereas single stocks are not. If such securities do become subject to its restrictions, the restrictions will be in place for a limited duration and will continue to permit short selling even when in place.

For the reasons discussed above, at this time we believe it is appropriate to limit the scope and number of circumstances under which a broker-dealer may mark a sell order as "short exempt." We recognize, however, the concerns raised by commenters and note that to help ensure the future workability of Rule 201, or for other reasons, we may reconsider whether certain exceptions or exemptions are warranted.

1. Broker-Dealer Provision

After the 10% circuit breaker is triggered for a covered security, Rule 201(c) will permit a broker-dealer submitting a short sale order for the covered security to a trading center to mark the order "short exempt" if the broker-dealer identifies the order as being at a price above the

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former Rule 10a-1 was conditioned on the ETF meeting certain enumerated conditions, either specific to certain products or included as part of a broader "class exemption."

447 See, e.g., Investment Company Institute, 2009 Investment Company Fact Book, (49 ed.); National Stock Exchange, NSX Annouces Record January ETF Trading Volume Surpasses $2.2 Trillion, News & Views, Feb. 14, 2008 available at http://www.nsx.com/content/news/story/90.

448 See, e.g., letter from Robert E. Koza, dated May 4, 2009; letter from Robert W. Angove, President, Santiam Mountain Investment, dated May 5, 2009; letter from David Tarrell, dated May 6, 2009; letter from Mitchel Schlesinger, Principal, FBB Capital Partners, dated May 8, 2009; letter from Paladin Investment; letter from Shelby Frisch, dated May 15, 2009; letter from Robert Cannataro, dated June 5, 2009; letter from High Street Advisors; letter from European Investors (June 2009); letter from Ascendant Capital; letter from Kelly Capital; letter from European Investors (Sept. 2009); letter from NAREIT.

current national best bid at the time of submission.[449] We have modified this provision from the Proposal to clarify that a broker-dealer may only mark an order as "short exempt" after the circuit breaker has been triggered for a covered security.[450] In addition, consistent with the Proposal, Rule 201(c) requires any broker-dealer relying on this provision to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the requirements of Rule 201(c) and requires the broker-dealer regularly to surveil to ascertain the effectiveness of these policies and procedures, and to take prompt action to remedy deficiencies.[451]

As discussed above, in response to our request for comment,[452] several commenters stated that if we were to adopt a short sale price test restriction, it should include a broker-dealer provision.[453] One commenter stated that the broker-dealer provision is necessary to prevent contradictory requirements for broker-dealers under Regulation NMS and Regulation SHO.[454]

Other commenters disagreed, stating that they do not think that the broker-dealer provision is necessary. One commenter pointed to problems that may arise from the provision, such as increasing the potential for confusion in the marketplace, creating an unlevel playing field, and penalizing participants who have the most efficient market data infrastructures.[455]

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449 See Rule 201(c).

450 We have also made technical modifications to Rule 201(c) to reflect that it is the broker-dealer submitting the order that must also mark the order as "short exempt" and to reflect the difference in operation of the alternative uptick rule from the proposed circuit breaker with modified uptick rule.

451 See Rule 201(c).

452 See Proposal, 74 FR at 18073-18074.

453 See, e.g., letter from SIFMA (June 2009); letter from BATS (May 2009); letter from EWT (Sept. 2009); letter from Qtrade.

454 See letter from EWT (Sept. 2009).

455 See letter from Lime Brokerage (June 2009).

Commenters also noted that the broker-dealer provision has the potential to greatly increase costs to the industry and to adversely impact the ability of smaller broker-dealers to compete.[456] One commenter stated that, what it termed a "requirement," that broker-dealers maintain "snapshots," may impose significant costs, including costs associated with technology, data storage, and surveillance and review and that the Commission's cost estimates of over $100,000 per broker-dealer "seem to underestimate the cost to large, full service broker-dealers, since the volume of orders handled by these firms are likely to lead to significantly greater technology and storage costs alone as well as more frequent reviews."[457] We note that, as discussed in the Proposal and in more detail below, we believe that "snapshots" of the market could aid broker-dealers in complying with Rule 201(c), but Rule 201 does not "require" such snapshots.[458]

Another commenter expressed the belief that a majority of broker-dealer participants that service customer orders will want to take advantage of the provision to remain competitive and to ensure that client orders receive the best possible execution, which will result in many non-trading center participants becoming subject to market data "snapshotting" and other compliance-related changes.[459]

After considering the comments, as discussed above, we have determined to include in Rule 201(c) a provision to permit a broker-dealer submitting a short sale order for a covered security to a trading center after the circuit breaker is triggered for a covered security, to mark the order "short exempt" if the broker-dealer identifies the order as being at a price above the

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[456] See letter from STANY (June 2009); letter from Lime Brokerage (June 2009); letter from NSCP.

[457] Letter from NSCP.

[458] See Proposal, 74 FR at 18054 – 18055.

[459] See letter from Lime Brokerage (June 2009).

current national best bid at the time of submission.[460] Rule 201(c) will provide broker-dealers with the option to manage their order flow, rather than having to always rely on their trading centers to manage their order flow on their behalf.

Although we recognize commenters' concerns, including regarding potential increased costs to the industry with respect to technology, data storage and surveillance, we note that most broker-dealers may already have developed "snapshot" capability in connection with Regulation NMS's Order Protection Rule. We also agree that "snapshot" capability will require data storage by broker-dealers; however, as noted by one commenter,[461] because the alternative uptick rule does not require sequencing of the national best bid, the data storage requirements under the alternative uptick rule are lower than they would be under the proposed modified uptick rule or the proposed uptick rule. In addition, we believe that the costs of a policies and procedures approach that provides for a snapshot of the applicable current national best bid of the security are justified because snapshot capability will aid broker-dealers in dealing with time lags in receiving data regarding the national best bid from different data sources and facilitate verification of whether a short sale order was executed or displayed at a permissible price.

In addition, we note that this provision will not undermine our goals for short sale regulation because any broker-dealer marking an order "short exempt" in accordance with this provision must have mechanisms in place to enable the broker-dealer to identify the short sale order as priced in accordance with the provisions of Rule 201(c). In accordance with Rule 201(c)(1), these mechanisms must include written policies and procedures reasonably designed to prevent the incorrect identification of orders as being permissibly priced in accordance with

460 See Rule 201(c).

461 See letter from STA (Sept. 2009).

the provisions of 201(c).[462] Thus, although a broker-dealer relying on this provision in marking an order "short exempt" will not need to identify the order as permissibly priced to the trading center, it will need to have written policies and procedures in place reasonably designed to enable it to identify that an order was permissibly priced at the time of submission of the order to a trading center.[463] We believe these policies and procedures will further our goals by helping to ensure that short sale orders are not incorrectly marked as "short exempt," and, thereby, helping to preclude impermissible short sales from being executed when the price test restriction has been triggered.[464]

At a minimum, a broker-dealer's policies and procedures must be reasonably designed to enable a broker-dealer to monitor, on a real-time basis, the national best bid, so as to determine the price at which the broker-dealer may submit a short sale order to a trading center in compliance with the provisions of Rule 201(c). To ensure compliance with Rule 201(c), a broker-dealer may also have policies and procedures that will enable it to have a record identifying the current national best bid at the time of submission of a short sale order. Such "snapshots" of the market will also aid SROs in evaluating a broker-dealer's written policies and procedures and compliance with Rule 201(c). In addition, such snapshots will aid broker-dealers in verifying that a short sale order was priced in accordance with the provisions of Rule 201(c) if bid flickering during the period between identification of the current national best bid and the submission of the short sale order to a trading center creates confusion regarding whether or not the short sale order was submitted at a permissible price. Snapshots of the market at the time of

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462 See Rule 201(c)(1).

463 Such policies and procedures should be similar to those required for trading centers complying with paragraph (b) of Rule 201.

464 We also note that it would be a violation of Rule 200(g) to mark a short sale order as "short exempt" when a security is not subject to the alternative uptick rule.

submission of an order will also aid broker-dealers in dealing with time lags in receiving data regarding the national best bid from different data sources. Under Rule 201(c)(2), latencies in obtaining data regarding the national best bid will need to be addressed.[465] In addition, to the extent such latencies occur, a broker-dealer's policies and procedures will need to implement reasonable steps to monitor such latencies on a continuing basis and take appropriate steps to address a problem should one develop.

Surveillance will be a required part of a broker-dealer's satisfaction of its legal obligations. Rule 201(c)(2) provides that a broker-dealer must regularly surveil to ascertain the effectiveness of the policies and procedures required under Rule 201(c)(1) and must take prompt action to remedy deficiencies in such policies and procedures.[466] This provision will reinforce the on-going maintenance and enforcement requirements of Rule 201(c) by explicitly assigning an affirmative responsibility to broker-dealers to surveil to ascertain the effectiveness of their policies and procedures.[467] Thus, under paragraphs (c)(1) and (c)(2) of Rule 201, broker-dealers may not merely establish policies and procedures that may be reasonable when created and assume that such policies and procedures will continue to satisfy the requirements of the Rule. Rather, broker-dealers will be required to regularly assess the continuing effectiveness of their procedures and take prompt action when needed to remedy deficiencies. In particular, each broker-dealer will need to engage in regular and periodic surveillance to determine whether it is submitting short sale orders marked "short exempt" without complying with the requirements of

[465] See Rule 201(c)(2).

[466] See id.

[467] We note that Rule 611(a)(2) of Regulation NMS contains a similar surveillance provision. See 17 CFR 242.611(a)(2).

Rule 201(c) and whether the broker-dealer has failed to implement and maintain policies and procedures that would have reasonably prevented such impermissible submissions.

A broker-dealer will also need to take such steps as will be necessary to enable it to enforce its policies and procedures effectively.[468] For example, broker-dealers may establish policies and procedures that include regular exception reports to evaluate their trading practices. If a broker-dealer's policies and procedures include exception reports, any such reports will need to be examined to affirm that a broker-dealer's policies and procedures have been followed by its personnel and properly coded into its automated systems and, if not, promptly identify the reasons and take remedial action.

2. Seller's Delay in Delivery[469]

We are adopting Rule 201(d)(1) without modification to provide that a broker-dealer may mark an order "short exempt" if the broker-dealer has a reasonable basis to believe that the seller owns the security being sold and that the seller intends to deliver the security as soon as all restrictions on delivery have been removed.[470] Specifically, Rule 201(d)(1) provides that a broker-dealer may mark a short sale order "short exempt" if the broker-dealer has a reasonable basis to believe the short sale order of a covered security is by a person that is "deemed to own"

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468 See Rule 201(c)(2).

469 We note that we have modified paragraph (d) of Rule 201 from that provision as proposed to reflect that a broker-dealer may only mark an order as "short exempt" pursuant to the provisions in paragraph (d) after the circuit breaker has been triggered for a covered security.

470 Subsection (e)(1) of former Rule 10a-1 contained an exception relating to a seller's delay in the delivery of securities. The provision in Rule 201(d)(1) parallels the exception in former Rule 10a-1(e)(1).

the covered security pursuant to Rule 200 of Regulation SHO,[471] provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.[472]

Rule 200(g)(1) of Regulation SHO provides that a sale can be marked "long" only if the seller is deemed to own the security being sold and either (i) the security is in the broker-dealer's physical possession or control; or (ii) it is reasonably expected that the security will be in the broker-dealer's possession or control by settlement of the transaction.[473] Thus, even where a seller owns a security, if delivery will be delayed, such as in the sale of formerly restricted securities pursuant to Rule 144 of the Securities Act of 1933,[474] or where a convertible security, option, or warrant has been tendered for conversion or exchange, but the underlying security is not reasonably expected to be received by settlement date, such sales must be marked "short." As a result, Rule 201(d)(1) is necessary to allow for sales of securities that, although owned, are subject to the provisions of Regulation SHO governing short sales due solely to the seller being unable to deliver the covered security to its broker-dealer prior to settlement based on

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471 See 17 CFR 242.200(a) – (f) (defining the term "deemed to own").

472 See Rule 201(d)(1). This provision is also consistent with Rule 203(b)(2)(ii) and Rule 204(a)(2) of Regulation SHO. Rule 203(b)(2)(ii) provides an exception from the "locate" requirement of Rule 203(b)(1) of Regulation SHO for "[a]ny sale of a security that a person is deemed to own pursuant to §242.200, provided that the broker or dealer has been reasonably informed that the person intends to deliver such security as soon as all restrictions on delivery have been removed…". Rule 204(a)(2) provides additional time to close out fails to deliver "[i]f a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security resulting from a sale of a security that person is deemed to own pursuant to §242.200 and that such person intends to deliver as soon as all restrictions on delivery have been removed, the participant shall, by no later than the beginning of regular trading hours on the thirty-fifth consecutive calendar day following the trade date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity." We note that to the extent that an exception to Regulation SHO's locate requirement applies to a short sale order, such order must be marked "short" in accordance with Rule 200(g) of Regulation SHO unless the order can be marked "short exempt" pursuant to Rule 200(g)(2) of Regulation SHO.

473 See 17 CFR 242.200(g)(1).

474 17 CFR 230.144.

circumstances outside the seller's control. In response to our request for comment, commenters that specifically addressed this provision were supportive of it.[475]

After considering the comments, we believe it is appropriate to adopt Rule 201(d)(1) as proposed. This provision is consistent with the goals of Rule 201 and with other provisions of Regulation SHO related to sales of securities that although owned are subject to the provisions of Regulation SHO governing short sales. Thus, we are adopting Rule 201(d)(1) such that the provision will apply to the sale of any covered securities that a seller is deemed to own pursuant to Rule 200 of Regulation SHO and cannot deliver by settlement date based on circumstances outside the seller's control, provided the seller intends to deliver the securities as soon as all restrictions on delivery have been removed.[476]

3. Odd Lot Transactions

We are adopting in Rule 201(d)(2), without modification, the ability for a broker-dealer to mark a short sale order as "short exempt" if the broker-dealer has a reasonable basis to believe

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[475] See, e.g., letter from BATS (May 2009); letter from SIFMA (June 2009); letter from Jesse D. Hill, Director of Regulatory Relations, Office of Regulatory Counsel, Edward Jones, dated Sept. 21, 2009 ("Edward Jones"); letter from NYSE Euronext (Sept. 2009).

[476] Such circumstances could include the situation where a convertible security, option or warrant has been tendered for conversion or exchange, but the underlying security is not reasonably expected to be received by settlement date. See Regulation SHO Adopting Release, 69 FR at 48015; see also 17 CFR 242.200(b) (defining when a person shall be "deemed to own" a security). In addition, we understand that sellers that own restricted equity securities that wish to sell such securities pursuant to an effective registration statement pursuant to Rule 415 under the Securities Act of 1933 experience similar types of potential settlement delays as those persons selling Rule 144 securities. Thus sales of such securities pursuant to Rule 415 may be marked "short exempt" in accordance with Rule 201(d)(1) if the securities subject to the sale are outstanding at the time they are sold, and the sale occurs after the registration statement has become effective. In addition, and as noted by one commenter, we understand that sales made pursuant to broker-dealer assisted cashless exercises of compensatory options to purchase a company's securities may result in potential settlement delays that would otherwise require the seller to mark such sales "short" pursuant to the definition under Rule 200(g) of Regulation SHO. Such sales may be marked "short exempt" pursuant to Rule 201(d)(1). See Rule 204 Adopting Release, 74 FR at 38277, n.141; see also 17 CFR 230.415.

that the short sale order is by a market maker to offset a customer odd-lot[477] order or to liquidate an odd-lot position that changes such broker-dealer's position by no more than a unit of trading.[478] In response to our request for comment, commenters that specifically addressed this provision were supportive of inclusion of this provision in any short sale price test restriction.[479]

Under former Rule 10a-1, an exception for certain odd-lot transactions was created in an effort to reduce the burden and inconvenience that short sale restrictions would place on odd-lot transactions. In 1938, the Commission found that odd-lot transactions played a very minor role in potential manipulation by short selling.[480] Initially, sales of odd-lots were not subject to the restrictions of former Rule 10a-1.[481] However, the Commission became concerned over the volume of odd-lot transactions, which possibly indicated that the exception was being used to circumvent the rule. As a result, the exception was changed to include the two odd lot exceptions described below.[482]

Former Rule 10a-1(e)(3) contained a limited exception that allowed short sales by odd-lot dealers registered in the security and by third market makers of covered securities to fill

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477 Rule 201(a)(5) provides that the term "odd lot" shall have the same meaning as in 17 CFR 242.600(b)(49). Rule 600(b)(49) defines an "odd lot" as "an order for the purchase or sale of an NMS stock in an amount less than a round lot." 17 CFR 242.600(b)(49).

478 See Rule 201(d)(2). SRO rules define a "unit of trading" or "normal unit of trading," and the term generally means 100 shares, i.e., a round lot. For example, FINRA Rule 6320A(a)(7) defines a "normal unit of trading" to mean "100 shares of a security unless, with respect to a particular security, FINRA determines that a normal unit of trading shall constitute other than 100 shares." NYSE Rule 55 states that "[t]he unit of trading in stocks shall be 100 shares, except that in the case of certain stocks designated by the Exchange the unit of trading shall be such lesser number of shares as may be determined by the Exchange, with respect to each stock so designated. . . ."

479 See, e.g., letter from BATS (May 2009); letter from SIFMA (June 2009); letter from NYSE Euronext (Sept. 2009).

480 See Former Rule 10a-1 Adopting Release, 3 FR 213.

481 The Commission initially adopted three exceptions for odd-lot transactions. While the first one, excepting all odd-lot transactions, seemed to make other odd-lot exceptions unnecessary, the 1938 adopting release included all three exceptions without discussion. See Former Rule 10a-1 Adopting Release, 3 FR 213.

482 See Exchange Act Release No. 11030 (Sept. 27, 1974), 39 FR 35570 (Oct. 2, 1974) ("1974 Release").

customer odd lot orders. Former Rule 10a-1(e)(4) provided an exception under the rule for any sale to liquidate an odd-lot position by a single round lot sell order that changed the broker-dealer's position by no more than a unit of trading.

Rule 201(d)(2), as proposed and adopted, generally parallels the exceptions in subsections (e)(3) and (e)(4) of former Rule 10a-1. In addition, however, as proposed, we are extending the provision to cover all market makers acting in the capacity of an odd-lot dealer. When former Rule 10a-1 was adopted, odd-lot dealers dealt exclusively with odd-lot transactions, and were so registered. Today, market makers registered in a security typically also act as odd-lot dealers of the security. Thus, as proposed, we are broadening the provision in Rule 201(d)(2) to all broker-dealers acting as "market makers" in odd lots.[483]

We believe that a provision that will allow a broker-dealer to mark a short sale order "short exempt" if it has a reasonable basis to believe that the short sale order is by a market maker to offset a customer odd-lot order or liquidate an odd-lot position that changes such broker-dealer's position by no more than a unit of trading, will continue to be of utility under Rule 201 and will not be in conflict with the goals of the Rule.

Because odd-lot transactions by market makers to facilitate customer orders are not of a size that could facilitate a downward movement in the particular security, we do not believe that Rule 201(d)(2) will adversely affect the goals of short sale regulation that Rule 201 seeks to advance. Thus, we believe that a broker-dealer should be able to mark such orders "short exempt" so that those acting in the capacity of a "market maker," with the commensurate negative and positive obligations, will be able to offset a customer odd-lot order and liquidate an

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483 Section 3(a)(38) of the Exchange Act defines the term "market maker," and includes specialists. See 15 U.S.C. 78c(a)(38).

odd-lot position without a trading center's policies and procedures preventing the execution or display of such orders at a price that is less than or equal to the current national best bid.

4. Domestic Arbitrage

We are adopting in Rule 201(d)(3) without modification the ability for a broker-dealer to mark as "short exempt" short sale orders associated with certain bona fide domestic arbitrage transactions. Although commenters generally stated that a domestic arbitrage provision should be included in any short sale price test restriction, some commenters also stated that the provision, as proposed, should be expanded to cover more trading scenarios.[484] However, one commenter stated that arbitrage activities are not unique in contributing to market efficiency and any short sale price test restriction that the Commission adopts should require few, if any, exceptions to maintain market quality.[485]

As discussed above, the short sale price test restriction adopted in Rule 201(b) will apply to a covered security only after the security has experienced a significant intra-day price decline, will remain in place for a limited period of time, and will continue to permit short selling at a price above the national best bid (rather than, for example, halting all short selling in that security). As such, we do not believe it is appropriate at this time to broaden the scope of the

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484 See, e.g., letter from SIFMA (June 2009) (stating that the exception should cover convertible arbitrage strategies); letter from AIMA (stating that the provisions relating to domestic and international arbitrage are too narrow in scope, and that they should be broadened to include: (1) bona fide strategies and risk management tools that provide necessary market liquidity and efficiency, and (2) other forms of convertible securities that differ from standard American-style convertibles); letter from Credit Suisse (June 2009); letter from Citadel et al. (June 2009) (stating that the exception should be broadened to cover any transaction in connection with domestic arbitrage, even if not contemporaneous in time); letter from RBC (June 2009) (stating that the exception should accommodate convertible arbitrage strategies as well as arbitrage strategies that do not meet the contemporaneous requirement of this provision); letter from MFA (June 2009) (stating that we should broaden the domestic arbitrage provision to include "bona fide hedging transactions," such as risk arbitrage and statistical arbitrage transactions).

485 See letter from Hudson River Trading; see also letter from Liquidnet (expressing concern regarding the complexity of the arbitrage and other exceptions to a short sale price test restriction and concern that the exceptions could result in different rules applying to different industry participants).

domestic arbitrage provision. Due to the already limited scope and applicability of Rule 201, we believe that expanding the domestic arbitrage provision to cover more trading scenarios would undermine our goals in adopting Rule 201. Thus, we are adopting the provision as proposed.

Subsection (e)(7) of former Rule 10a-1 contained an exception related to domestic arbitrage.[486] That exception applied to bona fide arbitrage undertaken to profit from a current difference in price between a convertible security and the underlying common stock.[487] The term "bona fide arbitrage" describes an activity undertaken by market professionals in which essentially contemporaneous purchases and sales are effected in order to lock in a gross profit or spread resulting from a current differential in pricing of two related securities.[488] For example, a person may sell short securities to profit from a current price differential based upon a convertible security that entitles him to acquire a number of securities equivalent to the securities sold short. We continue to believe that bona fide arbitrage activities are beneficial to the markets because they tend to reduce pricing disparities between related securities and, thereby, promote market efficiency.[489]

Rule 201(d)(3) parallels the exception in former Rule 10a-1(e)(7). Specifically, Rule 201(d)(3) provides that a broker-dealer may mark a short sale order of a covered security "short

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486 See Exchange Act Release No. 1645 (Apr. 8, 1938).

487 See 1999 Concept Release, 64 FR 57996.

488 1999 Concept Release, 64 FR at 58001, n.54 and accompanying text (discussing the domestic arbitrage exception under former Rule 10a-1). See also Section 220.6(b) of Regulation T, which states that the term "bona fide arbitrage" means: "(1) A purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable for the purpose of taking advantage of a difference in prices in the two markets; or (2) A purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security together with an offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the prices of the two securities." 12 CFR 220.6(b). See also Exchange Act Release No. 15533 (Jan. 29, 1979), 44 FR 6084 (Jan. 31, 1979) ("1979 Release") (interpretation concerning the application of Exchange Act Section 11(a)(1) to bona fide arbitrage).

489 See 1979 Release, 44 FR 6084.

exempt" if the broker-dealer has a reasonable basis to believe that the short sale order is "for a good faith account of a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer."[490]

The domestic arbitrage exception in former Rule 10a-1 was intended to be consistent with the arbitrage provision of Regulation T.[491] Thus, consistent with that provision, former Rule 10a-1(e)(7) referred to a "special arbitrage account" and not a "good faith account."[492] The Federal Reserve Board amended Regulation T in 1998 to eliminate the "special arbitrage account" and to allow the functions formerly effected in that account to be effected in a "good faith account." Consistent with that language, Rule 201(d)(3) refers to a "good faith account."

Because allowing domestic arbitrage at a price that is less than or equal to the current national best bid will potentially promote market efficiency, we have included in Rule 201 a limited provision to allow broker-dealers to mark short sale orders "short exempt" where the broker-dealer has a reasonable basis to believe that the conditions in proposed Rule 201(d)(3) have been met. Thus, Rule 201 is designed to permit the execution or display of such orders in connection with bona fide arbitrage transactions involving convertible, exchangeable, and other rights to acquire the securities sold short, where such rights of acquisition were originally

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490 Rule 201(d)(3).

491 See 12 CFR 220.6.

492 See Proposal, 74 FR at 18056.

attached to, or represented by, another security, or were issued to all the holders of any such class of securities of the issuer.

5. International Arbitrage

We are adopting Rule 201(d)(4) without modification to allow a broker-dealer to mark as "short exempt" short sale orders associated with certain international arbitrage transactions. In response to our request for comment, commenters were generally supportive of this provision relating to international arbitrage.[493] Some commenters, however, stated that they believe that the provision should be expanded to cover more trading scenarios.[494]

As discussed above, the short sale price test restriction of Rule 201(b) will apply to a covered security only after the security has experienced a significant intra-day price decline, will remain in place for a limited period of time, and will continue to permit short selling at a price above the current national best bid (rather than, for example, halting all short selling in that security). As such, we do not believe it is appropriate at this time to broaden the scope of the international arbitrage provision. Due to the already limited scope and applicability of Rule 201, we believe that expanding the scope of the international arbitrage provision to cover more trading scenarios would undermine our goals in adopting Rule 201 because its scope would be even further limited, thereby risking not achieving our goals in adopting Rule 201. Thus, we are adopting the provision as proposed.

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493 See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009); letter from NYSE Euronext (Sept. 2009); letter from STANY (Sept. 2009).

494 See, e.g., letter from RBC (June 2009) (stating that the exception should accommodate convertible arbitrage strategies as well as arbitrage strategies that do not meet the contemporaneous requirement of this provision); letter from Credit Suisse (June 2009); see also supra note 484 (discussing comments regarding the domestic arbitrage provision).

Former Rule 10a-1(e)(8) included an international arbitrage exception that was adopted in 1939.[495] In adopting the exception, the Commission stated that it was necessary to facilitate "transactions which are of a true arbitrage nature, namely, transactions in which a position is taken on one exchange which is to be immediately covered on a foreign market."[496] We believe likewise that such transactions will have utility under Rule 201. As discussed above in connection with domestic arbitrage, bona fide arbitrage transactions promote market efficiency because they equalize prices at an instant in time in different markets or between relatively equivalent securities.

Rule 201(d)(4) parallels the exception contained in former Rule 10a-1(e)(8). Specifically, Rule 201(d)(4) provides that a broker-dealer may mark a short sale order of a covered security "short exempt" if the broker-dealer has a reasonable basis to believe that the short sale order is "for a good faith account and submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made."[497]

In Rule 201(d)(4), we have simplified the language of former Rule 10a-1(e)(8) to make it more understandable.[498] In addition, we have changed the reference in former Rule 10a-1(e)(8)

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495 See Exchange Act Release No. 2039 (Mar. 10, 1939), 4 FR 1209 (Mar. 14, 1939).

496 See id.

497 Rule 201(d)(4).

498 Former Rule 10a-1(e)(8) provided that the short sale price test restrictions of that rule shall not apply to: "Any sale of a security registered on, or admitted to unlisted trading privileges on, a national securities exchange effected for a special international arbitrage account for the bona fide purpose of profiting [sic] from a current difference between the price of such security on a securities market not within or subject to the jurisdiction of the United States and on a securities market subject to the jurisdiction of the United States; provided the seller at the time of such sale knows or, by virtue of information currently received, has reasonable grounds to believe

from a "special international arbitrage account" to a "good faith account." As discussed above in connection with the domestic arbitrage provision of Rule 201(d)(3), this revision will make the provision consistent with the arbitrage provision in Regulation T.

In addition, as proposed, we have incorporated language from the exception in former Rule 10a-1(e)(12) that provided that, for purposes of the international arbitrage exception, a depository receipt for a security shall be deemed to be the same security represented by the receipt. This language was originally included in the Commission's 1939 release adopting the international arbitrage exception, but was incorporated separately in former Rule 10a-1(e)(12).[499] Although we requested comment in the Proposal regarding whether a depository receipt for a security should be deemed to be the same security represented by the receipt, we did not receive comments specific to this request.[500] As proposed, we are incorporating in Rule 201(d)(4) the language from the exception in former Rule 10a-1(e)(12).[501]

As with the exception in former Rule 10a-1(e)(8), Rule 201(d)(4) will apply only to bona fide arbitrage transactions. Thus, this provision will only be applicable if at the time of the short sale there is a corresponding offer in a foreign securities market, so that the immediate covering purchase will have the effect of neutralizing the short sale. We believe Rule 201(d)(4) is necessary to facilitate arbitrage transactions in which a position is taken in a security in the U.S.

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that an offer enabling him to cover such sale is then available to him in such foreign securities market and intends to accept such offer immediately."

[499] See supra note 495.

[500] See Proposal, 74 FR at 18057.

[501] To the extent that the short sale is of a depository receipt and the seller intends to purchase the same security represented by the depository receipt to immediately cover the short sale of the depository receipt, the sale may be marked "short exempt' provided that the seller reasonably believes at the time of the sale that it will be able to convert the security to be purchased into the depository receipt and deliver the depository receipt by settlement date for the sale.

market, and which is to be immediately covered in a foreign market.[502] Thus, we do not believe that permitting broker-dealers to mark these orders "short exempt" will undermine our goals for adopting Rule 201, and, as described above, we believe facilitating or permitting these transactions has utility in terms of promoting market and pricing efficiency.

6. Over-Allotments and Lay-Off Sales

We have determined to adopt without modification in Rule 201(d)(5) a provision that will permit a broker-dealer to mark as "short exempt" short sale orders by underwriters or syndicate members participating in a distribution in connection with an over-allotment, and any short sale orders for purposes of lay-off sales by such persons in connection with a distribution of securities through a rights or standby underwriting commitment.[503] In response to our request for comment, commenters were generally supportive of inclusion of this provision relating to certain syndicate activity.[504] Some commenters, however, asked that we expand this provision beyond over-allotment and lay-off sales.[505]

As discussed above, the short sale price test restriction of Rule 201(b) will apply to a covered security only after the security has experienced a significant intra-day price decline, will remain in place for a limited period of time, and will continue to permit short selling at a price above the national best bid (rather than, for example, halting all short selling in that security). As such, we do not believe it is appropriate at this time to broaden the scope of the provision relating to over-allotment and lay-off sales. Due to the already limited scope and applicability of

[502] We note that the requirement that the transaction be "immediately" covered on a foreign market requires the foreign market to be open for trading at the time of the transaction. See Proposal, 74 FR at 18057, n.166; see also 2003 Regulation SHO Proposing Release, 68 FR at 62986, n.119.

[503] See Rule 201(d)(5).

[504] See, e.g., letter from BATS (May 2009); letter from SIFMA (June 2009); letter from NYSE Euronext (Sept. 2009).

[505] See, e.g., letter from SIFMA (June 2009).

Rule 201, we believe that expanding the scope of this provision to cover other sales effected in connection with a distribution would undermine our goals in adopting Rule 201 because it would further limit the scope of the Rule, thereby risking not achieving our goals in adopting Rule 201. Thus, we are adopting the provision as proposed. In addition, we note that we are including a "short exempt" marking provision for syndicate and lay-off sales in part because, as discussed further below, we have historically excepted such activity from short sale rules.

Former Rule 10a-1(e)(10) contained an exception for over-allotment and lay-off sales.[506] Although the exception was not adopted until 1974, the Commission's approval of the concept of excepting over-allotments and lay-off sales from short sale rules is long-standing.[507] In addition, we note that recently we excepted these sales from the July Emergency Order, which among other things required that short sellers borrow or arrange to borrow securities prior to effecting a short sale, stating that it was not necessary for the Order to cover such sales because such activity is covered by Regulation M under the Exchange Act,[508] an anti-manipulation rule.[509] In accordance with the long-standing Commission position regarding these sales, we are including in Rule 201(d)(5) a provision to permit broker-dealers to mark as "short exempt" short sale orders in connection with over-allotment and lay-off sales, which provision also parallels the exception in former Rule 10a-1(e)(10).

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506 See 1974 Release, 39 FR 35570.

507 See, e.g., Exchange Act Release No. 3454 (July 6, 1946), in which the Commission approved the NYSE's special offering plan, which permitted short sales in the form of over-allotments to facilitate market stabilization.

508 17 CFR 242.100 et seq.

509 See Exchange Act Release No. 58190 (July 18, 2008), 73 FR 42837 (July 23, 2008) (amending the July Emergency Order to include exceptions for certain short sales).

7. Riskless Principal Transactions

We have determined to adopt without modification in Rule 201(d)(6) a provision that will permit a broker-dealer to mark as "short exempt" short sale orders where broker-dealers are facilitating customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal.[510] In response to our request for comment, commenters that specifically addressed this provision supported its inclusion.[511]

As discussed in the Proposal,[512] in 2005, the Commission, via authority delegated to the Staff, granted exemptive relief under former Rule 10a-1 for any broker-dealer that facilitates a customer buy or long sell order on a riskless principal basis.[513] In granting the relief, the Commission noted representations made in the letter requesting relief that, in the situation where the amount of securities that the broker-dealer purchases for the customer may not be sufficient to give the broker-dealer an overall net "long" position, former Rule 10a-1 would constrain the ability of the broker-dealer to fill the customer buy order. Further, the Commission noted representations in the letter requesting relief that, because such short sales would be effected only in response to a customer buy order, this should vitiate any concerns about such sales having a depressing impact on the security's price.[514]

In addition, the Commission noted representations made in the letter requesting relief that where a broker-dealer is facilitating a customer long sale order in a riskless principal transaction,

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510 See Rule 201(d)(6).

511 See, e.g., letter from BATS (May 2009); letter from SIFMA (June 2009); letter from Credit Suisse (June 2009); letter from NYSE Euronext (Sept. 2009).

512 See Proposal, 74 FR at 18057-18058.

513 See letter from James A. Brigagliano, Assistant Director, Division of Market Regulation, SEC, to Ira Hammerman, Senior Vice President and General Counsel, Securities Industry Association, dated July 18, 2005 ("Riskless Principal Letter").

514 See id.

because the ultimate seller is long the shares being sold, these transactions present none of the potential abuses that former Rule 10a-1 was designed to address.[515] The Commission also noted representations that the application of former Rule 10a-1 to riskless principal transactions involving a customer long sale can inhibit the broker-dealer's ability to provide timely (or any) execution to such customer long sale. Specifically, if the broker-dealer has a net short position, the broker-dealer will be restricted from executing its own principal trade to complete the first leg of the riskless principal transaction.[516] Thus, compliance with former Rule 10a-1 would adversely affect a broker-dealer's ability to provide best execution to a customer order.[517]

Taken together, Rules 201(a)(8) and (d)(6) parallel the conditions for relief in the Riskless Principal Letter.[518] Consistent with the relief granted in the Riskless Principal Letter, we believe that including a provision to permit a broker-dealer to mark "short exempt" short sale orders in connection with riskless principal transactions is appropriate and will not undermine our goals in adopting short sale price test regulation. In particular, we note that such a provision will facilitate a broker-dealer's ability to provide best execution to customer orders. In addition, such provision will apply only where the customer is selling long.

Rule 201(a)(8) defines the term "riskless principal" to mean "a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee, or, after having received an order to

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515 See id.

516 See id.

517 See id.

518 These conditions are also consistent with the definition of "riskless principal transactions" under Rule 10b-18 of the Exchange Act. See 17 CFR 240.10b-18(a)(12).

sell, sells the security as principal at the same price to satisfy the order to sell, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee."[519]

Rule 201(d)(6) provides that a broker-dealer may mark a short sale order "short exempt" if the broker-dealer has a reasonable basis to believe that the short sale order is to effect the execution of a customer purchase or the execution of a customer "long" sale on a riskless principal basis.[520] In addition, Rule 201(d)(6) requires the broker-dealer, if it marks an order "short exempt" under this provision, to have written policies and procedures in place to assure that, at a minimum: (i) the customer order was received prior to the offsetting transaction; (ii) the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and (iii) that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[521]

We believe that Rule 201(d)(6) will provide broker-dealers with additional flexibility to facilitate customer orders and provide best execution. In addition, we believe that the conditions

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519 Rule 201(a)(8). In addition to being consistent with the conditions in the Riskless Principal Letter and Rule 10b-18(a)(12) of the Exchange Act, this definition is consistent with the definition of "riskless principal" in FINRA Rule 6642. See FINRA Rule 6642(d). We note that Rule 201(a)(8), as adopted, is slightly modified from the definition in the Proposal in that we have added language to clarify that the term "same price" shall be exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee. This language is consistent with the conditions in the Riskless Principal Letter and Rule 10b-18(a)(12). It is also consistent with FINRA's trade reporting rules which require a riskless principal transaction in which both legs are executed at the same price to be reported once, in the same manner as an agency transaction, exclusive of any markup, markdown, commission equivalent, or other fee. See FINRA Rule 6380A(d)(3)(B).

520 See Rule 201(d)(6). Due to the modification to the definition of "riskless principal" in Rule 201(a)(8), we have not included in Rule 201(d)(6) the proposed language that stated that the purchase or sell order must be given the same per-share price at which the broker-dealer sold or bought shares to satisfy the facilitated order, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee. See also supra note 519.

521 See Rule 201(d)(6). We note that we determined to adopt, as proposed, in Rule 201(d)(6) an explicit requirement that broker-dealers must establish policies and procedures for handling such transactions to be consistent with the conditions in the Riskless Principal Letter and Rule 10b-18(a)(12), which also contain such a requirement.

set forth in Rule 201(d)(6) will provide a mechanism for the surveillance of the provision's use by linking it to specific incoming orders and executions, and by requiring broker-dealers to establish procedures for handling such transactions. These requirements will help ensure that broker-dealers are complying with Rule 201(d)(6).

8. Transactions on a Volume-Weighted Average Price Basis

We have determined to adopt in Rule 201(d)(7) without modification the ability for a broker-dealer to mark as "short exempt" certain short sale orders executed on a volume-weighted average price ("VWAP") basis. In response to the Proposal, commenters to this provision were supportive of the provision. Some commenters, however, requested that we expand this provision to, for example, cover all benchmark orders, similar to the exception in Rule 611 of Regulation NMS.[522] As discussed above, the short sale price test restriction of Rule 201(b) will apply to a covered security only after the security has experienced a significant intra-day price decline, will remain in place for a limited period of time, and will continue to permit short selling at a price above the current national best bid (rather than, for example, halting all short selling in that security). As such, we do not believe it is appropriate at this time to broaden the scope of the provision relating to transactions on a VWAP basis. Due to the already limited scope and applicability of Rule 201, we believe that expanding the scope of this provision to cover other transactions would undermine our goals in adopting Rule 201 because it would further limit the scope of the Rule, thereby risking not achieving our goals in adopting Rule 201. Thus, we are adopting the provision as proposed.

[522] See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009); see also letter from Goldman Sachs (June 2009); letter from ICI (June 2009) (stating that a broadened exception would be necessary to facilitate execution of the types of large orders executed by institutional investors and that such benchmark orders do not raise concerns of manipulation or negative market effects that a short sale price test restriction would be designed to prevent); letter from Credit Suisse (Sept. 2009) (positing that the exception should be extended to cover any orders executed on a similar formulaic basis as VWAP orders).

Under former Rule 10a-1, the Commission, via authority delegated to the Staff, granted limited relief from that rule in connection with short sales executed on a VWAP basis.[523] The relief was limited to VWAP transactions that are arranged or "matched" before the market opens at 9:30 a.m., but are not assigned a price until after the close of trading when the VWAP value is calculated. The Commission granted the exemptions based, in part, on the fact that these VWAP short sale transactions appeared to pose little risk of facilitating the type of market effects that former Rule 10a-1 was designed to prevent.[524] In particular, the Commission noted that the pre-opening VWAP short sale transactions do not participate in or affect the determination of the VWAP for a particular security.[525] Moreover, the Commission stated that all trades used to calculate the day's VWAP would continue to be subject to former Rule 10a-1.[526]

Consistent with the relief granted under former Rule 10a-1 and with the Proposal, we are providing that a broker-dealer may mark as "short exempt" certain short sale orders executed at the VWAP. Rule 201(d)(7) differs from the relief granted under former Rule 10a-1, however, in that it is not limited to VWAP transactions that are arranged or "matched" before the market opens at 9:30 a.m., or that are not assigned a price until after the close of trading when the VWAP value is calculated. As noted in the Proposal, we believe this restriction is not necessary because VWAP short sale transactions appear to pose little risk of facilitating the type of market

523 See e.g. letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Edith Hallahan, Associate General Counsel, Phlx, dated Mar. 24, 1999; letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Soo J. Yim, Wilmer, Cutler & Pickering, dated Dec. 7, 2000; letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to Andre E. Owens, Schiff Hardin & Waite, dated Mar. 30, 2001; letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to Sam Scott Miller, Esq., Orrick, Herrington & Sutcliffe LLP, dated May 12, 2001; letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to William W. Uchimoto, Esq., Vie Institutional Services, dated Feb. 12, 2003.

524 See id.

525 See id.

526 See id.

effects that a short sale price test restriction is designed to prevent. In addition, in contrast to the Proposal, we have not included in Rule 201 the requirement that no short sale orders marked "short exempt" may be used to calculate the VWAP. We have not incorporated this condition into Rule 201(d)(7) because the information used to calculate the VWAP will not contain information regarding whether an order was marked "short exempt."

Thus, pursuant to Rule 201(d)(7), a broker-dealer may mark a short sale order of a covered security "short exempt" if the broker-dealer has a reasonable basis to believe that the short sale order is for the sale of a covered security at the VWAP that meets the following conditions:[527] (1) the VWAP for the covered security is calculated by: calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price; compiling an aggregate sum of all values; and dividing the aggregate sum by the total number of reported shares for that day in the security; (2) the transactions are reported using a special VWAP trade modifier; (3) the VWAP matched security qualifies as an "actively-traded security" (as defined under Rules 101(c)(1) and 102(d)(1) of Regulation M), or where the subject listed security is not an "actively-traded security," the proposed short sale transaction will be permitted only if it is conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than 5% of the value of the basket traded; (4) the transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security; and (5) a broker or dealer will act as principal on the contra-side to fill customer short sale orders only if the broker-dealer's position in the covered security, as committed by the broker-dealer during the pre-opening period of a trading

527 See Rule 201(d)(7).

day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume, as defined in Regulation M.[528]

Except as discussed above, the conditions set forth in Rule 201(d)(7) parallel the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions. We believe that these conditions worked well in restricting the exemptive relief to situations that generally would not raise the harms that short sale price tests are designed to prevent. We believe they will be similarly effective in serving that function today and, therefore, we have incorporated them into Rule 201(d)(7).

9. Decision Not to Adopt a Provision that a Broker-Dealer may Mark an Order "Short Exempt" in Connection with Bona Fide Market Making Activity

As discussed in the Proposal, former Rule 10a-1(e)(5) provided a limited exception from the restrictions of that rule for "[a]ny sale . . . by a registered specialist or registered exchange market maker for its own account on any exchange with which it is registered for such security, or by a third market maker for its own account over-the-counter, (i) Effected at a price equal to or above the last sale, regular way, reported for such security pursuant to an effective transaction reporting plan . . . . Provided, however, That any exchange, by rule, may prohibit its registered specialist and registered exchange market makers from availing themselves of the exemption afforded by this paragraph (e)(5) if that exchange determines that such action is necessary or appropriate in its market in the public interest or for the protection of investors."[529] Unless prohibited by exchange rule, this exception was intended to permit registered specialists or

528 See Rule 201(d)(7); 17 CFR 242.100(b) (defining average daily trading volume), 242.101(c)(1), 242.102(d)(1).

529 See Proposal, 74 FR at 18059.

market makers to protect customer orders against transactions in other markets in the consolidated system by allowing them to sell short at a price equal to the last trade price reported to the consolidated system, even if that sale was on a minus or zero-minus tick.[530] Although former Rule 10a-1 included this exception for market makers, exchanges adopted rules that prohibited their registered specialists and market makers from availing themselves of this exception.[531] In addition, former Rule 10a-1 did not contain a general exception for short selling in connection with bona fide market making activities.[532]

In the Proposal, in connection with one proposed rule, the proposed circuit breaker halt rule, we included a provision that would permit a broker-dealer to mark a short sale order "short exempt" in connection with certain bona fide market making activities. None of the other proposed rules contained a "short exempt" marking provision with respect to bona fide market making activities. In connection with the proposed circuit breaker halt rule, we included an exception for equity and options market makers engaged in bona fide market making

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530 See 1974 Release, 39 FR 35570. Former Rule 10a-1(a)(1)(i) referenced the last sale price reported to an effective transaction reporting plan, but former Rule 10a-1(a)(2) also permitted an exchange to make an election to use the last sale price reported in that exchange market. Certain exchanges, such as the NYSE, implemented short sale price test rules consistent with former Rule 10a-1(a)(2). See, e.g., former NYSE Rule 440B.

531 See 1974 Release, 39 FR 35570.

532 We note, however, that NASD's former bid test contained an exception for short sales executed by qualified market makers in connection with bona fide market making. Although the NASD's former bid test contained an exception for short sales executed by qualified market makers in connection with bona fide market making activity, we understand that market makers relied on the exception a small percentage of the time. For example, a 1997 study indicates that during a sample month in 1997, market maker short sales at or below the inside bid accounted for only 2.41% of their total share volume. See D. Timothy McCormick and Bram Zeigler, The Nasdaq Short Sale Rule: Analysis of Market Quality Effects and The Market Maker Exemption, NASD Economic Research, (August 7, 1997) at 27; see also 2003 Regulation SHO Proposing Release, 68 FR at 62989. In addition, we note that when the Commission approved NASD's former bid test and the market maker exception to the bid test, it noted concerns that the market maker exception could create opportunities for abusive short selling. See Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994). See also supra note 43 (discussing NASD Rule 3350).

activities.[533] We also included in the proposed circuit breaker halt rule an exception related to bona fide market making in derivatives.[534]

In response to our decision not to provide in the Proposal for most of the proposed alternatives that a broker-dealer may mark an order "short exempt" in connection with bona fide market making activity, we received a wide variety of comments both supporting and opposing such a provision. Many commenters stated that any short sale price test restriction adopted by the Commission must include an exception for market makers due to the large amount of liquidity that they provide to the markets; although comments varied with respect to the necessity of such an exception to the various proposed price test restrictions and circuit breaker rules and to whom such an exception should apply.[535] Commenters stated that the lack of a market maker exception to any short sale price test restriction could result in, among other things, reduced

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533 See Proposal, 74 FR at 18110. Proposed Rule 201(d)(1) of the proposed circuit breaker halt rule provided that the short selling halt would not apply to "[a]ny sale of a covered security by a registered market maker, block positioner, or other market maker obligated to quote in the over-the-counter market, in each case that are selling short a covered security as part of bona fide market making in such covered security." Id.

534 See id. Proposed Rule 201(d)(4) of the proposed circuit breaker halt rule provided that the short selling halt would not apply to "[a]ny sale of a covered security by any person that is a market maker, including an over-the-counter market maker, if the sale is part of a bona fide market making and hedging activity related directly to bona fide market making in: (i) Derivative securities based on that covered security; or (ii) exchange traded funds and exchange traded notes of which that covered security is a component." Id.

535 See, e.g., roundtable statement of Rosenblatt Securities; letter from BATS (May 2009); letter from Matlock Capital (May 2009); letter from Pink OTC; letter from Direct Edge (June 2009); letter from Engmann Options; letter from Prof. Rosenthal; letter from Credit Suisse (June 2009); letter from John Gilmartin, Co-CEO and Ben Londergan, Co-CEO, Group One Trading, L.P., dated June 17, 2009 ("Group One Trading (June 2009)"); letter from Allston Trading (June 2009); letter from Knight Capital (June 2009); letter from STANY (June 2009); letter from AIMA; letter from Barclays (June 2009); letter from Citadel et al. (June 2009); letter from EWT (June 2009); letter from GETCO (June 2009); letter from Goldman Sachs (June 2009); letter from ICI (June 2009); letter from NYSE Euronext (June 2009); letter from RBC (June 2009); letter from SIFMA (June 2009); letter from STA (June 2009); letter from T.D. Pro Ex; letter from Vanguard (June 2009); letter from Direct Edge (Sept. 2009); letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Group One Trading (Sept. 2009); letter from Allston Trading (Sept. 2009); letter from Knight Capital (Sept. 2009); letter from STANY (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from EWT (Sept. 2009); letter from GETCO (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009); letter from William J. Brodsky, Chairman and CEO, The Chicago Board Options Exchange, Inc., dated Sept. 21, 2009 ("CBOE (Sept. 2009)"); letter from Edward Jones; letter from Virtu Financial.

liquidity, increased bid-ask spreads, increased volatility, increased barriers to entry for new market makers, reduced competition among market makers, and increased costs to market makers and investors.[536] Some commenters stated that the Commission should consider exceptions that would permit high frequency traders[537] and other market makers to continue to provide the same level of liquidity to the markets.[538]

Some commenters stated that an exception for options market makers, in particular, would be necessary for any short sale price test restriction, citing the important role that short selling plays in an options market maker's ability to hedge risk and the negative impact that a short sale price test restriction would have on options market quality, liquidity, bid-ask spreads, quote size, and investor costs.[539] One commenter noted that although former Rule 10a-1 did not contain an options market maker exception, the NASD's former bid test contained an exception that "allowed options market makers to provide liquidity and depth for listed options by allowing

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[536] See, e.g., letter from SIFMA (June 2009); letter from Knight Capital (June 2009); letter from EWT (June 2009); letter from GETCO (June 2009); letter from Goldman Sachs (June 2009); letter from EWT (Sept. 2009); letter from Virtu Financial; but cf. letter from Dr. Jim DeCosta, dated Sept. 14, 2009 ("Dr. Jim DeCosta") (noting that there are currently few barriers to entry for market makers and abuse can arise from small market makers, who are in need of business, being willing to misuse a bona fide market maker exemption in exchange for order flow).

[537] See letter from Bingham McCutchen.

[538] See, e.g., roundtable statement of Rosenblatt Securities; letter from MFA (June 2009); see also letter from Credit Suisse (Mar. 2009).

[539] See, e.g., roundtable statement of Rosenblatt Securities; letter from BATS (May 2009); letter from Matlock Capital (May 2009); letter from Direct Edge (June 2009); letter from Engmann Options; letter from Prof. Rosenthal; letter from Credit Suisse (June 2009); letter from Group One Trading (June 2009); letter from STANY (June 2009); letter from John Favia, Blue Capital Group LLC, dated June 19, 2009 ("Blue Capital"); letter from Goldman Sachs (June 2009); letter from ISE (June 2009); letter from NYSE Euronext (June 2009); letter from RBC (June 2009); letter from SIFMA (June 2009); letter from STA (June 2009); letter from T.D. Pro Ex; letter from Boston Options Exchange et al. (June 2009); letter from Direct Edge (Sept. 2009); letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Group One Trading (Sept. 2009); letter from Knight Capital (Sept. 2009); letter from STANY (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from ISE (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009); letter from Boston Options Exchange, Chicago Board Options Exchange, International Securities Exchange, Nasdaq Options Market, Nasdaq OMX PHLX, NYSE Amex, NYSE Arca and The Options Clearing Corporation, dated Sept. 22, 2009 ("Boston Options Exchange et al. (Sept. 2009)"); letter from CBOE (Sept. 2009).

them to hedge," but that also had "limited definitions and scope."[540] Another commenter recognized the risk of a transference effect resulting from an options market maker exception, namely that an exception may facilitate short selling by buying puts from or selling calls to market makers, but stated that there was no empirical evidence showing that the risk is more than theoretical.[541]

Some commenters stated that a market maker exception should include market makers in listed and OTC derivatives.[542] Other commenters stated that a market maker exception should cover block positioners.[543] In addition, some commenters stated that a market maker exception should include market makers in convertibles and warrants.[544] Several commenters stated that an exception for market makers in ETFs should be included in any price test restriction adopted by the Commission.[545]

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540 Letter from CBOE (June 2009); see also letter from Boston Options Exchange et al. (June 2009); letter from ISE (June 2009); letter from Citadel et al. (June 2009); letter from STANY (June 2009); letter from GETCO (June 2009).

541 See letter from Blue Capital; but cf. letter from John H. Frazer, Jr., dated May 4, 2009 ("Frazer") (stating that if options market makers are not subject to the short sale price test restriction, then "short sellers will simply purchase Puts knowing that Options Market Makers will simply sell the stock short without restriction.").

542 See, e.g., letter from Direct Edge (June 2009); letter from Credit Suisse (June 2009); letter from STANY (June 2009); letter from Barclays (June 2009); letter from Goldman Sachs (June 2009); letter from ICI (June 2009); letter from NYSE Euronext (June 2009); letter from RBC (June 2009); letter from SIFMA (June 2009); letter from ISDA; letter from Direct Edge (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from STANY (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009).

543 See letter from Credit Suisse (June 2009); letter from RBC (June 2009); letter from SIFMA (June 2009); letter from SIFMA (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from RBC (Sept. 2009).

544 See, e.g., letter from Credit Suisse (June 2009); letter from SIFMA (June 2009); letter from Credit Suisse (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from SIFMA (Sept. 2009).

545 See, e.g., letter from Credit Suisse (June 2009); letter from Allston Trading (June 2009); letter from STANY (June 2009); letter from Goldman Sachs (June 2009); letter from ICI (June 2009); letter from SIFMA (June 2009); letter from SIFMA (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from STANY (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from Direct Edge (Sept. 2009).

In addition, some commenters stated that to not include an exception for bona fide market making activities is inconsistent with the Commission's short sale-related emergency orders issued in mid- to late-2008, which included various forms of exceptions for bona fide market making activities.[546] Commenters also noted that since its adoption in 2004, Regulation SHO has included an exception for bona fide market making activities from the "locate" requirement of Rule 203(b)(1).[547] Several commenters also noted that fails to deliver resulting from certain bona fide market making activity are provided additional time to be closed out under Regulation SHO's close-out requirements.[548]

Several commenters, however, discussed the importance of limiting a market maker exception to bona fide market making activity and requested that the Commission define the term strictly so as to eliminate the possibility for gaming.[549] Moreover, some commenters stated that a market maker exception may not be necessary. For example, commenters noted that equity market makers will usually sell at their offer quote, which would not be inhibited by any price test restriction.[550] One commenter stated that if we were to adopt a circuit breaker

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546 See, e.g., letter from SIFMA (June 2009); letter from RBC (June 2009); letter from CBOE (June 2009); letter from Boston Options Exchange et al. (June 2009); letter from ISE (June 2009); letter from Citadel et al. (June 2009); letter from Goldman Sachs (June 2009); see also supra Section II.C. (discussing the Commission's emergency orders).

547 See, e.g., letter from SIFMA (June 2009); letter from CBOE (June 2009); letter from Boston Options Exchange et al. (June 2009); letter from Goldman Sachs (June 2009); letter from GETCO (June 2009); see also 17 CFR 242.203(b)(2)(iii).

548 See, e.g., letter from Goldman Sachs (June 2009); letter from Wolverine; letter from Boston Options Exchange et al. (June 2009); letter from GETCO (Sept. 2009); letter from Virtu Financial; letter from Nasdaq OMX Group (Oct. 2009); see also 17 CFR 242.204(a)(3).

549 See letter from Pink OTC; letter from SIFMA (June 2009); letter from STA (June 2009); letter from SIFMA (Sept. 2009); see also letter from NYSE Euronext (June 2009); letter from NYSE Euronext (Sept. 2009) (stating that the definition should contain some obligation to the market).

550 See letter from CBOE (June 2009); letter from GETCO (June 2009). Although GETCO stated that a market maker typically should not need an exception because the market maker will be able to sell short on the offer when providing liquidity, this commenter also noted that market makers such as GETCO "often employ market making strategies that sometimes include removing liquidity on the bid as part of the overall strategy, which

approach with the alternative uptick rule, an equity market making exception may not be as critical because equity market makers generally post their offers one price increment above the national best bid.[551] This commenter stated that "[i]n a market characterized by the kind of decline that would trigger a circuit breaker, remaining above the [national best bid] will tend to be the natural norm."[552]

Other commenters stated that there should not be an exception for market makers in any short sale price test restriction that the Commission adopts.[553] One commenter noted that the activities of market makers "are not unique in contributing to market efficiency; all market participants, regardless of trading frequency or professional expertise, improve market quality by their very participation, whether or not their trading activity is arbitrage or professional market making . . . the Commission's goal should be to implement rules that are sufficiently focused and require few, if any, exceptions to maintain market quality."[554] In addition, as discussed in Section III.B. above, several commenters cautioned against the Commission adopting numerous exceptions and discussed problems that may arise from adopting a short sale price test restriction with many or complex exceptions, such as additional implementation difficulties, greater compliance costs, lack of uniformity that may cause unfair application of the rule, increased

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may include short selling." GETCO stated that such strategies result in tighter spreads, more liquidity and potentially lower costs to investors. See letter from GETCO (June 2009).

551 See letter from Direct Edge (Sept. 2009).

552 Letter from Direct Edge (Sept. 2009).

553 See, e.g., letter from David G. Furr, dated Apr. 20, 2009; letter from R. Skinner, dated Apr. 21, 2009; letter from Frazer; letter from IBC; letter from Vitus Lask, dated June 20, 2009; letter from Stephen R. Porpora, dated Sept. 10, 2009; letter from Hudson River Trading; letter from David Furr, dated Nov. 3, 2009.

554 Letter from Hudson River Trading.

opportunities for gaming and abuse, and, overall, a less effective rule that only applies to a limited numbers of short sales.[555]

At this time, we believe that including a provision to permit broker-dealers to mark as "short exempt" short sale orders in connection with market making activity in the equity or options markets is not necessary and would not advance the goals of our adopting a short sale price test restriction. We recognize that there are distinct differences between options market making and market making in the equity markets and that Rule 201 may impact these markets differently. In addition, we recognize commenters' concerns regarding the potential negative market impact of not including an exception for market making activity in the equity or options markets. Due to the reasons discussed below, however, we believe such impact, if any, would be limited. In addition, we believe that the potential costs of not including exceptions for equity and options market makers are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from driving down further the price of a security that has already experienced a significant intra-day price decline.

We believe that the potential negative market impact from not including an equity or options market maker exception to Rule 201 will be limited, in large part, because Rule 201 is a narrowly-tailored Rule that will impose a short sale price test restriction only if the price of a covered security declines by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In addition, once triggered, the short sale price test restriction will apply for a limited period of time – the remainder of the day on which the circuit breaker has been triggered and the following day. Thus, unlike NASD's former bid test or former Rule 10a-1 (which also did not include an exception for bona fide market making activity), Rule 201 does not impose a

555 See supra note 434.

short sale price test restriction that will apply all the time to all covered securities. Nor does Rule 201 impose a halt on short selling. Instead, Rule 201 is a targeted Rule that will not impact trading in the majority of covered securities. As discussed in more detail above,[556] in response to our request for comment on an appropriate threshold at which to trigger the proposed circuit breaker short sale price restrictions, commenters submitted estimates of the number of securities that would trigger a circuit breaker rule at a 10% threshold[557] and the estimates reflect that a 10% circuit breaker threshold, on average, should result in a limited percentage of covered securities triggering the threshold.[558] In addition, following its review of trading data, the Staff found that, during the period covering April 9, 2001 to September 30, 2009, the price test restrictions of Rule 201 would have, on an average day, been triggered for approximately 4% of covered securities.[559] The Staff also found that for a low volatility period, covering January 1, 2004 to December 31, 2006, the 10% trigger level of Rule 201 would have, on an average day, been triggered for approximately 1.3% of covered securities.[560]

In addition, we believe that any negative market impact due to the lack of a bona fide market making exception for equity market makers will be limited, if any, because as noted by some commenters, for the most part, equity market makers sell at their offer quote.[561] Thus, the price test restriction of Rule 201, that requires short selling at a price above the national best bid and only if the circuit breaker has been triggered, is consistent with equity market making

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556 See supra Section III.A.5. (discussing the circuit breaker trigger level).

557 See, e.g., letter from Jordan & Jordan; letter from Citadel et al. (June 2009); letter from MFA (June 2009); letter from SIFMA (June 2009); letter from Credit Suisse (Sept. 2009).

558 See supra notes 305 to 308 and accompanying text.

559 See supra note 310 and accompanying text.

560 See supra note 311 and accompanying text.

561 See, e.g., letter from CBOE (June 2009); letter from GETCO (June 2009).

strategies because these market makers generally post their offer quotes at a price above the national best bid.[562] In addition, because equity market makers typically provide liquidity on the opposite side of the market, if a covered security is experiencing significant downward price pressure such that it is subject to Rule 201, market makers will tend to be buying not selling the security. Thus, equity market makers will continue to be able to provide liquidity in that security.

Although a number of commenters expressed concerns regarding the lack of an options market maker exception from a price test restriction, we do not believe that such an exception under Rule 201 is necessary because, unlike with a ban on short selling, options market makers will be able to sell short to hedge their positions even when the restriction is in place.[563] In addition, not all covered securities have options traded on them ("optionable covered securities"). As discussed above, data provided by commenters and Staff analysis indicate that, on an average day, a limited number of all covered securities would trigger a 10% circuit breaker level.[564] Thus, an even more limited number of optionable covered securities would trigger a 10% circuit breaker, thereby further reducing the need for an options market maker exception to the Rule's requirements. To the extent that an optionable covered security is subject to Rule 201, we recognize this may result in a delay in an options market maker's ability to sell short to hedge a position.[565] Such delay, and the resulting uncertainty options market makers may face

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562 See letter from Direct Edge (Sept. 2009).

563 We note that some commenters, in stating that a short sale price test restriction should include an options market maker exception, provided support for their arguments by referencing the impact of the Short Sale Ban Emergency Order that halted short selling in the securities subject to the emergency order, rather than imposing a short sale price test restriction that would continue to allow short selling while the restriction is in effect. See, e.g., letter from CBOE.

564 See supra note 310 and 311 and accompanying text.

565 We note that one commenter stated that "[options market makers] need immediacy in their hedges, which means selling at lower than the inside offer quote." See letter from CBOE (June 2009). Rule 201, if triggered,

(including as the price of an optionable covered security approaches the circuit breaker) regarding their ability to obtain immediate execution of their short sale hedging transactions, may have a negative impact on the options markets, such as the widening of options quote spreads.

We believe, however, that this potential negative market impact and any resulting costs to options market makers will be limited and are justified by the benefits of the Rule. As discussed above, we believe these costs will be limited because, among other things, due to the Rule's circuit breaker approach, the Rule's restrictions will not apply to most optionable covered securities most of the time. In addition, even when a security is experiencing excessive downward price pressure such that the short sale price test restriction of Rule 201 has been triggered for a particular security, we expect there will be purchasers in the market willing to buy the security at the offer or at a price between the current national best bid and offer. Thus, for securities that are subject to Rule 201, there will be buying interest in the market that will result in execution of short sale hedging transactions.

We have also determined not to include an options market maker exception because we are concerned about creating an un-level playing field between options market makers and market makers in other derivatives that sell short to hedge their positions in the derivative.[566] For the reasons discussed above and below, we do not believe that any market maker exception is necessary.

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limits short selling to a price above the current national best bid. Thus, it does not prevent short selling at a price between the current national best bid and offer.

566 We also note that, as discussed in Section III.A.1. above, we, as well as some commenters, are concerned about the ability to obtain a short position through the use of derivative products and that synthetic short positions may increase as a result of the adoption of a short sale price test restriction. We are concerned that inclusion of an exception in Rule 201 for short sale hedging transactions would make such an increase even more likely. See supra Section III.A.1.

We are also concerned that the inclusion of an exception for equity or options market makers may create an opportunity for potential misuse. Whether from misuse or proper use, if a large volume of short selling were excepted from the short sale price test restrictions of the Rule, such an exception could potentially undermine our goals for adopting the Rule.[567] We are also concerned that the inclusion of an exception could result in significant additional surveillance and compliance costs necessary to help to determine whether market participants are validly claiming the applicable exception and to prevent any misuse. In determining not to include such an exception, we also considered these additional costs.

Although some commenters noted that the NASD's former bid test contained exceptions for equity and options market makers, as noted above, former Rule 10a-1, which was in place for almost seventy years, and applied on a permanent, market-wide basis, did not contain any such exceptions. We are not aware of any negative impact on market quality or any significant costs to investors arising from the lack of such exceptions. In addition, we note that although Regulation SHO currently contains a limited exception from its locate requirement[568] and an additional two days to close out fails to deliver under its close-out requirement for certain market making activity,[569] these exceptions relate to the ability to obtain shares in time to make delivery by settlement date rather than to downward price pressure and potential price manipulation

567 See, e.g., Ekkehart Boehmer, Charles M. Jones and Xiaoyan Zhang, 2009, Shackling Short Sellers: The 2008 Shorting Ban. This study on the Short Sale Ban Emergency Order found that "[d]uring the shorting ban (19 Sep through 8 Oct), [NYSE-executed] short sales are 7.72% of overall trading volume for stocks on the original ban list, compared to 19.32% of overall trading volume over the same time interval for the matching set of non-banned stocks." The authors of the study attributed the on-going short sales in the banned stocks to market makers selling short as part of their market making and hedging activity, as such activity was excepted from the Short Sale Ban Emergency Order. See id. While short sale volume decreased in the banned stocks, based on this study's results and its comparison of ban and non-ban stocks, approximately 40% of the short sale trading volume would be expected to be exempt short selling. This short selling may have occurred as a result of market making exceptions.

568 See 17 CFR 242.203(b)(2)(iii).

569 See 17 CFR 242.204(a)(3).

resulting from short selling. Thus, although commenters noted these exceptions as support for an exception from a short sale price test restriction, we do not agree that the inclusion of such exceptions to Regulation SHO's locate and close-out requirements necessitates the inclusion of such an exception in Rule 201.

Moreover, we note that we recently eliminated an exception to Regulation SHO's close-out requirement relating to fails to deliver resulting from options market making activity because, as we noted in the Options Market Maker Elimination Release, a substantial level of fails to deliver continued to persist in threshold securities, and it appeared that a significant number of the fails were as a result of the options market maker exception.[570] In addition, in adopting that amendment, we noted that although we acknowledged commenters' concerns regarding the potential impact of the elimination of the options market maker exception on market making risk, quote depths, spread widths, and market liquidity, we believed that these potential effects were justified by the benefits of requiring such fails to deliver to be closed out within specific time-frames rather than being allowed to persist indefinitely.[571]

Similarly, although we recognize commenters' concerns about the potential impact of the lack of an options market maker exception or a general equity market maker exception on market liquidity, volatility, spread widths, and investor costs, we believe, for the reasons discussed, that these potential costs are justified by the benefits of requiring that when a covered security's price is undergoing significant downward price pressure, short selling in the security by market makers

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[570] See Options Market Maker Elimination Release, 73 FR at 61696. In addition, as we stated in the Options Market Maker Elimination Release, preliminary analysis by the Staff indicated that there was a significant increase in fails to deliver in threshold securities with options traded on them following elimination of the grandfather exception to Regulation SHO's close-out requirement. See id. at 61693.

[571] See id. at 61696. As discussed above and as noted by several commenters to the Proposal and Re-Opening Release, since the elimination of the options market maker exception to Regulation SHO's close-out requirement, among other Commission actions, data from the Staff indicates there has been a significant reduction in fails to deliver. See supra note 119 (discussing the recent reduction in fails to deliver).

generally is restricted. Moreover, as discussed above, because the short sale price test restriction of Rule 201(b) will apply to a covered security only after the security has experienced a significant intra-day price decline, will remain in place for a limited period of time, and will continue to permit short selling at a price above the current national best bid (rather than, for example, halt all short selling in that security) even when the restriction is in place, we believe that the negative market impact, if any, when the restriction is in place, will be limited.[572]

For the reasons discussed above, rather than provide an exception for short selling in connection with bona fide market making activity, whether in the equity or options markets, we have determined to limit the extent to which market makers will be permitted to sell short without restriction under Rule 201. We note, however, as discussed above, Rule 201 permits broker-dealers to mark short sale orders as "short exempt" in connection with riskless principal transactions. We also note that under Rule 201, a trading center's policies and procedures will be designed to permit the execution or display of short sale orders at the offer. As discussed above, and as noted by some commenters, equity market makers typically will sell at their offer quote.[573] Thus, Rule 201 generally will not restrict short selling by equity market makers engaged in bona fide market making activity. Moreover, in connection with both equity and options market makers, because most covered securities and, to an even greater extent, most optionable covered securities, will not be subject to the short sale price test restriction of Rule 201, these market makers will be able to continue to provide liquidity and hedge positions, as applicable, by selling short at or below the national best bid in most securities most of the time. For all these reasons, at this time we do not believe it is necessary to provide that a broker-dealer

572 See supra Sections III.A.3. and III.A.4. (discussing, among other things, the market impact of the alternative uptick rule in combination with a circuit breaker approach); see also infra Sections X.B.1.a. and X.B.2.a. (discussing the market impact of the alternative uptick rule and the circuit breaker approach).

573 See supra notes 550, 561, and 562 and accompanying text.

may mark an order "short exempt" where the short sale order is in connection with bona fide market making activity, whether in the equity or options markets.[574]

IV. Order Marking

In the Proposal, we proposed amending Rule 200(g) of Regulation SHO to add a "short exempt" marking requirement.[575] Rule 200(g) of Regulation SHO provides that a broker-dealer must mark all sell orders of any security as "long" or "short."[576] As initially adopted, Regulation SHO included an additional marking requirement of "short exempt" applicable to short sale orders if the seller was "relying on an exception from the tick test of 17 CFR 240.10a-1, or any short sale price test of any exchange or national securities association."[577] We adopted amendments to Rule 200(g) of Regulation SHO to remove the "short exempt" marking requirement in conjunction with our elimination of former Rule 10a-1.[578]

In conjunction with the adoption of Rule 201 of Regulation SHO to add a short sale circuit breaker rule, we are amending Rule 200(g) of Regulation SHO, substantially as proposed, to again impose a "short exempt" marking requirement.[579] Specifically, Rule 200(g), as amended, provides that "[a] broker or dealer must mark all sell orders of any equity security as

574 We note, however, as discussed in more detail below, we have instructed the Staff to assess the impact of the Rule on the options markets and to provide a written assessment of the impact. See infra Section VIII.

575 See Proposal, 74 FR at 18082-18083.

576 See 17 CFR 242.200(g).

577 See 2004 Regulation SHO Adopting Release, 69 FR at 48030.

578 See 2007 Price Test Adopting Release, 72 FR 36348.

579 In connection with Rule 200(g), we note that we have made one technical modification to Rule 200(g)(2) from the language in the proposed circuit breaker with modified uptick rule. Specifically, we have specified the subsections of Rule 201 -- subsections (c) and (d) -- that set forth the circumstances under which a short sale order may be marked "short exempt."

"long," "short," or "short exempt."[580] In addition, Rule 200(g)(2) provides that a sale order shall be marked "short exempt" only if the provisions of paragraph (c) or (d) of Rule 201 are met.[581]

In response to our requests for comment, several commenters noted that a new "short exempt" marking requirement would require adjustments to front end systems, that many firms have multiple front end systems, and that such costs would be multiplied for firms with correspondent clearing operations because each correspondent firm can have its own front end system.[582] Commenters also stated that market participants would need to make adjustments to reporting systems, including blue sheets, OATS, and OTS reporting systems,[583] in addition to order entry and routing applications.[584]

In contrast, several commenters indicated that requiring broker-dealers to mark all sell orders "long," "short," or "short exempt" would provide valuable information to the Commission[585] and that such information would be worth the costs of requiring such marking.[586] One commenter indicated that the information provided by a "short exempt" marking requirement would provide the Commission with data on the extent to which exceptions are being used to circumvent the requirements of Rule 201.[587] In addition, with respect to implementation periods, one commenter stated that the "short exempt" marking requirement

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580 Rule 200(g).

581 See Rule 200(g)(2).

582 See letter from RBC (June 2009); letter from NSCP; see also letter from FIF (June 2009).

583 See letter from RBC (June 2009); letter from NSCP; letter from FIF (June 2009).

584 See letter from FIF (June 2009).

585 See, e.g., letter from CFA; letter from STA (June 2009).

586 See, e.g., letter from STA (June 2009).

587 See id.

would require coding for new fields in order records, which should be accomplished in approximately three months.[588]

After considering the comments, we have determined to adopt the proposed "short exempt" marking requirement, including the requirement that a sale order shall be marked "short exempt" only if the provisions of paragraph (c) or (d) of Rule 201 are met. The "short exempt" marking requirement will provide a record that a broker-dealer is availing itself of one of the provisions of paragraph (c) or (d) of Rule 201. The records provided pursuant to the "short exempt" marking requirements of Rule 200(g) will also aid surveillance by SROs and the Commission for compliance with the provisions of Rule 201. In addition, under the policies and procedures approach required by Rule 201, the "short exempt" marking requirement will indicate to a trading center whether it must execute or display a short sale order without regard to whether the short sale order is at a price that is less than or equal to the current national best bid.

We recognize that the "short exempt" marking requirement will increase implementation and compliance costs, including costs related to adjusting front-end systems, reporting systems, and order entry and routing applications.[589] We believe, however, that these costs are justified by the benefit of the information that the "short exempt" marking requirement will provide. In addition, to allow sufficient time to make any necessary systems changes, we are providing for a six month implementation period for the "short exempt" marking requirement of Rule 200(g) such that market participants will have to comply with this requirement six months following the effective date of these amendments. We believe that a six month implementation period will provide market participants with sufficient time in which to modify their systems and procedures.

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588 See id.

589 See infra Section X.A.3. and Section X.B.4. (discussing the benefits and costs of the "short exempt" order marking requirement).

in order to comply with the proposed marking requirements. In addition, the six month implementation period is consistent with the implementation period for Rule 201.

V. Exemptive Procedures

Consistent with the provisions proposed, Rule 201(f) as adopted includes provisions establishing procedures for the Commission, upon written request or its own motion, to grant an exemption from the Rule's provisions, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.[590] Pursuant to this provision, we will consider and act upon appropriate requests for relief from the provisions of Rule 201 and will consider the particular facts and circumstances relevant to each such request and any appropriate conditions to be imposed as part of the exemption.

In response to our request for comment, one commenter stated that "it is important for the Commission to have detailed procedures for granting exemptions," but that exemptions can decrease overall compliance with the rule by encouraging other market participants to tailor their situation to qualify for an exemption.[591] The commenter stated that the Commission "must set the bar high for those seeking exemptive relief."[592]

We have determined to include in Rule 201 a provision related to granting exemptions from the Rule's provisions in order to provide clear procedures for requests and grants of exemptions. As stated above, we will consider requests for relief and grant exemptions from Rule 201 if the Commission determines that an exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, taking into account the

590 See Rule 201(f).

591 Letter from STA (June 2009).

592 Id.

particular facts and circumstances relevant to each such request and any appropriate conditions to be imposed in connection with the exemption.

VI. Overseas Transactions

In connection with former Rule 10a-1, the Commission consistently took the position that the rule applied to trades in securities subject to that rule where the trade was "agreed to" in the U.S., but booked overseas.[593] In addition, in the 2004 Regulation SHO Adopting Release we stated that any broker-dealer using the United States jurisdictional means to effect short sales in securities traded in the United States would be subject to Regulation SHO, regardless of whether the broker-dealer is registered with the Commission or relying on an exemption from registration.[594] For example, a U.S. money manager decides to sell a block of 500,000 shares in a covered security. The money manager negotiates a price with a U.S. broker-dealer, who sends the order ticket to its foreign trading desk for execution. In our view, this trade was agreed to in the United States and occurred in the United States as much as if the trade had been executed by

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[593] See Exchange Act Release No. 27938 (Apr. 23, 1990), 55 FR 17949 (Apr. 30, 1990) (stating that the no-action position exempting certain index arbitrage sales from former Rule 10a-1 would not apply to an index arbitrage position that was established in an offshore transaction unless the holder acquired the securities from a seller that acted in compliance with former Rule 10a-1 or other comparable provision of foreign law). See also Exchange Act Release No. 21958 (Apr. 18, 1985), 50 FR 16302, 16306, n.48 (Apr. 25, 1985) (stating that, "Rule 10a-1 does not contain any exemption for short sales effected in international markets."). The question of whether a particular transaction negotiated in the U.S. but nominally executed abroad by a foreign affiliate is a domestic trade for U.S. regulatory purposes was also addressed in the Commission's Order concerning Wunsch Auction Systems. Inc. (WASI). The Commission stated its belief that "trades negotiated in the U.S. on a U.S. exchange are domestic, not foreign trades. The fact that the trade may be time-stamped in London for purposes of avoiding rule 390 does not in our view affect the obligation of WASI and BT Brokerage to maintain a complete record of such trades and report them as U.S. trades to U.S. regulatory and self-regulatory authorities and, where applicable, to U.S. reporting systems." See Exchange Act Release No. 28899 (Feb. 20, 1991), 56 FR 8377, 8381 (Feb. 28, 1991). In what is commonly referred to as the "fax market," a U.S. broker-dealer acting as principal for its customer negotiates and agrees to the terms of a trade in the U.S., but transmits or faxes the terms overseas to be "printed" on the books of a foreign office. This practice of "booking" trades overseas was analyzed in depth in the Division of Market Regulation's Market 2000 Report. In the Report, the Division estimated that at that time approximately seven million shares a day in NYSE stocks were faxed overseas, and many of these trades were nominally "executed" in the London over-the-counter market. See Division of Market Regulation, SEC, Market 2000: An Examination of Current Equity Market Developments (Jan. 1994), Study VII, p. 2.

[594] See 2004 Regulation SHO Adopting Release, 69 FR at 48014, n.54.

the broker-dealer at a U.S. trading desk. Consistent with these prior statements, we stated in the Proposal that if a short sale is agreed to in the United States, it must be effected in accordance with the requirements of the proposed rules, unless otherwise excepted.[595]

In response to our request for comment, one commenter stated that "[g]enerally speaking, the Commission has taken the position that the provisions of Regulation SHO apply to transactions in covered securities 'agreed to' in the United States, but sent to a foreign market for execution. Notwithstanding, there has been on-going confusion in this area. The Commission should use this opportunity to clarify the applicability of the restrictions (and Regulation SHO generally) to transactions in covered securities executed on overseas markets."[596] Consistent with our prior statements, we note that Rule 201 applies to any short sale effected using the United States jurisdictional means, regardless of the jurisdiction in which the short sale is executed.

VII. Rule 201 Implementation Period

In the Proposal and Re-Opening Release, we proposed a three-month and two-month implementation period, respectively, and requested comment regarding these implementation periods.[597] We are adopting in Rule 201 a six-month implementation period, such that trading centers will have to comply with Rule 201 six months following the effective date of Rule 201. We believe that this implementation period will provide trading centers, broker-dealers and other market participants with sufficient time in which to modify their systems, policies and procedures in order to comply with the requirements of Rule 201.

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595 See Proposal, 74 FR at 18083-18084.

596 Letter from RBC (June 2009).

597 See Proposal, 74 FR at 18042; Re-Opening Release, 74 FR at 42036.

In response to our request for comment, commenters indicated that a circuit breaker rule triggering the alternative uptick rule will require an implementation period of between three and twelve months.[598] Several commenters noted that because the alternative uptick rule, unlike the other proposed price tests, would not require sequencing of bids or last sale prices, the alternative uptick rule could be implemented more quickly than the other proposed price tests and could be implemented within three to six months.[599] One commenter noted that implementation concerns with respect to a short sale price test restriction could be minimized, provided that trading centers "could leverage existing architecture developed to comply with the Order Protection Rule in Reg NMS (Rule 611)."[600] Another commenter noted that implementation of a circuit breaker triggering the alternative uptick rule would be easier to implement, "provided that the Commission permits firms to leverage the numerous systems changes made to facilitate compliance with Regulation NMS (including the use of internal market data rather than consolidated data supplied by the industry plans)."[601] Other commenters noted that adopting the alternative uptick rule in conjunction with a circuit breaker, rather than as a permanent, market-wide rule, would not add significantly to the implementation time required.[602]

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598 See, e.g., letter from FIF (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from EWT (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009); letter from MFA (Oct. 2009); letter from Amer. Bankers Assoc.; see also letter from NSCP; letter from RBC (June 2009); letter from STA (June 2009).

599 See, e.g., letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); letter from STA (Sept. 2009); letter from FIF (Sept. 2009).

600 Letter from MFA (Oct. 2009).

601 Letter from Goldman Sachs (Sept. 2009).

602 See, e.g., letter from Credit Suisse (Sept. 2009); letter from Nasdaq OMX Group (Oct. 2009).

Several commenters, however, did not agree that the absence of a sequencing requirement would shorten the implementation time required for the alternative uptick rule.[603] In addition, several commenters did not agree that previous implementation of Regulation NMS might allow for quicker implementation of a price test.[604] Other commenters stated that adopting the alternative uptick rule in conjunction with a circuit breaker would add to the implementation time.[605] Some commenters expressed concerns that allowing for certain exceptions could affect the implementation time.[606]

We believe that a six month implementation period is appropriate.[607] This implementation period, which is longer than the implementation periods proposed in the Proposal and the Re-opening Release, takes into consideration commenters' concerns that implementation of a price test could be complex. We do not believe that a longer implementation time is warranted because Rule 201 will not require monitoring of the sequence of bids or last sale prices, unlike other proposed price tests, and because Rule 201 will require the implementation of policies and procedures similar to those required for trading centers under Regulation NMS. In addition, market participants will be able to leverage the numerous systems changes made and current architecture developed to facilitate compliance with Regulation NMS. These factors should reduce implementation time.

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603 See, e.g., letter from Citadel et al. (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009).

604 See, e.g., letter from NSCP; letter from RBC (June 2009).

605 See letter from Direct Edge (Sept. 2009) (stating that adopting the alternative uptick rule with a circuit breaker would add approximately four to six weeks to the development process); letter from NYSE Euronext (Sept. 2009).

606 See letter from Goldman Sachs (Sept. 2009); letter from FIF (Sept. 2009).

607 We note that, in effect, market participants will have approximately eight months from publication in the Federal Register to implement Rule 201. Rule 201 will not become effective until sixty days following publication in the Federal Register and the Compliance Date for Rule 201 is six months following the Rule's Effective Date.

In addition, we believe the six month implementation period will allow sufficient time to address any complexities implementing the circuit breaker and the "short exempt" order marking requirement.[608] We note that broker-dealers are already familiar with and have experience implementing a "short exempt" marking requirement as Regulation SHO, as originally adopted, included such a requirement.[609] The "short exempt" marking requirement was eliminated together with the elimination of all short sale price test restrictions in July 2007.[610] In addition, we note that broker-dealers were able to make significant systems changes to de-program the "short exempt" marking requirement from their systems in less than 90 days from the compliance date for elimination of the requirement.[611] Thus, we believe that a six month implementation period should be sufficient.

We also believe that a six month implementation period is appropriate for any systems changes that must be made by listing markets and single plan processors to comply with Rule 201. As discussed above, the single plan processors currently receive information from listing markets regarding trading restrictions (i.e. Regulatory Halts as defined in those plans) on individual securities and disseminate such information. Thus, the requirements of Rule 201(b)(3) are similar to existing obligations on plan processors pursuant to the requirements of Regulation NMS, the CTA and CQ Plans and the Nasdaq UTP Plan. Due to this similarity, we believe that a six month implementation period is appropriate.

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608 See supra Section III.B. (discussing the "short exempt" marking provisions of Rule 201) and supra Section IV. (discussing the "short exempt" marking requirement of Rule 200(g)).

609 See 2004 Regulation SHO Adopting Release, 69 FR 48008.

610 See 2007 Price Test Adopting Release, 72 FR 36348.

611 See letter from Josephine J. Tao, Assistant Director, Division of Market Regulation, SEC, to Ira Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, dated July 2, 2007.

VIII. Decision Not to Implement Rule 201 on a Pilot Basis

In the Proposal, we requested comment regarding whether, before determining whether to adopt a short sale price test restriction or circuit breaker rule on a permanent basis, we should adopt a rule that would apply on a pilot basis to specified securities.[612] In response to our request for comment, a number of commenters stated that any price test restriction should be adopted on a pilot basis.[613] A number of commenters indicated that a pilot study should be conducted prior to adoption of a price test on a permanent basis in order to gather empirical evidence on the effectiveness and/or market impact of a price test.[614] Some commenters stated that adopting a price test on a pilot basis only would limit any negative market impact to the subset of securities subject to the price test.[615] Another commenter stated that a pilot study would allow the Commission to gather data on the effects of a price test as compared to a control group not

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612 See, e.g., Proposal, 74 FR at 18071.

613 See, e.g., letter from BATS (May 2009); letter from IAG; letter from BIO; letter from James J. Angel, Ph.D., CFA, Associate Professor of Finance, McDonough School of Business, Georgetown University, dated June 19, 2009 ("Prof. Angel (June 2009)"); letter from Barclays (June 2009); letter from Citadel et al. (June 2009); letter from EWT (June 2009); letter from NSCP; letter from RBC (June 2009); letter from STA (June 2009); letter from NYSE Euronext (June 2009); letter from Knight Capital (June 2009); letter from STANY (June 2009); letter from T. Rowe Price (June 2009); letter from Credit Suisse (June 2009); memorandum regarding meeting with Penson; letter from CFA; letter from Knight Capital (Sept. 2009); letter from Prof. Angel (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from EWT (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from Qtrade; letter from RBC (Sept. 2009); letter from STANY (Sept. 2009); letter from Virtu Financial.

614 See, e.g., letter from BATS (May 2009); letter from BIO; letter from Prof. Angel (June 2009); letter from Credit Suisse (June 2009); letter from Knight Capital (June 2009); letter from NSCP; letter from RBC (June 2009); letter from STANY (June 2009); memorandum regarding meeting with Penson; letter from CFA; letter from Prof. Angel (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from EWT (Sept. 2009); letter from Knight Capital (Sept. 2009); letter from Qtrade; letter from RBC (Sept. 2009); letter from STANY (Sept. 2009); see also letter from Park National (stating that a review of a price test based on the national best bid should be conducted six months after implementation to ensure effectiveness). We also note that a number of commenters indicated that the Commission should gather empirical evidence through further study, though not necessarily in the form of a pilot study, prior to adopting a price test. See, e.g., letter from BATS (May 2009); letter from Citadel et al. (June 2009); letter from Dialectic Capital (June 2009); letter from Geoffrey F. Foisie, Investments Manager, Shawbrook, dated June 16, 2009; letter from Amer. Bar Assoc. (July 2009); letter from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, American Bar Association, dated Sept. 30, 2009 ("Amer. Bar Assoc. (Sept. 2009)"); letter from Goldman Sachs (Sept. 2009).

615 See, e.g., letter from Credit Suisse (June 2009); letter from STA (June 2009).

subject to a price test.[616] One commenter noted that a pilot study would allow the Commission to observe the effects of a price test under current market conditions,[617] while another stated that the Commission should study a price test in the context of severe market conditions.[618] Another commenter stated that a pilot study is particularly important for the alternative uptick rule because it has not been in effect in the market previously and would be more restrictive than other proposed price tests.[619] Other commenters noted that a pilot study could provide data regarding the impact or need for various exceptions to a price test.[620] Several commenters indicated that pilot study data should be made publicly available to permit third parties to analyze the results of the pilot study.[621]

In contrast, several commenters stated that the Commission should not adopt a price test restriction on a pilot basis.[622] Several of these commenters expressed concerns regarding the costs to implement a price test on a pilot basis,[623] with some stating that such costs would outweigh the benefits of a pilot study.[624] One commenter stated that a price test should be implemented as soon as possible, without a pilot study, because a pilot study would produce little

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616 See letter from Citadel et al. (June 2009).

617 See letter from NYSE Euronext (June 2009).

618 See letter from Virtu Financial.

619 See letter from STANY (Sept. 2009).

620 See, e.g., letter from T. Rowe Price (June 2009); letter from Direct Edge (Sept. 2009); see also letter from Wells Fargo (June 2009) (noting that additional study regarding an exception for bona fide market making activity would be needed if the Commission adopted a circuit breaker rule).

621 See letter from BATS (May 2009); letter from STA (June 2009).

622 See, e.g., letter from Amer. Bankers Assoc.; letter from SIFMA (June 2009); letter from IBC.

623 See, e.g., letter from Amer. Bankers Assoc.; letter from NYSE Euronext (June 2009); letter from SIFMA (June 2009); letter from STA (June 2009).

624 See, e.g., letter from Amer. Bankers Assoc.; letter from SIFMA (June 2009).

or no benefit.[625] Several commenters expressed support for a "sunset" provision allowing the Commission to more easily remove a price test restriction if it was determined that the restriction was not meeting the Commission's goals or was harming the market.[626]

We have determined not to adopt Rule 201 on a pilot basis. We believe that adopting the rule on a temporary pilot basis and/or only for a subset of securities will not advance the goals of our adopting Rule 201. For example, one goal in adopting Rule 201 is to address erosion of investor confidence in our markets. We believe that adopting Rule 201 on a pilot basis, such that the Rule would apply for the duration of the pilot only, could undermine this goal because, among other things, investors would know that the Rule is in place for a limited period of time rather than on a permanent basis and, therefore, may believe that any benefits that result from the Rule could be temporary.

In addition, we note that unlike the Pilot, which removed then-existing short sale price test restrictions for a subset of securities, undertaking a pilot study in connection with Rule 201 would require market participants to undertake as much time, effort and expense as full implementation of the new rule. As noted by one commenter, the implementation cost would be the same whether the Rule is adopted on a pilot or a permanent basis.[627] We also do not believe a "sunset" provision would advance our goal of restoring investor confidence because, as with a pilot, investors would know that the Rule is in place for a limited period of time rather than on a

625 See letter from IBC.

626 See, e.g., letter from SIFMA (June 2009); letter from Dialectic Capital (June 2009). One commenter also cited easier removal of the price test restriction as an argument for a pilot study. See letter from STANY (June 2009).

627 See letter from STA (June 2009). We note that a number of commenters expressed concerns regarding the implementation costs of a price test. See infra Sections X.B.1.b. and X.B.2.b. (discussing implementation costs).

permanent basis and, therefore, may believe that any benefits that result from the Rule could be temporary.

We encourage researchers, however, to provide the Commission with their own empirical analyses regarding the impact of the Rule on the options markets, and on market quality in general. We will, moreover, carefully monitor the operation of the Rule to assess its impact and effectiveness, including the Rule's impact on market quality, to determine whether any modifications to the Rule are warranted. In addition, we have instructed the Staff to assess the impact of the Rule on the options markets and to provide us with a written report of their assessment within the shortest time practicable for completing a meaningful study, which we expect, in any event, will not exceed two years from the Compliance Date.

To the extent that we determine at any time that any of the current parameters of Rule 201, such as the exceptions to the Rule, the 10% trigger level, the duration of the price test restriction if triggered, the basing of the trigger level on the prior day's closing price as determined by the covered security's listing market, or changed market conditions, result in Rule 201 not adequately addressing our concerns or meeting our goals in adopting Rule 201, we will consider whether to amend Rule 201, or grant relief thereunder, as appropriate at that time.

IX. Paperwork Reduction Act

A. Background

Certain provisions of the amendments to Regulation SHO contain new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[628] We submitted the collection of information to the Office of Management and Budget ("OMB") for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR

[628] 44 U.S.C. 3501 et seq.

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 OMB control number. The title for the collection of information is "Rules 201 and 200(g)" and the OMB control number for the collection of information is 3235-0651.

We are adopting amendments to Rules 201 and 200(g) of Regulation SHO under the Exchange Act. The amendments to Rule 201 impose a short sale-related circuit breaker that, if triggered, will impose a short sale price test restriction on a particular security for a limited period of time. Specifically, Rule 201 requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[629] In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[630] In addition, we are adopting amendments to Rule 200(g) of Regulation SHO to provide that a broker-dealer may mark certain qualifying sell orders "short exempt." In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to

[629] Rule 201(b). See also supra Section III.A.7. (discussing the policies and procedures approach).

[630] Id.

the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[631]

B. Summary

As detailed below, several provisions under the amendments to Regulation SHO impose a new "collection of information" within the meaning of the PRA.

1. Policies and Procedures Requirement under Rule 201

Rule 201 imposes a new "collection of information" within the meaning of the PRA. Rule 201 requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[632] In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan. Thus, a trading center's policies and procedures must be reasonably designed to permit the trading center to be able to obtain information from the single plan processor regarding whether a covered security is subject to the short sale price test restriction of Rule 201; if the covered security is subject to the short sale price test restriction of Rule 201, to determine whether or not the short sale order is priced in

[631] See Rules 200(g) and 200(g)(2); see also supra Section IV. (discussing the amendments to Rule 200(g)).

[632] Rule 201(b). See also supra Section III.A.7. (discussing the policies and procedures approach).

accordance with the provisions of Rule 201(b); and to recognize when an order is marked "short exempt" such that the trading center's policies and procedures do not prevent the execution or display of such orders at a price that is less than or equal to the current national best bid, even if the covered security is subject to the short sale price test restriction of Rule 201.[633]

At a minimum, a trading center's policies and procedures must enable a trading center to monitor, on a real-time basis, the national best bid, so as to determine the price at which the trading center may execute or display a short sale order. As mentioned above, a trading center must have policies and procedures reasonably designed to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.[634]

A trading center must also take such steps as will be necessary to enable it to enforce its policies and procedures effectively. A trading center must regularly surveil to ascertain the effectiveness of the policies and procedures required under the Rule and must take prompt action to remedy deficiencies in such policies and procedures.[635] The nature and extent of the policies and procedures that a trading center must establish to comply with these requirements will depend upon the type, size, and nature of the trading center.

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633 Id.

634 Rule 200(g)(2). The broker-dealer marking the order "short exempt" will have responsibility for being able to identify on which provision of Rule 201 it was relying in marking the order "short exempt."

635 This provision will reinforce the on-going maintenance and enforcement requirements of Rule 201(b)(1) by explicitly assigning an affirmative responsibility to trading centers to surveil to ascertain the effectiveness of their policies and procedures. See Rule 201(b)(2). We note that Rule 611(a)(2) of Regulation NMS contains a similar provision for trading centers. See 17 CFR 242.611(a)(2).

2. Policies and Procedures Requirement under the Broker-Dealer and Riskless Principal Provisions

Rule 201 contains a broker-dealer provision that requires a new "collection of information" under the PRA. Rule 201(c) permits a broker-dealer submitting a short sale order for the covered security to a trading center to mark the order "short exempt" if the broker-dealer identifies the order as being at a price above the current national best bid at the time of submission.[636] This provision requires a new collection of information in that a broker-dealer marking an order "short exempt" under Rule 201(c) must identify a short sale order as priced in accordance with the requirements of Rule 201(c); establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the requirements of Rule 201(c); regularly surveil to ascertain the effectiveness of these policies and procedures, and to take prompt action to remedy deficiencies.[637]

Rule 201 also contains a riskless principal provision that requires a new "collection of information" under the PRA. Specifically, Rule 201(d)(6) permits a broker-dealer to mark as "short exempt" short sale orders where broker-dealers are facilitating customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal, provided certain conditions are satisfied.[638] This provision requires a new collection of information in that it requires a broker-dealer marking an order "short exempt"

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[636] See Rule 201(c). As a result, a trading center's policies and procedures will need to be reasonably designed to permit the execution or display of such orders without regard to whether the order is at a price that is less than or equal to the current national best bid. See Rule 201(b)(1)(iii).

[637] See Rules 201(c)(1) and 201(c)(2).

[638] See Rule 201(d)(6). As a result, a trading center's policies and procedures will need to be reasonably designed to permit the execution or display of such orders without regard to whether the order is at a price that is less than or equal to the current national best bid. See Rule 201(b)(1)(iii).

under this provision to have written policies and procedures in place to assure that, at a minimum: (i) the customer order was received prior to the offsetting transaction; (ii) the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and (iii) that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[639]

3. Marking Requirements

While the current marking requirements in Rule 200(g) of Regulation SHO, which require broker-dealers to mark all sell orders of any equity security as either "long" or "short,"[640] remain in effect, the amendments to Rule 200(g) add a new marking requirement of "short exempt."[641] In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[642] The new "short exempt" marking requirements impose a new collection of information.

C. Use of Information

1. Policies and Procedures Requirement under Rule 201

The information collected under Rule 201's written policies and procedure requirement[643] will help ensure that the trading center does not execute or display any impermissibly priced

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[639] See Rule 201(d)(6).

[640] 17 CFR 242.200(g).

[641] See Rule 200(g); see also supra Section IV. (discussing the amendments to Rule 200(g)).

[642] See Rule 200(g)(2).

[643] See Rule 201(b).

short sale orders, unless an order is marked "short exempt," in accordance with the Rule's requirements. This written policies and procedures requirement will also provide trading centers with flexibility in determining how to comply with the requirements of Rule 201. The information collected also will aid the Commission and SROs that regulate trading centers in monitoring compliance with the Rule's requirements. In addition, it will aid trading centers and broker-dealers in complying with the Rule's requirements.

2. Policies and Procedures Requirement under the Broker-Dealer and Riskless Principal Provisions

The broker-dealer provision in Rule 201(c) permits a broker-dealer submitting a short sale order for the covered security to a trading center to mark the order "short exempt" if the broker-dealer identifies the order as being at a price above the current national best bid at the time of submission.[644] This provision includes a policies and procedures requirement that is designed to help prevent incorrect identification of orders for purposes of Rule 201(c)'s broker-dealer provision. The information collected will also enable the Commission and SROs to examine for compliance with the requirements of the exception.

Moreover, the information collected under the written policies and procedures requirement in the riskless principal exception in Rule 201(d)(6)[645] will help assure that broker-dealers comply with the requirements of this provision. The information collected will also enable the Commission and SROs to examine for compliance with the requirements of the exception.

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[644] See Rule 201(c).

[645] See Rule 201(d)(6).

3. Marking Requirements

The amendments to Rule 200(g) add a new marking requirement of "short exempt."[646] In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[647] The purpose of the information collected is to enable the Commission and SROs to monitor whether a person entering a sell order covered by Rule 201 is acting in accordance with one of the provisions contained in paragraph (c) or (d) of the Rule. In particular, the "short exempt" marking requirement will provide a record that will aid in surveillance for compliance with the provisions of Rule 201. It also will provide an indication to a trading center regarding whether or not it must execute or display a short sale order in accordance with the Rule's provisions. In addition, it will help a trading center determine whether its policies and procedures are reasonable and whether its surveillance is effective.

D. Respondents

As discussed below, the Commission has considered each of the following respondents for the purposes of calculating the reporting burdens under the amendments to Rules 200(g) and 201 of Regulation SHO.

1. Policies and Procedures Requirement under Rule 201

Rule 201 requires each trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid during the

646 See Rule 200(g); see also supra Section IV. (discussing the amendments to Rule 200(g)).

647 See Rule 200(g)(2).

period when the circuit breaker is in effect, unless an exception applies.[648] A "trading center" is defined as "a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent."[649] Because Rule 201 applies to any trading center that executes or displays a short sale order in a covered security, the Rule applies to 10 registered national securities exchanges that trade covered securities (or "SRO trading centers"),[650] and approximately 407 broker-dealers (including ATSs) registered with the Commission (or "non-SRO trading centers").[651]

2. Policies and Procedures Requirement under the Broker-Dealer and Riskless Principal Provisions

The collection of information required in connection with the broker-dealer provision in Rule 201(c) and in connection with the riskless principal provision in Rule 201(d)(6) applies to all registered brokers-dealers submitting short sale orders in reliance on these provisions. While not all broker-dealers likely will enter sell orders in securities covered by the amendments to Rules 200(g) and 201 in a manner that will subject them to this collection of information, we

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648 See Rule 201(b).

649 See Rule 201(a)(9); see also 17 CFR 242.600(b)(78).

650 Currently, there are 10 national securities exchanges (BX, BATS, CBOE, CHX, ISE, Nasdaq, NSX, NYSE, NYSE Amex, and NYSE Arca) that operate an SRO trading facility for covered securities and thus will be subject to the Rule. The Proposal indicated that one national securities association (FINRA) would also be subject to the Rule. See Proposal, 74 FR at 18086, n.334. However, FINRA operates an SRO display-only facility for covered securities, rather than an SRO trading facility, and thus is not subject to the Rule.

651 This number includes the approximately 357 firms that were registered equity market makers or specialists at year-end 2008 (this number was derived from annual FOCUS reports and discussion with SRO staff), as well as the 50 ATSs that operate trading systems that trade covered securities. The Commission believes it is reasonable to estimate that in general, firms that are block positioners - i.e., firms that are in the business of executing orders internally - are the same firms that are registered market makers (for instance, they may be registered as a market maker in one or more Nasdaq stocks and carry on a block positioner business in exchange-listed stocks), especially given the amount of capital necessary to carry on such a business.

estimate, for purposes of the PRA, that all of the approximately 5,178[652] registered broker-dealers will do so.

3. Marking Requirements

The collection of information that is required pursuant to the "short exempt" marking requirements of Rule 200(g) applies to all registered brokers-dealers submitting short sale orders marked "short exempt" in accordance with the provisions contained in paragraph (c) or (d) of Rule 201. While not all broker-dealers likely will enter sell orders in securities covered by the amendments to Rules 200(g) and 201 in a manner that will subject them to this collection of information, we estimate, for purposes of the PRA, that all of the approximately 5,178[653] registered broker-dealers will do so.

E. Total Annual Reporting and Recordkeeping Burdens

1. Policies and Procedures Requirement under Rule 201

Rule 201 requires each trading center to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid during the period when the circuit breaker is in effect.[654] Thus, trading centers must develop written policies and procedures reasonably designed to permit the trading center to be able to obtain information from the single plan processor regarding whether a covered security is subject to the short sale price test restriction of Rule 201; if the covered security is subject to the short sale price test restriction of Rule 201, to determine whether or not the short sale order is priced in

[652] This number is based on a review of 2008 FOCUS Report filings reflecting registered broker-dealers, including introducing broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

[653] Id.

[654] See Rule 201(b)(1).

accordance with the provisions of Rule 201(b); and to recognize when an order is marked "short exempt" such that the trading center's policies and procedures do not prevent the execution or display of such orders at a price that is less than or equal to the current national best bid, even if the covered security is subject to the short sale price test restriction of Rule 201.

In the Proposal, we provided estimates of the reporting and recordkeeping burdens for trading centers under the proposed short sale price test restrictions, both on a permanent, market-wide basis and in conjunction with a circuit breaker.[655] We also requested comment, in the Proposal and the Re-Opening Release, as to whether the proposed burden estimates were appropriate or whether such estimates should be increased or reduced, and if so, for which entities and by how much.[656]

One commenter provided a cost estimate, including costs for "development man-hours" of $500,000 per firm for implementation of a new short sale price test restriction by trading centers, either on a permanent, market-wide basis, or in conjunction with a circuit breaker.[657] One commenter stated that a new short sale price test restriction would involve "significant implementation costs" and "the generation and retention of voluminous compliance reports" but did not provide a specific estimate of the cost or hours that would be involved.[658] Several commenters expressed general concerns regarding the time and cost that would be imposed for implementation and on-going monitoring and surveillance of a new short sale price test

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655 See Proposal, 74 FR at 18087.

656 See Proposal, 74 FR at 18088; Re-Opening Release, 74 FR at 42036.

657 Letter from Wolverine. Wolverine provided an estimate of $500,000 per firm for implementation costs, which it applied to both non-SRO trading centers and other registered broker-dealers.

658 Letter from EWT (Sept. 2009).

restriction, including a policies and procedures requirement, but did not provide specific estimates of such time and cost.[659]

We considered these comments in reviewing the burden estimates for trading centers that we proposed with respect to the collection of information requirements in Rule 201. We believe that the cost and time required for implementation of Rule 201 will be lower than some commenters' stated estimates[660] because we believe that the implementation and on-going monitoring and surveillance costs of the alternative uptick rule will be lower than the implementation and on-going monitoring and surveillance costs that would be associated with adoption of the proposed modified uptick rule or the proposed uptick rule. Unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price (i.e., whether the current national best bid or last sale price is above or below the previous national best bid or last sale price), the alternative uptick rule references only the current national best bid.

A number of commenters stated that because the alternative uptick rule would not require monitoring of the sequence of bids or last sale prices, implementing the alternative uptick rule would be less costly[661] or easier than implementing the proposed modified uptick rule or the

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659 See, e.g., letter from RBC (June 2009); letter from STANY (June 2009); letter from CPIC (June 2009); letter from EWT (Sept. 2009); letter from RBC (Sept. 2009). We received time estimates only with respect to the Commission's proposed implementation time and did not receive comments regarding estimated PRA burden hours. See supra Section VII. (discussing comments on implementation time).

660 We received comments expressing concerns about the implementation and on-going monitoring and compliance costs of a short sale price test restriction that were not specific to the alternative uptick rule. See, e.g., letter from RBC (June 2009); letter from STANY (June 2009); letter from CPIC (June 2009); letter from Wolverine.

661 See, e.g., letter from BATS (May 2009); letter from Michael L. Crowl, Managing Director, Global General Counsel, Barclays Global Investors, dated Sept. 21, 2009 ("Barclays (Sept. 2009)"); letter from BATS (Sept. 2009); letter from GETCO (Sept. 2009); letter from ICI (Sept. 2009); letter from Glen Shipway (Sept. 2009); letter from STA (Sept. 2009). In addition, several commenters acknowledged that implementation of the alternative uptick rule will likely be less costly, without referencing the sequencing issue. See, e.g., letter from Atherton Lane; letter from STANY (Sept. 2009).

proposed uptick rule.[662] In addition, several commenters stated that the alternative uptick rule would be easier to program into trading and surveillance systems than the proposed modified uptick rule or the proposed uptick rule.[663] Another commenter stated, with respect to the alternative uptick rule, that "actual implementation costs in terms of time and capital expenditure would be negligible when compared to those involved in implementing either the uptick rule or modified uptick rule."[664]

Several commenters indicated that implementation of the alternative uptick rule would not be easier or less costly than implementation of the proposed modified uptick rule or the proposed uptick rule.[665] However, we note that some of these commenters presented concerns that were not directly related to the alternative uptick rule[666] or to implementation costs or difficulties.[667] Additionally, one commenter did not provide the reasoning for its belief that the alternative uptick rule would not be easier or less costly to implement.[668]

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662 See, e.g., letter from Credit Suisse (June 2009); letter from Goldman Sachs (June 2009); letter from SIFMA (June 2009); letter from Glen Shipway (Sept. 2009); letter from SIFMA (Sept. 2009). In addition, one commenter acknowledged that implementation of the alternative uptick rule will likely be easier, without referencing the sequencing issue. See letter from Allston Trading (Sept. 2009).

663 See, e.g., letter from BATS (May 2009); letter from Goldman Sachs (June 2009); letter from Glen Shipway (Sept. 2009); letter from ICI (Sept. 2009); see also letter from National Stock Exchange et al.

664 Letter from BATS (Sept. 2009).

665 See, e.g., letter from Matlock Capital (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from RBC (Sept. 2009); letter from Knight Capital (Sept. 2009).

666 See, e.g., letter from NYSE Euronext (Sept. 2009) (stating that implementation of the alternative uptick rule would be more difficult on the basis that the alternative uptick rule would be paired with a circuit breaker and attributing implementation difficulties to the circuit breaker approach, not the alternative uptick rule); letter from RBC (Sept. 2009) (expressing concern about the implementation cost of any short sale price test restriction in general).

667 See, e.g., letter from Knight Capital (Sept. 2009) (characterizing a potential increase in friction, confusion, or inefficiency in the market as an implementation difficulty that may arise from the alternative uptick rule).

668 See letter from Matlock Capital (Sept. 2009).

Several commenters indicated that their belief that other commenters' estimates regarding the difficulty or costs of implementing and monitoring the proposed modified uptick rule and the proposed uptick rule were exaggerated.[669] We recognize that some commenters' estimates of the costs of the proposed modified uptick rule or the proposed uptick rule may have been conservative. We also believe that because the alternative uptick rule does not include a sequencing requirement, the implementation and on-going monitoring and surveillance costs of the alternative uptick rule will be less than such costs would be with respect to the other proposed short sale price test restrictions.

In addition, as noted in the Proposal, while we have based our burden estimates, in part, on the burden estimates provided in connection with the adoption of Regulation NMS,[670] we believe that these estimates may be on the high end because trading centers have already had to establish policies and procedures in connection with that Regulation's Order Protection Rule, which could help form the basis for the policies and procedures for Rule 201. Several commenters agreed, stating that previous experience with the policies and procedures required under Regulation NMS might reduce the implementation and on-going monitoring and compliance burdens on trading centers.[671] In contrast, some commenters indicated that the Commission overstated the benefit of such previous experience,[672] because, for example, "systems re-written and architected for Reg NMS ... did not include any short sale restrictions,"[673] or because such systems will require modifications in order to be used in the

[669] See, e.g., letter from Matlock Capital (Sept. 2009); letter from ISE (Sept. 2009); letter from Bingham McCutchen.

[670] See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087.

[671] See, e.g., letter from EWT (Sept. 2009); letter from MFA (Oct. 2009).

[672] See, e.g., letter from FIF (June 2009); letter from NSCP; letter from RBC (June 2009).

[673] Letter from FIF (June 2009); see also letter from RBC (June 2009).

context of a short sale price test restriction.[674] However, we considered these issues when considering the impact of previous experience with the policies and procedures requirement of Regulation NMS's Order Protection Rule. We continue to believe that because most trading centers already have in place systems and written policies and procedures to comply with Regulation NMS's Order Protection Rule, most trading centers will already be already familiar with establishing, maintaining, and enforcing trading-related policies and procedures, which will mitigate the burden of implementation of the policies and procedures requirement under Rule 201. We realize, however, that the exact nature and extent of the policies and procedures that a trading center is required to establish likely will vary depending upon the type, size, and nature of the trading center. Thus, our estimates take into account different types of trading centers and we realize that these estimates may be on the low-end for some trading centers while they may be on the high-end for other trading centers.

We considered whether our estimates of the burdens associated with the collection of information requirements for trading centers with respect to the proposed modified uptick rule included in the Proposal[675] would change under the circuit breaker approach of Rule 201, but, as discussed below, concluded that these estimates continue to represent reasonable estimates under the circuit breaker approach in combination with the alternative uptick rule.

Despite some commenters' concerns regarding the implementation costs of a circuit breaker rule,[676] we believe that the circuit breaker approach will result in largely the same implementation

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674 See letter from NSCP; letter from RBC (June 2009).

675 See Proposal, 74 FR at 18087.

676 See, e.g., letter from T. Rowe Price (June 2009); letter from Glen Shipway (June 2009); see also letter from STANY (June 2009) (stating that costs savings of a circuit breaker approach would be reduced if the circuit breaker triggered a short sale price test restriction); letter from NYSE Euronext (Sept. 2009) (stating that "a circuit breaker approach raises significant implementation complexities"); letter from SIFMA (June 2009) (including a survey reflecting implementation costs of a circuit breaker triggering a short sale price test based

costs as we estimated would be incurred if we adopted a permanent, market-wide short sale price test restriction.[677] As one commenter stated "[o]nce the price test is in place, there is minimal incremental effort required to add a Circuit Breaker that controls the application of the price test."[678] Similarly, another commenter stated that "[t]he additional coding required to implement a circuit breaker is minimal..."[679] We believe that there will be only minimal, if any implementation costs for a circuit breaker approach in addition to the costs we estimated previously for the implementation of a permanent, market-wide short sale price test rule because trading centers would need to establish written policies and procedures to implement the short sale price test restriction regardless of whether the short sale price test restriction is adopted on a permanent, market-wide basis or, in the case of Rule 201, adopted in conjunction with a circuit breaker. Several other commenters agreed, stating that the costs of the circuit breaker approach would be similar to, or only incrementally higher than, the costs of a permanent, market-wide approach.[680]

In addition, with respect to on-going monitoring and surveillance costs of the circuit breaker approach, we recognize, as noted by one commenter,[681] that trading centers will need to continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be offset because, under the circuit breaker approach, the alternative uptick rule is time limited and

on the national best bid). We note that one commenter indicated that adoption of a circuit breaker approach would add approximately four to six weeks to the implementation time of the alternative uptick rule. See letter from Direct Edge (Sept. 2009); see also supra Section VII. (discussing comments on implementation time).

677 See Proposal, 74 FR at 18087.

678 Letter from Nasdaq OMX Group (Oct. 2009).

679 Letter from Credit Suisse (Sept. 2009).

680 See, e.g., letter from STA (June 2009).

681 See letter from Glen Shipway (June 2009).

will only apply on a stock by stock basis, which will reduce our previously estimated costs for on-going monitoring and surveillance. This is because trading centers only need to monitor and surveil for compliance with the alternative uptick rule during the limited period of time that the circuit breaker is in effect with respect to a specific security. As such, the circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure. As noted by one commenter, a circuit breaker "is particularly efficient in stable and rising markets because it avoids imposing continuous monitoring and compliance costs where there is little or no corresponding risk of abusive short selling."[682]

Further, although, under the circuit breaker approach, market participants will need to monitor whether a stock is subject to Rule 201, we believe that familiarity with a circuit breaker approach may help mitigate such compliance costs. As discussed in the Proposal, currently, all stock exchanges and FINRA have rules or policies to implement coordinated circuit breaker halts.[683] Moreover, SROs have rules or policies in place to coordinate individual security trading halts corresponding to significant news events.[684]

On balance, we believe that the estimates of the burdens associated with the collection of information requirements for trading centers included in the Proposal[685] are appropriate with respect to Rule 201. Thus, our estimates have not changed from the Proposal, except to the

682 Letter from Nasdaq OMX Group (Oct. 2009); see also letter from SIFMA (Sept. 2009).

683 See supra note 292.

684 See, e.g., FINRA Rule 6120; see also Proposal, 74 FR at 18065-18066 (discussing the background on circuit breakers).

685 See Proposal, 74 FR at 18087.

extent that total burden estimates have changed because we have updated the estimated number of trading centers.[686]

Although the exact nature and extent of the policies and procedures that a trading center must establish likely will vary depending upon the nature of the trading center (e.g., SRO vs. non-SRO, full service broker-dealer vs. market maker), we estimate that it initially will, on average, take an SRO trading center approximately 220 hours[687] of legal, compliance, information technology and business operations personnel time,[688] and a non-SRO trading center approximately 160 hours[689] of legal, compliance, information technology and business operations personnel time,[690] to develop the required policies and procedures.

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686 The Proposal indicated that there were approximately 372 non-SRO trading centers, including approximately 325 firms that were registered equity market makers or specialists at year-end 2007 (this number was derived from annual FOCUS reports and discussion with SRO staff), as well as 47 ATSs that operate trading systems that trade NMS stocks. See Proposal, 74 FR at 18086. We now estimate that there are approximately 407 non-SRO trading centers, including approximately 357 firms that were registered equity market makers or specialists at year-end 2008 (this number was derived from annual FOCUS reports and discussion with SRO staff), as well as 50 ATSs that operate trading systems that trade covered securities. See supra note 651. We also note that the number of SRO trading centers has changed from 11 in the Proposal to 10. See supra note 650.

687 For purposes of this adopting release, we are basing our estimates on the burden hour estimates provided in connection with the adoption of Regulation NMS because the policies and procedures developed in connection with that Regulation's Order Protection Rule are in many ways similar to what a trading center will need to do to comply with Rule 201. See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087. We note, however, that these estimates may be on the high end because trading centers have already had to establish similar policies and procedures to comply with Regulation NMS.

688 Based on experience and estimates provided in connection with Regulation NMS, we anticipate that of the 220 hours we estimate will be spent to establish the required policies and procedures, 70 hours will be spent by legal personnel, 105 hours will be spent by compliance personnel, 20 hours will be spent by information technology personnel and 25 hours will be spent by business operations personnel of the SRO trading center.

689 For purposes of this adopting release, we are basing our estimates on the burden hour estimates provided in connection with the adoption of Regulation NMS because the policies and procedures developed in connection with that Regulation's Order Protection Rule are in many ways similar to what a trading center will need to do to comply with the Rule 201. See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087. We note, however, that these estimates may be on the high end because trading centers have already had to establish similar policies and procedures to comply with Regulation NMS.

690 Based on experience and the estimates provided in connection with Regulation NMS, we anticipate that of the 160 hours we estimate will be spent to establish policies and procedures, 37 hours will be spent by legal personnel, 77 hours will be spent by compliance personnel, 23 hours will be spent by information technology personnel and 23 hours will be spent by business operations personnel of the non-SRO trading center.

In addition to these estimates (of 220 hours for SRO respondents and 160 hours for non-SRO respondents), we expect that SRO and non-SRO respondents will incur one-time external costs for outsourced legal services. While we recognize that the amount of legal outsourcing utilized to help establish written policies and procedures may vary widely from entity to entity, we estimate that on average, each trading center will outsource 50 hours of legal time in order to establish policies and procedures in accordance with the amendments.[691]

We estimate that there will be an initial one-time burden of, on average, 220 (not including the outsourced 50 hours of legal time) burden hours per SRO trading center or 2,200 hours,[692] and, on average, 160 (not including the outsourced 50 hours of legal time) burden hours per non-SRO trading center or 65,120 hours,[693] for a total of 67,320 burden hours to establish the required written policies and procedures.[694] We estimate a cost of, on average, approximately $8,340,000 for both SRO and non-SRO trading centers resulting from outsourced legal work.[695]

Once a trading center has established the required written policies and procedures, we estimate that, on average, it will take an SRO and non-SRO trading center each approximately two hours per month of on-going internal legal time and three hours of on-going internal compliance time to ensure that its written policies and procedures are up-to-date and remain in

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691 As discussed above, we base our burden estimate of 50 hours of outsourced legal time on the burden estimate used for Regulation NMS because the policies and procedures developed in connection with that Regulation's Order Protection Rule are in many ways similar to what a trading center will need to do to comply with Rule 201. See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087.

692 The estimated 2,200 burden hours necessary for SRO trading centers to establish policies and procedures are calculated by multiplying 10 times 220 hours (10 x 220 hours = 2,200 hours).

693 The estimated 65,120 burden hours necessary for non-SRO trading centers to establish policies and procedures are calculated by multiplying 407 times 160 hours (407 x 160 hours = 65,120 hours).

694 See Rule 201(b).

695 This figure was calculated as follows: (50 legal hours x $400 x 10 SRO trading centers) + (50 legal hours x $400 x 407 non-SRO trading centers) = $8,340,000. Based on industry sources, we estimate that the average hourly rate for outsourced legal services in the securities industry is $400.

compliance with the amendments to Rule 201, or a total of 60 hours annually per respondent.[696] In addition, we estimate that, on average, it will take an SRO and non-SRO trading center each approximately 16 hours per month of on-going compliance time, 8 hours per month of on-going information technology time, and 4 hours per month of on-going legal time associated with on-going monitoring and surveillance for and enforcement of trading in compliance with Rule 201, or a total of 336 hours annually per respondent.[697]

2. Policies and Procedures Requirement under the Broker-Dealer and Riskless Principal Provisions

To rely on the broker-dealer provision of Rule 201(c), a broker-dealer marking a short sale order in a covered security "short exempt" under Rule 201(c) must identify the order as being at a price above the current national best bid at the time of submission to the trading center and must establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the incorrect identification of orders as being submitted to the trading center at a permissible price.[698] At a minimum, the broker-dealer's policies and procedures must be reasonably designed to enable a broker-dealer to monitor, on a real-time basis, the national best bid so as to determine the price at which the broker-dealer may submit a short sale order to a trading center in compliance with the requirements of Rule 201(c). In addition, a broker-dealer

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[696] This figure was calculated as follows: (2 legal hours x 12 months) + (3 compliance hours x 12 months) = 60 hours annually per respondent. As discussed above, this burden estimate of 60 hours is based on experience and what was estimated for Regulation NMS to ensure that written policies and procedures were up-to-date and remained in compliance. See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087.

[697] This figure was calculated as follows: (16 compliance hours x 12 months) + (8 information technology hours x 12 months) + (4 legal hours x 12 months) = 336 hours annually per respondent. As discussed above, this burden estimate of 336 hours is based on experience and what was estimated for Regulation NMS regarding similarly required on-going monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

[698] See Rule 201(c).

must take such steps as necessary to enable it to enforce its policies and procedures effectively.[699]

To rely on the riskless principal provision under Rule 201(d)(6) a broker-dealer must have written policies and procedures in place to assure that, at a minimum: (i) the customer order was received prior to the offsetting transaction; (ii) the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and (iii) that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[700]

In the Proposal, we provided estimates of the reporting and recordkeeping burdens for broker-dealers to implement, monitor and surveil on an on-going basis the policies and procedures required to rely on the broker-dealer provision of Rule 201(c) or the riskless principal provision under Rule 201(d)(6).[701] We also requested comment, in the Proposal and the Re-Opening Release, as to whether the proposed burden estimates were appropriate or whether such estimates should be increased or reduced, and if so, for which entities and by how much.[702] The following discussion of comments on the proposed burden estimates for broker-dealers includes comments that were discussed above with respect to the burden estimates for trading centers[703]

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699 This will include the requirement that broker-dealers regularly surveil to ascertain the effectiveness of their policies and procedures and take prompt remedial steps. This provision is intended to reinforce the on-going maintenance and enforcement requirements of the provision contained in Rule 201(c)(1) by explicitly assigning an affirmative responsibility to broker-dealers to surveil to ascertain the effectiveness of their policies and procedures. See Rule 201(c)(2).

700 See Rule 201(d)(6).

701 See Proposal, 74 FR at 18088-18089.

702 See Proposal, 74 FR at 18089; Re-Opening Release, 74 FR at 42036.

703 See supra Section IX.E.1. (discussing reporting and recordkeeping burdens for trading centers).

because, in some cases, commenters provided comments and estimates on the costs of establishing and monitoring policies and procedures under the proposed short sale price tests without distinguishing between costs that would be applicable to trading centers as opposed to broker-dealers.

One commenter provided a cost estimate, including costs for "development man-hours" of $500,000 per firm for implementation of Rule 201 by broker-dealers.[704] One commenter stated that a new short sale price test restriction would involve "significant implementation costs" and "the generation and retention of voluminous compliance reports" but did not provide a specific estimate of the cost or hours that would be involved.[705] Several commenters expressed general concerns regarding the time and cost that would be imposed on market participants for implementation and on-going monitoring and surveillance of a new short sale price test restriction, including a policies and procedures requirement but did not provide specific estimates of such time and cost.[706]

In addition, several commenters noted that implementation and on-going monitoring and surveillance of the requirements of the broker-dealer provision would impose significant costs on broker-dealers, but did not provide an estimate of such costs.[707] Several commenters stated that

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704 Letter from Wolverine. Wolverine provided an estimate of $500,000 per firm for implementation costs, which it applied to both non-SRO trading centers and other registered broker-dealers.

705 Letter from EWT (Sept. 2009). EWT also did not specify whether this comment on our estimated annual reporting and recordkeeping burdens with respect to provisions of the proposed rules that would require a new "collection of information" was specific to the provisions applicable to trading centers or to the provisions applicable to broker-dealers.

706 See, e.g., supra note 659. These commenters' concerns regarding implementation costs either were expressed with respect to market participants generally or included references to obligations that would be imposed on, or changes that would have to be made by, broker-dealers.

707 See, e.g., letter from Credit Suisse (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009); letter from NSCP; letter from STANY (June 2009); letter from EWT (Sept. 2009).

the costs of the broker-dealer provision could be particularly burdensome for smaller broker-dealers, but did not provide a time or cost estimate of such burdens.[708]

We considered these comments in reviewing the burden estimates for broker-dealers that we proposed with respect to the collection of information requirements in Rule 201. We believe that the cost and time required for implementation and on-going monitoring and surveillance of the policies and procedures required to rely on the broker-dealer provision of Rule 201(c) will be lower than some commenters' stated estimates[709] because the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price.[710] Because the alternative uptick rule does not require sequencing of the national best bid, we believe that the policies and procedures required in order to rely on the broker-dealer provision under the alternative uptick rule, which are similar to those required for non-SRO trading centers in complying with paragraph (b) of Rule 201, will be easier and less costly to implement and monitor than would be the case under the proposed modified uptick rule or the proposed uptick

[708] See, e.g., letter from Credit Suisse (June 2009); letter from NSCP; letter from T.D. Pro Ex. We received time estimates on the Commission's proposed implementation time, but did not receive comments with respect to the estimated PRA burden hours. See supra Section VII. (discussing comments on implementation time).

[709] We received comments expressing concerns about the implementation and on-going monitoring and compliance costs to broker-dealers of a short sale price test restriction that were not specific to the alternative uptick rule. See, e.g., letter from Credit Suisse (June 2009); letter from RBC (June 2009); letter from STANY (June 2009); letter from CPIC (June 2009); letter from Wolverine; letter from T.D. Pro Ex; letter from FIF (June 2009); letter from Lime Brokerage (June 2009); letter from NSCP.

[710] We also note that it is possible that some smaller broker-dealers that determine to rely on the broker-dealer provision may determine that it is cost-effective for them to outsource certain functions necessary to comply with Rule 201(c) to larger broker-dealers, rather than performing such functions in house, to remain competitive in the market. This may help mitigate costs associated with implementing and complying with Rule 201(c). Additionally, they may decide to purchase order management software from technology firms. Order management software providers may integrate changes imposed by Rules 200(g) and 201 into their products, thereby providing another cost-effective way for smaller broker-dealers to comply with the requirement of Rule 201(c).

rule.[711] We note that one of the commenters that expressed concerns about the implementation cost of the broker-dealer provision also acknowledged that a rule "that would not require data centralization and sequencing would be significantly less complex and faster to implement."[712]

We disagree with several commenters who stated that, although implementation and on-going monitoring and surveillance of the alternative uptick rule might be easier and/or less costly for trading centers, this would not hold true for broker-dealers.[713] One of these commenters stated that "in order to avoid rejection of short sale orders under an alternative uptick rule, programming would need to be implemented to anticipate changes in the national best bid between the time a short sale order is entered and the time it reaches the relevant market center."[714] However, the broker-dealer provision of Rule 201(c) is designed specifically to help avoid this result. Under the broker-dealer provision, a broker-dealer may, in accordance with the policies and procedures required by the provision, identify the order as being at a price that is above the current national best bid at the time the order is submitted to the trading center and mark the order "short exempt." Trading centers are required to have written policies and procedures in place to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.[715]

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711 See supra notes 660 to 669 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

712 Letter from Credit Suisse (June 2009).

713 See, e.g., letter from Citadel et al. (Sept. 2009); letter from EWT (Sept. 2009); letter from Lime Brokerage (Sept. 2009).

714 Letter from Citadel et al. (Sept. 2009).

715 See Rule 201(b)(1)(iii).

In addition, as noted in the Proposal, while we have based our burden estimates on the burden estimates provided in connection with the adoption of Regulation NMS with respect to non-SRO trading centers (which includes broker-dealers),[716] we note that these estimates may be on the high end for those broker-dealers that have already had to establish policies and procedures in connection with that Regulation's Order Protection Rule, which could help form the basis for the policies and procedures for the broker-dealer provision of Rule 201(c), or the riskless principal provision under Rule 201(d)(6). Several commenters agreed, indicating that broker-dealers' previous experience with the policies and procedures required under Regulation NMS might reduce the implementation and on-going monitoring and compliance burdens on broker-dealers.[717] Some commenters stated that the Commission overstated the benefit of such previous experience[718] because, for example, "systems re-written and architected for Reg NMS ... did not include any short sale restrictions,"[719] or because such systems will require modifications in order to be used in the context of a short sale price test restriction.[720] However, we considered these issues when considering the impact of previous experience with the policies and procedures requirement of Regulation NMS's Order Protection Rule. We continue to believe that because broker-dealers may already have in place systems and written policies and procedures in connection with Regulation NMS's Order Protection Rule, those broker-dealers will already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, which will mitigate the burden of implementation of the policies and procedures

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716 See supra note 670.

717 See, e.g., letter from EWT (Sept. 2009); letter from MFA (Oct. 2009).

718 See, e.g., letter from FIF (June 2009); letter from NSCP; letter from RBC (June 2009).

719 Letter from FIF (June 2009); see also letter from RBC (June 2009).

720 See letter from NSCP; letter from RBC (June 2009).

requirement under the broker-dealer provision of Rule 201(c), or the riskless principal provision under Rule 201(d)(6). We realize, however, that the exact nature and extent of the policies and procedures that a broker-dealer must establish likely will vary depending upon the type, size, and nature of the broker-dealer. Thus, our estimates take into account different types of broker-dealers and we realize that these estimates may be on the low-end for some broker-dealers while they may be on the high-end for other broker-dealers.

We considered whether our estimates of the burdens associated with the collection of information requirements for broker-dealers with respect to the proposed modified uptick rule included in the Proposal[721] would change under the circuit breaker approach of Rule 201, but concluded, as discussed below, that these estimates continue to represent reasonable estimates under the circuit breaker approach.

As discussed previously,[722] despite some commenters' concerns regarding the implementation costs of a circuit breaker rule,[723] we believe that the circuit breaker approach will result in largely the same implementation costs as we estimated would be incurred if we adopted a permanent, market-wide short sale price test restriction.[724] We believe that that there will be only minimal, if any, implementation costs for a circuit breaker approach in addition to the costs we estimated previously for the implementation of a permanent, market-wide short sale price test rule because broker-dealers relying on Rule 201(c) or Rule 201(d)(6) must establish written policies and procedures required to comply with those provisions regardless of whether the short sale

[721] See Proposal, 74 FR at 18088-18089.

[722] See supra Section IX.E.1. (discussing estimated burdens of the collection of information requirements applicable to trading centers under Rule 201).

[723] See supra note 676.

[724] See Proposal, 74 FR at 18088.

price test restriction is adopted on a permanent, market-wide basis or, in the case of Rule 201, adopted in conjunction with a circuit breaker. Several other commenters agreed, stating that the costs of the circuit breaker approach would be similar to, or only incrementally higher than, the costs of a permanent, market-wide approach.[725]

In addition, with respect to on-going monitoring and surveillance costs of the circuit breaker approach, we recognize, as noted by one commenter,[726] that broker-dealers relying on Rule 201(c) or Rule 201(d)(6) must continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be offset because, under the circuit breaker approach, the alternative uptick rule is time limited and will only apply on a stock by stock basis, which will reduce our previously estimated costs for on-going monitoring and surveillance. This is because broker-dealers relying on Rule 201(c) will only need to monitor and surveil for compliance with the alternative uptick rule, and broker-dealers relying on Rule 201(d)(6) will only need to monitor for compliance with the requirements of that provision, during the limited period of time that the circuit breaker is in effect with respect to a specific security. As such, the circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure.[727]

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725 See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from Credit Suisse (Sept. 2009); letter from STA (June 2009).

726 See letter from Glen Shipway (June 2009).

727 See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

On balance, we believe that the estimates of the burdens associated with the collection of information requirements for broker-dealers included in the Proposal[728] are appropriate with respect to Rule 201. Thus, our estimates have not changed from the Proposal, except to the extent that total burden estimates have changed because we have updated the estimated number of broker-dealers.[729]

Although the exact nature and extent of the required policies and procedures that a broker-dealer must establish under the broker-dealer or the riskless principal provisions likely will vary depending upon the nature of the broker-dealer (e.g., full service broker-dealer vs. market maker), we estimate that it initially will, on average, take a broker-dealer approximately 160 hours[730] of legal, compliance, information technology and business operations personnel time,[731] to develop the required policies and procedures. In addition to this estimate of 160 hours, we expect that broker-dealers will incur one-time external costs for outsourced legal services. While we recognize that the amount of legal outsourcing utilized to help establish written policies and procedures will vary widely from entity to entity, we estimate that on

[728] See Proposal, 74 FR at 18088-18089.

[729] The Proposal indicated that there were approximately 5,561 broker-dealers. This number was based on a review of 2007 FOCUS Report filings reflecting registered broker-dealers, including introducing broker-dealers. This number did not include broker-dealers that were delinquent on FOCUS Report filings. See Proposal, 74 FR at 18086. We now estimate that there are approximately 5,178 broker-dealers. See supra note 652 and accompanying text.

[730] We base this estimate of 160 hours on the estimated burden hours we believe it will take a non-SRO trading center (which includes broker-dealers) to develop similarly required policies and procedures, since the policies and procedures required under the broker-dealer provision or the riskless principal exception will be similar to those required for non-SRO trading centers in complying with paragraph (b) of Rule 201. See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087.

[731] Based on experience and the estimates provided in connection with Regulation NMS, we anticipate that of the 160 hours we estimate will be spent to establish policies and procedures, 37 hours will be spent by legal personnel, 77 hours will be spent by compliance personnel, 23 hours will be spent by information technology personnel and 23 hours will be spent by business operations personnel of the broker-dealer.

average, each broker-dealer will outsource 50 hours[732] of legal time in order to establish policies and procedures in accordance with the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6).

We estimate that, on average, there will be an initial one-time burden of 160 burden hours per broker-dealer or 828,480 hours[733] to establish policies and procedures required under the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6). We estimate an average cost of approximately $103,560,000 for broker-dealers resulting from outsourced legal work.[734]

Once a broker-dealer has established written policies and procedures that are required under Rule 201(c) or Rule 201(d)(6), we estimate that it will take, on average, a broker-dealer approximately two hours per month of internal legal time and three hours of internal compliance time to ensure that its written policies and procedures are up-to-date and remain in compliance with Rule 201(c) or 201(d)(6), or a total of 60 hours annually per respondent.[735] In addition, we estimate that, on average, it will take a broker-dealer approximately 16 hours per month of on-going compliance time, 8 hours per month of on-going information technology time, and 4 hours per month of on-going legal time associated with on-going monitoring and surveillance for and

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[732] As discussed above, we base our burden estimate of 50 hours of outsourced legal time on the burden estimate used for Regulation NMS because the policies and procedures developed in connection with that Regulation's Order Protection Rule are in many ways similar to what a broker-dealer will need to do to comply with the policies and procedures required under the broker-dealer provision and the riskless principal exception of Rule 201. See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087.

[733] The estimated 828,480 burden hours necessary for a broker-dealer to establish policies and procedures are calculated by multiplying 5,178 times 160 hours (5,178 x 160 hours = 828,480 hours). See supra note 730.

[734] This figure was calculated as follows: (50 legal hours x $400 x 5,178 broker-dealers) = $103,560,000. Based on industry sources, we estimate that the average hourly rate for outsourced legal services in the securities industry is $400.

[735] This figure was calculated as follows: (2 legal hours x 12 months) + (3 compliance hours x 12 months). As discussed above, this burden estimate of 60 hours is based on experience and what was estimated for a Regulation NMS respondent to ensure that its written policies and procedures were up-to-date and remained in compliance.

enforcement of trading in compliance with Rule 201, or a total of 336 hours annually per respondent.[736]

3. Marking Requirements

The amendments to Rule 200(g) add a new marking requirement of "short exempt."[737] In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[738]

In the Proposal, we provided estimates of the reporting and recordkeeping burdens for the "short exempt" marking requirement. We also requested comment, in the Proposal and Re-Opening Release, on the accuracy of such estimates.[739]

Several commenters noted that the "short exempt" marking requirement would impose significant implementation costs, but did not provide a specific estimate of such costs.[740] One commenter stated that costs of the "short exempt" marking requirement would be worth the benefits gained.[741] We considered these comments in reviewing the burden estimates of the "short exempt" marking requirement of Rule 200(g).

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736 This figure was calculated as follows: (16 compliance hours x 12 months) + (8 information technology hours x 12 months) + (4 legal hours x 12 months) = 336 hours annually per respondent. As discussed above, this burden estimate of 336 hours is based on experience and what was estimated for Regulation NMS for similarly required on-going monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

737 See Rule 200(g); see also supra Section IV. (discussing the amendments to Rule 200(g)).

738 See Rule 200(g)(2).

739 See Proposal, 74 FR at 18089; Re-Opening Release, 74 FR at 42036.

740 See, e.g., letter from FIF (June 2009); letter from NSCP; letter from RBC (June 2009).

741 See letter from STA (June 2009).

We also considered whether our estimates of the burdens associated with the collection of information requirements for broker-dealers with respect to the amendments to Rule 200(g) in conjunction with the proposed modified uptick rule included in the Proposal[742] would change under the circuit breaker approach of Rule 201, but concluded, as discussed below, that these estimates continue to represent reasonable estimates under the circuit breaker approach.

We believe that the "short exempt" marking requirements of Rule 200(g), in conjunction with a circuit breaker approach, will result in largely the same implementation costs as would be incurred if the "short exempt" marking requirements were combined with a market-wide short sale price test restriction. This is because broker-dealers relying on the provisions of Rule 201(c) or Rule 201(d) would need to make systems changes to implement the "short exempt" marking requirements regardless of whether the short sale price test restriction is adopted on a permanent, market-wide basis or, in the case of Rule 201, adopted in conjunction with a circuit breaker.

In addition, with respect to on-going monitoring and surveillance costs of the "short exempt" marking requirements in conjunction with a circuit breaker approach, we recognize, as noted by one commenter,[743] that market participants will need to continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be offset because, under the circuit breaker approach, use of the "short exempt" provisions of Rule 201(c) and Rule 201(d) and the related marking requirements are time limited and will only apply on a stock by stock basis, which will reduce our previously estimated costs for on-going monitoring and surveillance. This is because broker-dealers who choose to rely on Rule 201(c) or Rule 201(d) will only need to

742 See Proposal, 74 FR at 18089.

743 See letter from Glen Shipway (June 2009).

monitor and surveil for compliance with the requirements of those provisions and will only need to mark qualifying orders "short exempt" during the limited period of time that the circuit breaker is in effect with respect to a specific security. As such, the circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure.[744]

On balance, we believe our proposed estimates of the burdens associated with the collection of information requirements of the "short exempt" marking requirement[745] are appropriate with respect to Rule 200(g) as adopted. Thus, our estimates have not changed from the Proposal, except to the extent that total burden estimates have changed because we have updated the estimated number of broker-dealers.[746]

We believe that the implementation cost of the "short exempt" marking requirement will likely be similar to the implementation cost of the order marking requirements of Rule 200(g) of Regulation SHO, which had originally included the category of "short exempt." Industry sources at that time estimated initial implementation costs for the former "short exempt" marking requirement to be approximately \$100,000 to \$125,000.[747] Based on these estimates, as adjusted for inflation, we estimate that the initial implementation cost of the "short exempt" marking

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744 See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

745 See Proposal, 74 FR at 18089.

746 See supra note 729.

747 See 2004 Regulation SHO Adopting Release, 69 FR at 48023.

requirement will be approximately $115,000 to $145,000 per broker-dealer [748] for a total initial implementation cost of approximately $595,470,000 to $750,810,000 for all broker-dealers.[749]

While not all broker-dealers likely will enter sell orders in securities covered by the amendments to Rules 200(g) and 201 in a manner that will subject them to this collection of information, we estimate, for purposes of the PRA, that all of the approximately 5,178 registered broker-dealers will do so. For purposes of the PRA, the Staff has estimated that a total of approximately 12.9 billion "short exempt" orders are entered annually.[750]

This is an average of approximately 2,491,309 annual responses by each respondent.[751] As we discussed in the Proposal, each response of marking sell orders "short exempt" will take approximately .000139 hours (.5 seconds) to complete. This estimate is based on the same time estimate for marking sell orders "long" or "short" used upon adoption of Rule 200(g) under Regulation SHO.[752] We believe this estimate is appropriate because, in accordance with the current marking requirements of Rule 200(g) of Regulation SHO, broker-dealers are already

748 The adjustment for inflation was calculated using information in the Consumer Price Index, U.S. Department of Labor, Bureau of Labor Statistics.

749 These figures were calculated as follows: ($115,000 x 5,178) = $595,470,000 and ($145,000 x 5,178) = $750,810,000.

750 As we stated in the Proposal, our estimate of 12.9 billion "short exempt" orders was calculated based on a review of short sale trades and short sale orders during August 2008. We believe that August 2008 data is representative of a normal month of trading. Specifically, we calculated that there were about 263 million short sale trades during August 2008 for Amex, FINRA, Nasdaq, NYSE Arca, and NYSE market centers. Based on a review of Rule 605 reports from the three largest market centers during August 2008, we estimate a ratio of 14.4 orders to trades. We gross up 263 million short sale trades by 14.4, which yields 3.8 billion short sale orders during August 2008 or an annualized figure of 45.4 billion. We estimate that approximately 28.5% of short sale orders are short exempt using Nasdaq short sale data from January to April 2005. We multiply 45.4 billion times 0.285 to obtain our estimate of 12.9 billion short exempt orders. See Proposal, 74 FR at 18089. We also note that, because the circuit breaker rule will not be in place at all times or for all securities, the frequency and, therefore, the estimated burden of marking "short exempt" is expected to be lower. We did not receive any comments on the estimated number of annual "short exempt" orders.

751 This figure was calculated as follows: 12.9 billion "short exempt" orders divided by 5,178 broker-dealers.

752 See 2004 Regulation SHO Adopting Release, 69 FR at 48023, n.140; see also 2003 Regulation SHO Proposing Release, 68 FR at 63000, n.232.

required to mark a sell order either "long" or "short." Thus, most broker-dealers already have the necessary mechanisms and procedures in place and are already familiar with processes and procedures to comply with the marking requirements of Rule 200(g) of Regulation SHO and broker-dealers will be able to continue to use the same mechanisms, processes and procedures to comply with the amendments to Rules 200(g) and 200(g)(2). We note, however, that this estimate may be too high given technological advances, such as automation of sell order marking, since the adoption of Rule 200(g) in 2004.

Thus, the total approximate estimated annual hour burden per year is 1,793,100 burden hours (12,900,000,000 orders marked "short exempt" multiplied by 0.000139 hours/order marked "short exempt"). Our estimate for the paperwork compliance for the marking requirement of Rule 200(g) for each broker-dealer is approximately 346 burden hours (2,491,309 responses multiplied by 0.000139 hours/responses) or (a total of 1,793,100 burden hours divided by 5,178 respondents).

F. Collection of Information Is Mandatory

1. Policies and Procedures Requirements

The collection of information required under Rule 201's policies and procedures requirement is mandatory for trading centers executing and displaying short sale orders in covered securities. The collection of information required under Rule 201's policies and procedures requirements in connection with the broker-dealer provision in Rule 201(c) and the riskless principal exception in Rule 201(d)(6) is mandatory for broker-dealers relying on these provisions.

2. Marking Requirements

The collection of information is mandatory for all broker-dealers submitting sale orders marked "short exempt" in reliance on one of the provisions contained in paragraph (c) or (d) of Rule 201.

G. Confidentiality

1. Policies and Procedures Requirements

We expect that the information collected pursuant to Rule 201's required policies and procedures for trading centers will be communicated to the members, subscribers, and employees (as applicable) of all trading centers. In addition, the information collected pursuant to Rule 201's required policies and procedures for trading centers will be retained by the trading centers and will be available to the Commission and SRO examiners upon request, but not subject to public availability. The information collected pursuant to Rule 201's broker-dealer provision and the riskless principal exception will be retained by the broker-dealers and will be available to the Commission and SRO examiners upon request, but not subject to public availability.

2. Marking Requirements

The information collected pursuant to the "short exempt" marking requirements in Rule 200(g) and Rule 200(g)(2) will be submitted to trading centers and will be available to the Commission and SRO examiners upon request. The information collected pursuant to the "short exempt" marking requirement may be publicly available because it may be published, in a form that would not identify individual broker-dealers, by SROs that publish on their Internet Web sites aggregate short selling volume data in each individual equity security for that day and, on a one-month delayed basis, information regarding individual short sale transactions in all exchange-listed equity securities.

H. Record Retention Period

1. Policies and Procedures Requirements

Any records generated in connection with Rule 201's requirements that trading centers and broker-dealers (with respect to the broker-dealer and riskless principal provisions) establish written policies and procedures must be preserved in accordance with, and for the periods specified in, Exchange Act Rules 17a-1[753] for SRO trading centers and 17a-4(e)(7)[754] for non-SRO trading centers and registered broker-dealers.

2. Marking Requirements

The amendments to Rule 200(g) and Rule 200(g)(2) do not contain any new record retention requirements. All registered broker-dealers that are subject to the amendments are currently required to retain records in accordance with Rule 17a-4(e)(7) under the Exchange Act.[755]

X. Cost-Benefit Analysis

We are sensitive to the costs and benefits of our rules. To assist us in evaluating the costs and benefits of the amendments to Regulation SHO, in the Proposal and the Re-Opening Release, we encouraged commenters to discuss any costs or benefits that the proposed rules might impose.[756] In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the proposed amendments for registrants, issuers, investors, broker-dealers, other securities industry

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[753] 17 CFR 240.17a-1.

[754] 17 CFR 240.17a-4(e)(7).

[755] Id.

[756] See Proposal, 74 FR at 18090; Re-Opening Release, 74 FR at 42037.

professionals, regulators, and others.[757] We also requested comment as to the extent to which placing price restrictions on short selling could impact or lessen some of the benefits of legitimate short selling or could lead to a decrease in market efficiency, price discovery, or liquidity.[758] Commenters were requested to provide analysis and data to support their views on the costs and benefits associated with the proposed amendments to Rule 201 and Rule 200(g).[759] We discuss below the benefits and costs, including cost mitigation features, of Rule 201.

A. Benefits

We believe it is appropriate at this time to adopt in Rule 201 a circuit breaker approach combined with the alternative uptick rule. Specifically, Rule 201(b) requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[760] In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[761]

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[757] See Proposal, 74 FR at 18090.

[758] See id.

[759] See id.; Re-Opening Release, 74 FR at 42037.

[760] Rule 201(b).

[761] Rule 201(b).

In conjunction with the amendments to Rule 201, we are amending Rule 200(g) of Regulation SHO to provide that a broker-dealer may mark certain qualifying sell orders "short exempt." In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[762]

We discuss below the benefits of Rule 201 with respect to two inter-related aspects of the Rule: the short sale price test restriction, specifically the alternative uptick rule, and the circuit breaker approach that triggers application of that restriction. We have separated the discussion into two parts in order to more clearly address the comments that we received with respect to the various aspects of Rule 201. However, the circuit breaker approach and the alternative uptick rule under Rule 201 operate in conjunction with one another and should not be considered isolated provisions.

1. Alternative Uptick Rule

The alternative uptick rule is designed to prevent the execution or display of short sale orders at a price that is less than or equal to the current national best bid. By not allowing short sellers to sell at or below the current national best bid, the alternative uptick rule will allow long sellers, by selling at the bid, to sell first in a declining market for a particular security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of such restrictions is to allow long sellers to sell first in a declining market.[763] A short seller that is seeking to profit quickly from accelerated, downward market moves may find it advantageous to

[762] See Rules 200(g) and 200(g)(2).

[763] See supra note 17.

be able to short sell at the current national best bid. By placing long sellers ahead of short sellers in the execution queue under certain circumstances, Rule 201 will help promote capital formation, since investors may be more willing to hold long positions if they know they may have a preferred position over short sellers when they wish to sell.[764]

In addition, because the alternative uptick rule, when triggered, will generally permit short selling only at a price above the current national best bid, the alternative uptick rule will not allow short sales to get immediate execution at the bid.[765] In other words, short sellers will not be permitted to act as liquidity takers when the alternative uptick rule applies, but will participate, if at all, as liquidity providers (unless an exception applies), adding depth to the market. Put another way, unless an exception applies, short sales will execute only when purchasers arrive willing to buy at prices above the national best bid. In discussing the alternative uptick rule, one commenter stated that "[n]ot only does it faithfully replicate the old uptick rule it improves upon it by making each and every short sale a liquidity providing transaction."[766]

Further, the alternative uptick rule is designed to help restore investor confidence in the securities markets.[767] It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price

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764 But see infra notes 821 to 827 and accompanying text (discussing the potential negative impact of Rule 201 on various trading strategies that include short selling).

765 As noted by some commenters, there may be situations in which a short seller could get immediate execution, such as where an order is executed in a facility that provides executions at the mid-point of the national best bid and offer. See, e.g., letter from ISE (Sept. 2009); see also letter from BATS (Sept. 2009).

766 Letter from Glen Shipway (Sept. 2009).

767 See, e.g., supra note 94 (citing comment letters suggesting that reinstatement of short price test restrictions in some form will help restore investor confidence in the markets).

decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors. Bolstering investor confidence in the markets should help to encourage investors to be more willing to invest in the markets, thus adding depth and liquidity to the markets. In addition, we note that a number of commenters stated that they believe that a short sale price test restriction will aid small investors.[768]

As we stated in the Proposal, short sale price test restrictions, whether a permanent market-wide restriction or in combination with a circuit breaker, might help prevent short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.[769] Because the alternative uptick rule only permits short selling at a price above the current national best bid, unless an exception applies, we believe it will be more effective than the proposed uptick rule or the proposed modified uptick rule at achieving our goals in helping to prevent short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security. Several commenters stated that the alternative uptick rule would dramatically decrease price pressure on a security[770] and, thereby, the ability of market participants to use short selling as a market manipulation tool.[771] Another commenter, in supporting the alternative uptick rule,

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[768] See supra note 97 (citing commenters who stated that a short sale price test restriction would aid small investors).

[769] See Proposal, 74 FR at 18050, 18053, 18059, 18061, 18065, 18069; see also Securities and Exchange Commission, Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., at 251 (1963).

[770] See, e.g., letter from BATS (Sept. 2009); letter from Wells Fargo (Sept. 2009); see also letter from SIFMA (Sept. 2009) (stating that a circuit breaker coupled with the alternative uptick rule "would limit instances where a security is the subject of severe downward pressure").

[771] See letter from BATS (Sept. 2009); letter from Wells Fargo (Sept. 2009); letter from STA (Sept. 2009); letter from Glen Shipway (Sept. 2009).

stated that it would "likely be more restrictive on short selling than the original Rule 10a-1 'uptick rule'."[772]

In addition, we believe that the alternative uptick rule is preferable to the proposed modified uptick rule or the proposed uptick rule, in part, because it will be easier and less costly to implement and monitor. Unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price, the alternative uptick rule references only the current national best bid. Several commenters expressed support for the alternative uptick rule, stating that the alternative uptick rule was preferable to the proposed modified uptick rule or the proposed uptick rule because it would eliminate sequencing issues[773] and would be easier and less costly to implement.[774] One commenter noted that the alternative uptick rule would simplify on-going surveillance and enforcement, as compared to the other proposed short sale price test restrictions.[775] In addition, we believe that the implementation and on-going monitoring and compliance costs of the alternative uptick rule are justified by the benefits provided in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

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772 Letter from Virtu Financial.

773 See, e.g., letter from Direct Edge (June 2009); letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from STA (Sept. 2009); letter from Wells Fargo (Sept. 2009); see also letter from Hudson River Trading (expressing a preference for the alternative uptick rule, as opposed to the proposed modified uptick rule or the proposed uptick rule, if in conjunction with a circuit breaker); see also supra notes 661 to 664 and accompanying text.

774 See, e.g., letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from European Investors (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from STA (Sept. 2009); letter from Glen Shipway (Sept. 2009); letter from T. Rowe Price (Sept. 2009); letter from Wells Fargo (Sept. 2009); see also letter from Hudson River Trading; see also supra notes 661 to 664 and accompanying text.

775 See letter from SIFMA (Sept. 2009).

2. Circuit Breaker Approach

Under the circuit breaker approach, the alterative uptick rule will apply only if the price of a covered security has declined by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[776] In addition, the short sale price test restriction will only remain in place for the remainder of the day and for the following day.[777] The listing market for each covered security must determine whether that covered security is subject to Rule 201[778] and must immediately notify the single plan processor responsible for consolidation of information for the covered security in accordance with Rule 603(b) of Regulation NMS[779] of the fact that a covered security has become subject to the short sale price test restriction of Rule 201. The plan processor must then disseminate this information.[780]

We believe that a circuit breaker approach strikes the appropriate balance between our goal of preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets.[781] The circuit breaker approach of Rule 201 will help benefit the market for a particular security by allowing participants, when a security is undergoing a significant intra-day price decline, an opportunity to re-evaluate circumstances and respond to

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776 See Rule 201(b).

777 See id.

778 See Rule 201(b)(3).

779 17 CFR 242.603(b); see supra note 368.

780 See Rule 201(b)(3); 17 CFR 242.603(b).

781 See supra Section III.A.4.

volatility in that security. We also believe that a circuit breaker will better target short selling that may be related to potential bear raids[782] and other forms of manipulation that may be used to exacerbate a price decline in a covered security.

In response to our requests for comment, some commenters expressed support for a circuit breaker approach because it would be more narrowly-tailored to address our concerns about the effects of short selling in a market subject to a significant downturn than a permanent, market-wide short sale price test restriction.[783] For example, one commenter noted that "by implementing the alternative uptick rule only after a circuit breaker threshold has been reached, [the commenter] believes the Commission would strike the appropriate balance between the desirable goals of maximizing efficiency when the market is operating within normal trading ranges and prohibiting potentially abusive short selling when it is not, while refraining from imposing excessive implementation costs on the industry."[784] Another commenter stated that a circuit breaker is preferable because it "will restrict short selling when prices begin to decline substantially and short selling becomes more likely to be abusive and potentially harmful."[785]

As discussed above, short selling is an important tool in price discovery and the provision of liquidity to the market, and we recognize that imposition of a short selling circuit breaker that when triggered imposes the alternative uptick rule could restrict otherwise legitimate short selling activity

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782 See supra note 36 and accompanying text.

783 See, e.g., letter from Direct Edge (June 2009); letter from Citadel et al. (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from BATS (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from Hudson River Trading (Sept. 2009); letter from Qtrade; letter from SIFMA (Sept. 2009); letter from Virtu Financial; see also letter from Goldman Sachs (June 2009); letter from SIFMA (June 2009); letter from Nasdaq OMX Group (Oct. 2009).

784 Letter from BATS (Sept. 2009).

785 Letter from Nasdaq OMX Group (Oct. 2009); see also letter from Goldman Sachs (June 2009); letter from BATS (Sept. 2009); letter from SIFMA (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Virtu Financial.

during periods of significant volatility. Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day. As discussed previously,[786] commenters' estimates and the Staff's analysis show that a 10% circuit breaker threshold generally should affect only a limited percentage of covered securities. In addition, when triggered, the short sale price test restriction will apply for a limited period of time, i.e., the remainder of the day and the following day, rather than all the time. Thus, Rule 201 is structured so that it will not be triggered for the majority of covered securities most of the time and, thereby, will not interfere with the smooth functioning of the markets for those securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising. To the extent that Rule 201 results in a disruption to the smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

Several commenters stated their belief that implementing short sale price test restrictions on a permanent, market-wide basis, rather than in combination with a circuit breaker, would substantially diminish the benefits that short sellers bring to the markets.[787] Another commenter stated that a circuit breaker is preferable to a permanent, market-wide short sale price test restriction because it "permits normal market activity while a stock is trading in a natural range

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[786] See supra Section III.A.5. (discussing the circuit breaker trigger level).

[787] See, e.g., letter from Direct Edge (Sept. 2009); letter from Credit Suisse (Sept. 2009).

and short selling is more likely to benefit the market (by, for example, increasing price discovery and liquidity)."[788]

The Commission has long held the view that circuit breakers may help restore investor confidence during times of substantial uncertainty.[789] We believe that the requirements of Rule 201 will produce such benefits. By imposing the alternative uptick rule once a security's price is experiencing a significant intra-day price decline, the short selling circuit breaker rule in Rule 201(b) is designed to target only those securities that experience such declines and, therefore, will help to prevent short selling from being used as a tool to exacerbate the decline in the price of those securities. This approach establishes a narrowly-tailored Rule that targets only those securities experiencing such a decline and which only applies a short sale price test restriction for a limited period of time. We believe that addressing short selling in connection with such declines will help restore investor confidence in the markets generally. One commenter noted that "preventing rapid declines in stock prices strengthens investor confidence."[790] Another commenter stated that a circuit breaker triggering a short sale price test restriction would provide "investors with confidence that short sellers will be restricted from conducting any perceived market manipulation strategies such as 'bear raids.'"[791]

A circuit breaker approach will also allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure. As noted by one commenter, a circuit breaker "is

[788] Letter from Nasdaq OMX Group (Oct. 2009); see also letter from Goldman Sachs (June 2009); letter from BATS (Sept. 2009); letter from SIFMA (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Virtu Financial.

[789] See, e.g., 1998 Release, 63 FR 18477; see also Proposal, 74 FR at 18067.

[790] Letter from BIO.

[791] Letter from Brian M. Collie, Esq., Associate, Taurus Compliance Consulting, LLC, dated June 19, 2009 ("Taurus Compliance").

particularly efficient in stable and rising markets because it avoids imposing continuous monitoring and compliance costs where there is little or no corresponding risk of abusive short selling."[792]

Requiring the listing market for a covered security to determine whether the security has become subject to the short sale price test restrictions of Rule 201 will help ensure consistency for each covered security with respect to such determinations as only the listing market for that covered security will be making the determination. In addition, we believe that listing markets will be in the best position to respond to anomalous or unforeseeable events that may impact a covered security's price, such as an erroneous trade, because the listing markets generally have in place specific procedures designed to address such events.[793] Further, because the single plan processors currently receive information from listing markets regarding trading restrictions (i.e. Regulatory Halts as defined in those plans) on individual securities and disseminate such information, the requirements of Rule 201(b)(3) are similar to existing obligations on plan processors pursuant to the requirements of Regulation NMS, the CTA and CQ Plans and the Nasdaq UTP Plan.

3. Marking Requirements

The "short exempt" marking requirements under Rule 200(g) will provide a record that a broker-dealer is availing itself of the provisions of paragraph (c) or (d) of Rule 201. Thus, the records created pursuant to the "short exempt" marking requirements of Rule 200(g) will aid surveillance by SROs and the Commission for compliance with the provisions of Rule 201. In addition, the "short exempt" marking requirement will provide an indication to a trading center

[792] Letter from Nasdaq OMX Group (Oct. 2009); see also letter from SIFMA (Sept. 2009).

[793] See supra note 327 (discussing NYSE's procedures to ensure the accuracy and reliability of its closing price).

regarding when it must execute or display a short sale order without regard to whether the order is at a price that is less than or equal to the current national best bid and will aid broker-dealers in complying with their legal requirements.

In response to our requests for comment, several commenters indicated that requiring broker-dealers to mark all sell orders "long," "short," or "short exempt" would provide valuable information to the Commission[794] and that such information would be worth the costs of requiring such marking.[795] One commenter stated that the information provided by a "short exempt" marking requirement would provide the Commission with data on the extent to which exceptions are being used to circumvent the requirements of Rule 201.[796]

B. Costs

In the Proposal, we discussed the anticipated costs of the proposed short sale price test restrictions, both on a permanent, market-wide basis and in conjunction with a circuit breaker.[797] We requested comment, in the Proposal and Re-Opening Release, on the costs associated with the proposed amendments.[798] In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures.[799] We also requested comment as to the extent to which placing price restrictions on short selling could impact or lessen some of the benefits of legitimate short selling or could lead to a decrease in market

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794 See, e.g., letter from STA (June 2009); letter from CFA.

795 See, e.g., letter from STA (June 2009).

796 See letter from STA (June 2009).

797 See Proposal, 74 FR at 18092-18100.

798 See Proposal, 74 FR at 18100; Re-Opening Release, 74 FR at 42037.

799 See Proposal, 74 FR at 18090.

efficiency, price discovery, or liquidity.[800] We discuss the comments that we received with respect to the costs of Rule 201 in detail in Sections X.B.1., X.B.2., X.B.3 and X.B.4., below.

We recognize that Rule 201 will impose costs on market participants to implement and assure compliance with the requirements of the Rule. After considering empirical evidence regarding former Rule 10a-1 and the comments that we received in response to the Proposal and the Re-Opening Release, as discussed below, we believe that Rule 201 will have a minimal, if any, negative effect on market liquidity, price efficiency, and quote depths.[801] In addition, we recognize that there will be market costs associated with Rule 201 in terms of the potential impact of such a short sale-related circuit breaker on execution speed and probability. By requiring for a limited time-period that short sales may only be executed or displayed above the current national best bid once a covered security has experienced an intra-day price decline of 10% or more, Rule 201 may slow the speed of executions and impose additional costs on market participants, including buyers.[802] Such costs may increase the costs of legitimate short selling.

To the extent that Rule 201 results in increased costs for short selling in covered securities that trigger the alternative uptick rule, it may increase the trading costs of legitimate short selling for these securities and may result in a reduction in short selling generally. Restricting short selling may also reduce "long" activity where the short selling is part of a larger trading strategy.

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800 See id.

801 See infra note 878 (citing empirical evidence showing that former Rule 10a-1 did not have an effect on market liquidity and price efficiency and that price test restrictions resulted in an increase in quote depths). We note that, although the alternative uptick rule is by definition more restrictive than the proposed modified uptick rule, differences between the operation of the proposed uptick rule and the alternative uptick rule mean that one approach or the other would be more restrictive in particular circumstances. See, e.g., supra note 242 and accompanying text (discussing automated trade matching systems).

802 As discussed above, on the day the Pilot went into effect, listed Pilot securities underperformed listed control group securities by approximately 24 basis points. The Pilot and control group securities, however, had similar returns over the first six months of the Pilot. See supra note 52 (referencing Staff's Summary Pilot Report at 8).

We believe, however, that such costs will be mitigated by the circuit breaker approach of Rule 201. Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day. As discussed previously,[803] commenters' estimates and the Staff's analysis show that a 10% circuit breaker threshold generally should affect only a limited percentage of covered securities. In addition, when triggered, the short sale price test restriction will apply for a limited period of time, i.e., the remainder of the day and the following day, rather than all the time. Thus, Rule 201 is structured so that it will not be triggered for the majority of covered securities most of the time and, thereby, will not interfere with the smooth functioning of the markets for those securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising. To the extent that Rule 201 results in increased costs for short selling in covered securities that trigger the alternative uptick rule, a reduction in short selling generally, and a reduction in "long" activity where the short selling is part of a larger trading strategy, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

In addition, we recognize that Rule 201, when triggered, will impose a short sale price test restriction, when, currently, there is an absence of any short sale price test restrictions. This will result in costs in terms of modifications to systems and surveillance mechanisms, as well as changes to processes and procedures. We anticipate that these changes will likely result in immediate implementation costs for trading centers and SROs and other market participants

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803 See supra Section III.A.5. (discussing the circuit breaker trigger level).

associated with reprogramming trading and surveillance systems to account for short sale price test restrictions based on best bid information, as discussed in more detail below. We also believe Rule 201 will impose costs on trading centers and SROs and other market participants related to systems changes to computer software, reprogramming costs, and surveillance and compliance costs, as well as staff time and technology resources, associated with monitoring compliance with Rule 201, as discussed below.

Moreover, imposing a short sale-related circuit breaker that, if triggered, will impose a short sale price test restriction, when there are currently no short sale price test restrictions in place also may mean that staff (compliance personnel, associated persons, etc.) may need to be trained or re-trained regarding rules related to short sale price test restrictions. As such, we believe Rule 201 may impose training and compliance costs for trading centers, SROs, and other market participants.

However, as discussed below, because the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price, we believe that the alternative uptick rule will be easier and less costly to implement and monitor than the proposed modified uptick rule or the proposed uptick rule.[804]

Further, we note that the policies and procedures that are required to be implemented under Rule 201 are similar to those that are required under the Order Protection Rule of Regulation NMS.[805] Thus, we believe trading centers and broker-dealers may already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures,

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804 See infra Section X.B.1.b.i. and Section X.B.1.b.ii. (discussing the implementation and on-going monitoring and surveillance costs of the alternative uptick rule on trading centers and broker-dealers).

805 See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087; 17 CFR 242.611.

including programming their trading systems in accordance with such policies and procedures. We believe this familiarity may reduce the implementation costs of Rule 201 and may make Rule 201 less burdensome to implement.

In addition, we believe that the implementation, and on-going monitoring and compliance costs of Rule 201 are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

We discuss below the costs of Rule 201 with respect to two inter-related aspects of the Rule: the short sale price test restriction, specifically the alternative uptick rule, and the circuit breaker approach that triggers application of that restriction. We have separated the discussion into two parts in order to more clearly address the comments that we received with respect to the various aspects of Rule 201. However, the circuit breaker approach and the alternative uptick rule under Rule 201 operate in conjunction with one another and should not be considered isolated provisions.

1. Alternative Uptick Rule

Rule 201 requires a trading center to have written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[806]

[806] See Rule 201(b)(1).

a. Impact on Market Quality

As stated above, in the Proposal and Re-Opening Release, we requested comment on the costs of a short sale price test restriction,[807] and specifically as to the extent to which placing price restrictions on short selling could impact or lessen some of the benefits of legitimate short selling or could lead to a decrease in market efficiency, price discovery, or liquidity.[808]

The Commission received comments stating that the alternative uptick rule, or any short sale price restriction for that matter, would reduce the benefits that short selling provides to the markets.[809] For example, commenters stated that a short sale price test restriction would negatively impact liquidity,[810] market volume,[811] bid-ask spreads and price discovery.[812] Several

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807 See Proposal, 74 FR at 18090, 18100; Re-Opening Release, 74 FR at 42037.

808 See Proposal, 74 FR at 18090.

809 See, e.g., letter from Prof. Lipkin; letter from Citadel et al. (June 2009); letter from GETCO (June 2009); letter from Goldman Sachs (June 2009); letter from ICI (June 2009); letter from ISDA; letter from Lime Brokerage (June 2009); letter from RBC (June 2009); letter from Vanguard (June 2009); letter from Allston Trading (Sept. 2009); letter from TD Asset Management; letter from EWT (Sept. 2009); letter from BATS (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from CPIC (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from EWT (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from GETCO (Sept. 2009); letter from Hudson River Trading; letter from Lime Brokerage (Sept. 2009); letter from RBC (Sept. 2009); letter from STA (Sept. 2009); letter from STANY (Sept. 2009); letter from Vanguard (Sept. 2009); letter from Bingham McCutchen; letter from MFA (Oct. 2009); letter from Nasdaq OMX Group (Oct. 2009); see also letter from Credit Suisse (Mar. 2009).

810 See, e.g., letter from Chad Stogel, Trillium Trading, LLC, dated May 26, 2009 ("Chad Stogel"); letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from Lime Brokerage (June 2009); letter from MFA (June 2009); letter from STA (June 2009); letter from EWT (Sept. 2009); letter from BATS (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Lime Brokerage (Sept. 2009); letter from RBC (Sept. 2009); letter from STA (Sept. 2009); letter from Bingham McCutchen; see also letter from Credit Suisse (Mar. 2009).

811 See, e.g., letter from Chad Stogel; letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from MFA (June 2009); letter from STA (June 2009); letter from EWT (Sept. 2009); letter from BATS (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from RBC (Sept. 2009); letter from Bingham McCutchen; see also letter from Credit Suisse (Mar. 2009).

812 See, e.g., letter from Credit Suisse (June 2009); letter from MFA (June 2009); letter from Lime Brokerage (June 2009); letter from STA (June 2009); letter from RBC (Sept. 2009); see also letter from Credit Suisse (Mar. 2009).

commenters also stated that a short sale price test restriction might increase volatility.[813]

We believe, however, that the short sale price test restriction of Rule 201 will have a limited negative effect on liquidity, market volume, bid-ask spreads, price discovery and volatility. The Pilot Results found that the former tick test of Rule 10a-1 and former bid test of NASD, which were permanent, market-wide short sale price tests, did not have a significant impact on daily volatility, and also found some evidence that the short sale price tests dampened intra-day volatility for smaller stocks.[814] In addition, the Pilot Results found that the Pilot data provided limited evidence that then-current short sale price test restrictions distort a security's price. The Pilot Results also found that the short sale price test restrictions resulted in an increase in quote depths.[815] Realized liquidity levels, however, were unaffected by the removal of such short sale price test restrictions.[816] In addition, one study concluded that former Rule 10a-1 had little or no effect on price efficiency.[817] Another study found no evidence that former Rule 10a-1 negatively impacted price discovery.[818] Due to differences in the operation of former Rule 10a-1 and Rule 201, when it applies, the alternative uptick rule under Rule 201 will be more restrictive than former Rule 10a-1 in some circumstances and less restrictive in others.[819] As discussed above, however, due to the circuit breaker approach in Rule 201, the alternative

813 See, e.g., letter from Prof. Lipkin; letter from AIMA; letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from RBC (June 2009); letter from SIFMA (June 2009); letter from Citadel et al. (Sept. 2009); letter from TD Asset Management; letter from Barclays (Sept. 2009); see also letter from NSCP.

814 See Staff's Summary Pilot Report at 55-56.

815 See Staff's Summary Pilot Report at 55; see also Karl B. Diether, Kuan Hui Lee and Ingrid M. Werner, 2009, It's SHO Time! Short-Sale Price-Tests and Market Quality, Journal of Finance 64:37.

816 See supra note 54.

817 See J. Julie Wu, Uptick Rule, short selling and price efficiency, Aug. 14, 2006.

818 See Lynn Bai, 2008, The Uptick Rule of Short Sale Regulation – Can it Alleviate Downward Price Pressure from Negative Earnings Shocks? Rutgers Business Law Journal 5:1-63.

819 See, e.g., supra note 242 and accompanying text (discussing automated trade matching systems).

uptick rule of Rule 201 generally will apply to a limited number of covered securities[820] and will apply only when the circuit breaker has been triggered for a covered security. As such, it will not be triggered for the majority of covered securities at any given time and, when triggered, will remain in effect for a short duration – that day and the following day. Considering the empirical studies and the comments, and because of the limited scope and duration of Rule 201, we believe that the impact of Rule 201, if any, on liquidity, market volume, bid-ask spreads, price discovery and volatility will be limited. To the extent that Rule 201 negatively impacts liquidity, market volume, bid-ask spreads, price discovery and volatility, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

The Commission received a number of comments addressing the extent to which a short sale price test restriction might cause a reduction in short selling.[821] For example, commenters stated that a reduction in short selling might result from: the implementation costs and on-going compliance costs of a short sale price test restriction;[822] uncertainty about whether a short sale order can be executed;[823] and reduced use of trading strategies that are market neutral or that rely

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[820] See supra Section III.A.5. (discussing the circuit breaker trigger level and duration).

[821] See, e.g., letter from Peter J. Driscoll, Chairman, John C. Giesea, President and CEO, Security Traders Association, dated May 4, 2009 ("STA (May 2009)"); letter from Citadel et al. (June 2009); letter from CPIC (June 2009); letter from MFA (June 2009); letter from Allston Trading (Sept. 2009); letter from Barclays (Sept. 2009); letter from CBOE (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from CPIC (Sept. 2009); letter from EWT (Sept. 2009); letter from GETCO (Sept. 2009); letter from ICI (Sept. 2009); letter from ISE (Sept. 2009); letter from RBC (Sept. 2009); letter from MFA (Oct. 2009).

[822] See, e.g., letter from CPIC (June 2009); letter from Barclays (Sept. 2009).

[823] See, e.g., letter from STA (May 2009); letter from Citadel et al. (June 2009); letter from STA (June 2009); letter from Barclays (Sept. 2009); letter from STA (Sept. 2009); see also letter from Lime Brokerage (June 2009) (explaining specifically the increased risk that would be associated with virtual market making strategies).

on the ability to hedge through short sales.[824] Several commenters stated that the alternative uptick rule would restrict short sales more than the other proposed short sale price test restrictions, specifically because it would not allow immediate execution, and fewer short sales might be executed as a result.[825] A number of commenters stated that a reduction in short selling would result in decreased liquidity, wider price spreads, and more costly trading for investors overall.[826] Some commenters stated that such an increase in costs to investors would have a negative effect on investor confidence.[827]

The short sale price test restriction of Rule 201 may cause a limited reduction in short selling as a result of the implementation costs and on-going compliance costs of a short sale price test restriction; uncertainty about whether a short sale order can be executed; and reduced use of trading strategies that are market neutral or that rely on the ability to hedge through short sales. However, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day. Due to the limited scope and applicability of Rule 201, we

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[824] See, e.g., letter from STA (May 2009); letter from Credit Suisse (June 2009); letter from STA (June 2009); letter from Barclays (Sept. 2009); letter from STA (Sept. 2009); letter from MFA (Oct. 2009); see also letter from Lime Brokerage (June 2009) (explaining specifically the increased risk that would be associated with virtual market making strategies).

[825] See, e.g., letter from Allston Trading (Sept. 2009); letter from Barclays (Sept. 2009); letter from CBOE (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from CPIC (Sept. 2009); letter from EWT (Sept. 2009); letter from GETCO (Sept. 2009); letter from ICI (Sept. 2009); letter from ISE (Sept. 2009); letter from RBC (Sept. 2009); letter from MFA (Oct. 2009).

[826] See, e.g., letter from STA (May 2009); letter from Chad Stogel; letter from Allston Trading (June 2009); letter from Credit Suisse (June 2009); letter from STA (June 2009); letter from STA (Sept. 2009); letter from MFA (June 2009).

[827] See, e.g., letter from Citadel et al. (June 2009); letter from Vanguard (June 2009); letter from Allston Trading (Sept. 2009); letter from EWT (Sept. 2009); letter from GETCO (Sept. 2009); see also letter from NSCP (stating that, without empirical evidence of inefficiency or failure in the equity markets that both caused deterioration of investor confidence and that would be remedied by a short sale price test restriction, a loss in confidence in the Commission as a fair and impartial regulator could do more harm in the long-run to damage the confidence of investors); letter from STA (June 2009) (stating that "[p]romulgating a rule that would not have any impact on the execution of abusive short sales may, in fact, foster further deterioration of investor confidence").

believe that any reduction in short selling will be limited.[828] In addition, we believe that any such reduction in short selling will have a minimal, if any, resulting negative impact on liquidity and price efficiency. As noted above, the Pilot Results found that the Pilot data provided limited evidence that then-current short sale price test restrictions, which were permanent and market-wide, distort a security's price. The Pilot Results also found that the short sale price test restrictions resulted in an increase in quote depths.[829] Realized liquidity levels, however, were unaffected by the removal of such short sale price test restrictions.[830] In addition, one study concluded that former Rule 10a-1 had little or no negative effect on price efficiency.[831] Another study found no evidence that former Rule 10a-1 negatively impacted price discovery.[832] Due to differences in the operation of former Rule 10a-1 and Rule 201, when it applies, the alternative uptick rule under Rule 201 will be more restrictive than former Rule 10a-1 in some circumstances and less restrictive in others.[833] As discussed above, however, due to the circuit breaker approach in Rule 201, the alternative uptick rule of Rule 201 generally will apply to a limited number of covered securities[834] and will apply only when the circuit breaker has been triggered for a covered security. As such, it will not be triggered for the majority of covered securities at any given time and, when triggered, will remain in effect for a short duration – that day and the following day. Considering the empirical studies and the comments, and due to the

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828 See supra Section III.A.5. (discussing the circuit breaker trigger level and duration).

829 See Staff's Summary Pilot Report at 55 and supporting text; see also Karl B. Diether, Kuan Hui Lee and Ingrid M. Werner, 2009, It's SHO Time! Short-Sale Price-Tests and Market Quality, Journal of Finance 64:37.

830 See supra note 54.

831 See J. Julie Wu, Uptick Rule, short selling and price efficiency, Aug. 14, 2006.

832 See Lynn Bai, 2008, The Uptick Rule of Short Sale Regulation – Can it Alleviate Downward Price Pressure from Negative Earnings Shocks? Rutgers Business Law Journal 5:1-63.

833 See, e.g., supra note 242 and accompanying text (discussing automated trade matching systems).

834 See supra Section III.A.5. (discussing the circuit breaker trigger level and duration).

limited scope and duration of Rule 201, we believe that any reduction in short selling as a result of Rule 201 will have a minimal, if any, negative impact on liquidity and price efficiency. To the extent that Rule 201 has a negative impact on liquidity and price efficiency, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

In addition, commenters stated that a short sale price test restriction in general, or the alternative uptick rule specifically, might negatively impact various trading strategies that include short selling,[835] such as high frequency trading,[836] options valuation models that are used to value and hedge equity derivatives transactions,[837] market neutral trading strategies or those that rely on hedging,[838] convertible arbitrage,[839] statistical arbitrage,[840] program or portfolio trading baskets,[841] and hedging strategies that significantly contribute to market liquidity, such as computerized liquidity providers or "virtual market makers."[842] Commenters noted what they believe would be the negative consequences of such an impact, including increasing bid-ask

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835 See, e.g., letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from ISDA; letter from RBC (June 2009); letter from STA (June 2009); letter from Vanguard (June 2009); letter from EWT (Sept. 2009); letter from TD Asset Management; letter from Lime Brokerage (Sept. 2009); letter from Bingham McCutchen; letter from MFA (Oct. 2009); see also letter from Credit Suisse (Mar. 2009).

836 See, e.g., letter from Bingham McCutchen.

837 See, e.g., letter from ISDA.

838 See, e.g., letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from EWT (Sept. 2009); letter from TD Asset Management; letter from MFA (Oct. 2009). This category includes such trading methods as long short equity strategies, convertible securities investors, and hedged strategies such as 130/30 portfolios. See id.

839 See, e.g., letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from Goldman Sachs (June 2009); letter from SIFMA (June 2009).

840 See, e.g., letter from Citadel et al. (June 2009).

841 See letter from TD Asset Management.

842 See, e.g., letter from Lime Brokerage (June 2009); letter from Lime Brokerage (Sept. 2009).

spreads, reducing market volume,[843] reducing market liquidity,[844] reducing market efficiency,[845] complicating the raising of capital by corporate issuers,[846] and causing investors to exit the market.[847] Other commenters expressed the belief that restrictions on short selling might encourage the use of other trading strategies that largely mirror the benefits of short selling (such as sales of calls, purchase of puts, synthetic short sales of OTC derivatives, and sales of security futures), but that impose additional costs, such as reduced efficiency or inaccessibility to small investors.[848]

To the extent that Rule 201 may have a negative effect on various trading strategies that include short selling, we believe any such negative effect will be limited. Under Rule 201, although short selling will be restricted for a limited time by the alternative uptick rule if the price of a covered security decreases by 10% or more, unlike with securities subject to the Short Sale Ban Emergency Order, Rule 201 will permit short selling at a price above the current national best bid in the covered security even when the restriction is in place. Thus, short sellers engaged in various trading strategies that include short selling will generally continue to be able

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843 See, e.g., letter from Citadel et al. (June 2009); letter from Lime Brokerage (Sept. 2009); letter from Bingham McCutchen; letter from Credit Suisse (June 2009).

844 See, e.g., letter from Chad Stogel; letter from Citadel et al. (June 2009); letter from Lime Brokerage (June 2009); letter from STA (June 2009); letter from EWT (Sept. 2009); letter from BATS (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Lime Brokerage (Sept. 2009); letter from STA (Sept. 2009); letter from Bingham McCutchen.

845 See e.g., letter from Citadel et al. (June 2009); letter from Citadel et al. (Sept. 2009).

846 See, e.g., letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009); letter from Goldman Sachs (June 2009); letter from SIFMA (June 2009).

847 See, e.g., letter from Credit Suisse (June 2009).

848 See, e.g., letter from Prof. Rosenthal; letter from Barclays (June 2009) (warning that a mere transfer of short selling activity to other types of markets would impair the price discovery, efficiency, safety, and soundness of the public equity markets); letter from STA (June 2009) (discussing a possible shift to the derivative markets); letter from RBC (June 2009) (discussing sales of calls, purchases of puts, and short selling of security futures as methods to bypass the price restrictions); letter from Vanguard (June 2009) (discussing the use of synthetic short sales through OTC derivatives); see also supra Section III.A.1. (discussing the creation of "synthetic" short positions that are the economic equivalent of a short sale through the use of derivative securities).

to sell short for the limited period of time when the short sale price test restriction is in effect. In addition, we note that many of the above comments on potential market-wide impacts of a short sale price test restriction on various trading strategies that include short selling were not specific to a short sale price test applied in conjunction with a circuit breaker.[849] Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day.[850] We believe that the negative impact of Rule 201, if any, on various trading strategies that include short selling will be limited because of the limited scope and duration of Rule 201. To the extent that Rule 201 has a negative impact on various trading strategies that include short selling, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

We recognize that imposing a short sale price test restriction with respect to NMS stocks, without a similar restriction on derivative securities, could increase the use of derivative securities to create a short position and that such "synthetic" short positions could increase as a result of Rule 201. As discussed in Section III.A.1., above, however, short sales in the equity markets to hedge derivatives transactions are subject to Rule 201. In addition, we remain concerned that the ability to create a short position through the use of derivative securities may undermine the goals of short sale price test restrictions. At a later time, we may reconsider whether additional regulation of derivative securities and the use of "synthetic" short positions may be appropriate.

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849 See, e.g., letter from Bingham McCutchen; letter from ISDA; letter from TD Asset Management; letter from EWT (Sept. 2009); letter from Lime Brokerage (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from STA (Sept. 2009); letter from BATS (Sept. 2009); letter from MFA (Oct. 2009).

850 See supra Section III.A.5. (discussing the circuit breaker trigger level and duration).

Several commenters discussed how constraints on short selling might harm price discovery and pricing efficiency.[851] Commenters stated that, under the alternative uptick rule, only long sellers could hit bids displayed as part of the national market system, which would result in long sellers exclusively dictating the market price of purchases, which would harm price discovery.[852] Additionally, commenters stated that the alternative uptick rule would restrict the informational content that short sale orders contain to only passive orders, meaning that the information would not be fully communicated in the price discovery process and pricing inefficiency would arise.[853] Other commenters stated that the alternative uptick rule might result in an inflated transaction price[854] or upward stock price manipulation.[855]

We believe that Rule 201 will have a limited negative effect on price discovery and price efficiency. As discussed above, the Pilot Results[856] found that the Pilot data provided limited

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851 See, e.g., letter from Matlock Capital (May 2009); letter from Prof. Rosenthal; letter from Goldman Sachs (June 2009); Autore, Billingsley, and Kovacs, Short Sale Constraints, Dispersion of Opinion, and Market Quality: Evidence from the Short Sale Ban on U.S. Financial Stocks (June 19, 2009); letter from GETCO (June 2009); letter from STA (June 2009); letter from Allston Trading (Sept. 2009); letter from Bingham McCutchen; letter from Citadel et al. (Sept. 2009); letter from CPIC (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from EWT (Sept. 2009); letter from Hudson River Trading; letter from STA (Sept. 2009); letter from TD Asset Management.

852 See, e.g., letter from Citadel et al. (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from Bingham McCutchen; see also letter from GETCO (June 2009); letter from Charles A. Trzcinka, Professor of Finance and Chairman of the Finance Department, Kelly School of Business, Indiana University, dated May 10, 2009; letter from Prof. Rosenthal; Autore, Billingsley, and Kovacs, Short Sale Constraints, Dispersion of Opinion, and Market Quality: Evidence from the Short Sale Ban on U.S. Financial Stocks (June 19, 2009).

853 See, e.g., letter from TD Asset Management; letter from CPIC (Sept. 2009); see also letter from GETCO (June 2009); letter from Goldman Sachs (June 2009).

854 See, e.g., letter from Allston Trading (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from CPIC (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from EWT (Sept. 2009); letter from Hudson River Trading; letter from STA (Sept. 2009).

855 See, e.g., letter from Allston Trading (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from RBC (Sept. 2009); see also letter from AIMA; letter from Citadel et al. (June 2009); letter from Goldman Sachs (June 2009); letter from RBC (June 2009).

856 See Staff's Summary Pilot Report at 55; Karl B. Diether, Kuan Hui Lee and Ingrid M. Werner, 2009, It's SHO Time! Short-Sale Price-Tests and Market Quality, Journal of Finance 64:37-73; Gordon J. Alexander and Mark A. Peterson, 2008, The Effect of Price Tests on Trader Behavior and Market Quality: An Analysis of Reg. SHO, Journal of Financial Markets 11:84-111; J. Julie Wu, Uptick Rule, short selling and price efficiency, Aug.

evidence that the former tick test of Rule 10a-1(a) and former bid test of NASD, which were permanent, market-wide short sale price tests, distorted a security's price. In addition, one study concluded that former Rule 10a-1 had little or no effect on price efficiency.[857] Another study found no evidence that former Rule 10a-1 negatively impacted price discovery.[858] Due to differences in the operation of former Rule 10a-1 and Rule 201, when it applies, the alternative uptick rule under Rule 201 will be more restrictive than former Rule 10a-1 in some circumstances and less restrictive in others.[859] As discussed above, however, due to the circuit breaker approach in Rule 201, the alternative uptick rule of Rule 201 generally will apply to a limited number of covered securities[860] and will apply only when the circuit breaker has been triggered for a covered security. As such, it will not be triggered for the majority of covered securities at any given time and, when triggered, will remain in effect for a short duration – that day and the following day. Considering the empirical studies and the comments and because of the limited scope and duration of Rule 201, we believe that Rule 201 will have little, if any, negative effect on price discovery and price efficiency. To the extent that Rule 201 negatively affects price discovery and price efficiency, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

14, 2006; Lynn Bai, 2008, The Uptick Rule of Short Sale Regulation – Can it Alleviate Downward Price Pressure from Negative Earnings Shocks? Rutgers Business Law Journal 5:1-63.

[857] See J. Julie Wu, Uptick Rule, short selling and price efficiency. Aug. 14, 2006.

[858] See Lynn Bai, 2008, The Uptick Rule of Short Sale Regulation – Can it Alleviate Downward Price Pressure from Negative Earnings Shocks? Rutgers Business Law Journal 5:1-63.

[859] See, e.g., supra note 242 and accompanying text (discussing automated trade matching systems).

[860] See supra notes 305 to 311 and accompanying text (discussing data reflecting that, on average, a limited number of covered securities would hit a 10% trigger level each day).

A number of commenters discussed the impact that the alternative uptick rule might have on execution.[861] Several commenters stated that, under the alternative uptick rule, short sales would be ineligible for immediate execution, causing increased trading costs and opportunity costs, decreased liquidity, and widened spreads.[862] Commenters also stated that the alternative uptick rule would increase the risk of non-execution of a short sale, which would reduce the speed of price discovery and increase execution prices.[863] Commenters also noted that the alternative uptick rule could cause missed execution opportunities, thereby causing retail investors to pay artificially high prices to obtain execution.[864]

As we stated in the Re-Opening Release, because the alternative uptick rule will only permit short selling at a price above the current national best bid, the alternative uptick rule will generally not allow short sales to get immediate execution, even in an advancing market,[865] which may slow the speed of executions and impose additional costs on market participants, including buyers.[866] We note, however, that the above comments on the potential impacts of the alternative uptick rule on execution were not specific to a short sale price test in conjunction with

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861 See, e.g., letter from Citadel et al. (Sept. 2009); letter from Group One Trading (Sept. 2009); letter from TD Asset Management; letter from CPIC (Sept. 2009); letter from Lime Brokerage (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009); letter from STA (Sept. 2009); letter from Barclays (Sept. 2009).

862 See, e.g., letter from Citadel et al. (Sept. 2009); letter from TD Asset Management; letter from CPIC (Sept. 2009); letter from STA (Sept. 2009). As noted by some commenters, however, there may be situations in which a short seller could get immediate execution, such as where an order is executed in a facility that provides executions at the mid-point of the national best bid and offer. See, e.g., letter from ISE (Sept. 2009); see also letter from BATS (Sept. 2009).

863 See, e.g., letter from Barclays (Sept. 2009); letter from STA (Sept. 2009).

864 See, e.g., letter from Allston Trading (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Dialectic Capital (Sept. 2009); see also letter from Chad Stogel.

865 See Re-Opening Release, 74 FR at 42034; see also supra note 227 (noting that under some circumstances a short seller may be able to get immediate execution).

866 See supra note 52 (discussing returns for listed Pilot securities and listed control group securities during the first six months of the Pilot and referencing Staff's Summary Pilot Report at 8).

a circuit breaker.[867] Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day.[868] We believe that the negative impact of Rule 201, if any, on execution speed and probability will be limited because of the limited scope and duration of Rule 201. To the extent that Rule 201 negatively impacts execution speed and probability, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

Several commenters suggested that short sellers who remain in the markets, as well as other market participants, might change their trading behavior in response to a short sale price test restriction.[869] For example, commenters expressed the belief that other traders might use computer algorithms to identify the presence of short sellers who have sell orders exactly one increment above the bid and quickly adjust their bid price downward in anticipation of the stock price dropping, which would result in the price of the security declining even further overall.[870] Similarly, several commenters stated that short sale limit orders might be perceived by other market participants as a negative view on a covered security, which might have negative implications on market efficiency, market liquidity, and bid-ask spreads and might cause buyers

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867 See, e.g., letter from Allston Trading (Sept. 2009); letter from Barclays (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Dialectic Capital (Sept. 2009); letter from TD Asset Management; letter from CPIC (Sept. 2009); letter from STA (Sept. 2009).

868 See supra Section III.A.5. (discussing the circuit breaker trigger level and duration).

869 See, e.g., letter from STA (May 2009); letter from Group One Trading (Sept. 2009); letter from Lime Brokerage (Sept. 2009).

870 See letter from Group One Trading (Sept. 2009); letter from STANY (Sept. 2009).

to withdraw their bids.[871] One commenter noted that displayed short sale limit orders could be "subject to the risk that long sellers would use the information in the orders to their advantage and front-run or pick off the orders."[872] Additionally, commenters stated that short sellers who seek to execute above the best bid without displaying the offer would be driven to transact in market centers that do not display their better-priced bids as part of the national market system, such as dark pools, or through broker-dealers that offer internalization.[873] Commenters noted that such an increase in volume directed to non-public markets would decrease overall market transparency, liquidity, and pricing efficiency.[874]

Although we recognize that short sellers who remain in the markets, as well as other market participants, might change their trading behavior in response to a short sale price test restriction, we believe any such effect will be limited by the circuit breaker approach of Rule 201. Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day.[875] To the extent that Rule 201 results in changes in trading behavior, we believe that such an impact is justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

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871 See, e.g., letter from Barclays (Sept. 2009); letter from MFA (Oct. 2009); see also letter from STA (Sept. 2009) (stating that because short sale orders would have to be priced one increment above the national best bid, and would drop in price as bids were exhausted, the alternative uptick rule "would also prolong and deepen downward moves by forcing there to be overhanging, passive supply").

872 Letter from Citadel et al. (Sept. 2009).

873 See, e.g., letter from EWT (Sept. 2009); letter from Group One Trading (Sept. 2009); letter from STANY (Sept. 2009).

874 See id.; see also letter from STA (May 2009).

875 See supra Section III.A.5. (discussing the circuit breaker trigger level and duration).

In addition, we note that, as discussed in Section II.D., above, we reviewed the empirical analyses that commenters submitted to us or discussed in their comments. Consistent with the Pilot Results, a study of the effect that rescission of former Rule 10a-1 had on market quality found that the elimination had no measurable effect on market volatility,[876] while the results of other studies on the effect of the lack of a short sale price test restriction on volatility were mixed.[877] However, we note that the study showing no measurable effect on market volatility only analyzed daily volatility during a six-week period following the elimination of former Rule 10a-1 and, thus, may have limited statistical significance. In addition, the studies evidencing an increase in volatility do not address the extent to which other factors may have contributed to or caused the increased volatility.

Studies of other aspects of market quality suggest little measurable impact of a short sale price test restriction on price discovery, market efficiency, liquidity or market quality in general.[878] Several commenters cited empirical evidence showing that restrictions on short selling, particularly bans on short selling, may impede liquidity, price discovery, and market efficiency,[879] but the cited studies do not address the effects of a short sale price test restriction in general or Rule 201 in particular. The empirical analyses that commenters submitted on whether

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876 See Ekkehart Boehmer, Charles M. Jones, and Xiaoyan Zhang, Unshackling Short Sellers: The Repeal of the Uptick Rule (Nov. 2008).

877 See, e.g., letter from NAREIT; letter from High Street Advisors; letter from European Investors (Sept. 2009).

878 See, e.g., the Pilot Results; see also supra note 856 and accompanying text. Numerous commenters also sent analyses on short selling restrictions in general or on the short selling ban. See, e.g., letter from AIMA; letter Allston Trading (June 2009); Autore, Billingsley, and Kovacs, Short Sale Constraints, Dispersion of Opinion, and Market Quality: Evidence from the Short Sale Ban on U.S. Financial Stocks (June 19, 2009); letter from BATS (May 2009); letter from CBOE (June 2009); letter from Citadel et al. (June 2009); letter from Credit Suisse (June 2009), letter from CPIC (June 2009); letter from GETCO (June 2009); letter from Goldman Sachs (Sept. 2009); letter from Hudson River Trading; letter from ICI (June 2009); letter from NSCP; letter from NYSE Euronext (June 2009); letter from TD Asset Management; letter from STANY (June 2009); letter from Wolverine.

879 See supra note 128.

a short sale price test restriction dampens price pressure from short sellers are mixed, but generally focus on long time horizons, such as weeks or months, as opposed to short time horizons, such as seconds or minutes, which are more relevant to the impact of a short sale price test restriction on price pressure.[880]

In summary, after considering the empirical evidence and the comments that we received in response to the Proposal and the Re-Opening Release, we believe that Rule 201 will have a minimal, if any, negative effect on market liquidity, price efficiency, and quote depths.[881] In addition, we recognize that there will be market costs associated with Rule 201 in terms of the potential impact of such a short sale-related circuit breaker on execution speed and probability. Such costs may increase the costs of legitimate short selling. To the extent that Rule 201 results in increased costs for short selling in covered securities, it may increase the trading costs of legitimate short selling for these securities and may result in a reduction in short selling generally. Restricting short selling may also reduce "long" activity where the short selling is part of a larger trading strategy. As discussed above, we believe that these costs will be limited because of the circuit breaker approach of Rule 201.

We believe that the potential costs of Rule 201 are justified by its design, such that, when Rule 201 is triggered, it will allow long sellers, by selling at the bid, to sell first, ahead of short sellers, in a declining market for a particular security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of such restrictions is to allow long

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[880] See, e.g., J. Julie Wu, Uptick Rule, short selling and price efficiency, Aug. 14, 2006.

[881] See supra note 878 (citing empirical evidence showing that former Rule 10a-1 did not have an effect on market liquidity and price efficiency and that price test restrictions resulted in an increase in quote depths). We note that, although the alternative uptick rule is by definition more restrictive than the proposed modified uptick rule, differences between the operation of the proposed uptick rule and the alternative uptick rule mean that one approach or the other would be more restrictive in particular circumstances. See, e.g., supra note 242 and accompanying text (discussing automated trade matching systems).

sellers to sell first in a declining market.[882] A short seller that is seeking to profit quickly from accelerated, downward market moves may find it advantageous to be able to short sell at the current national best bid. In addition, by making bids accessible only by long sellers when a security's price is undergoing significant downward price pressure, Rule 201 will help to facilitate and maintain stability in the markets and help ensure that they function efficiently. It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors. In addition, combining the alternative uptick rule with a circuit breaker strikes the appropriate balance between our goal of preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets.

In addition, we believe several of the provisions contained in paragraph (d) of Rule 201 will help to mitigate any potential price distortions or costs associated with Rule 201. These provisions are designed to help promote the workability of Rule 201, while at the same time furthering our goals for adopting short sale price test regulation.

As discussed above,[883] we are adopting the seller's delay in delivery exception under Rule 201(d)(1) to allow sale orders of owned but restricted securities to be displayed or executed at a price that is less than or equal to the current national best bid, thereby mitigating the negative

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[882] See supra note 17.

[883] See supra Section III.B.2. (discussing the "short exempt" provision for seller's delay in delivery).

impact of Rule 201, if any, on execution speed and probability and helping to promote the workability of Rule 201.

Rule 201(d)(2) allows a broker-dealer to mark a short sale order as "short exempt" if the broker-dealer has a reasonable basis to believe that the short sale order is by a market maker to off-set a customer odd-lot order or liquidate an odd-lot position which changes such broker-dealer's position by no more than a unit of trading.[884] We believe that the odd-lot exception will promote the workability of Rule 201 and help mitigate potential price distortions or costs associated with the Rule, if any, because it will allow those acting in the capacity of a "market maker" to off-set customer odd-lot orders without regard to whether the sale order is at a price that is less than or equal to the current national best bid, thereby facilitating the liquidity providing function of market makers.

Rule 201(d)(3) permits a broker-dealer to mark as "short exempt" short sale orders associated with certain bona fide domestic arbitrage transactions.[885] Moreover, to facilitate arbitrage transactions in which a short position is taken in a security in the U.S. markets, and which is to be immediately covered on a foreign market, Rule 201(d)(4) permits a broker-dealer to mark as "short exempt" short sale orders associated with certain international arbitrage transactions.[886] Because domestic arbitrage and international arbitrage transactions promote market efficiency by equalizing prices at an instant in time in different markets or between relatively equivalent securities,[887] we believe these provisions will help mitigate the negative

[884] See supra Section III.B.3. (discussing the "short exempt" provision for odd lot transactions).

[885] See supra Section III.B.4. (discussing the "short exempt" provision for domestic arbitrage transactions).

[886] See supra Section III.B.5. (discussing the "short exempt" provision for international arbitrage transactions).

[887] See supra Sections III.B.4. and III.B.5. (discussing the benefits of bona fide arbitrage activities to market efficiency because they tend to reduce pricing disparities between related securities).

effect of Rule 201, if any, on market and pricing efficiency and help to promote the workability of Rule 201.

Rule 201(d)(5) permits a broker-dealer to mark as "short exempt" short sale orders by underwriters or syndicate members participating in a distribution in connection with an over-allotment, and any short sale orders for purposes of lay-off sales by such persons in connection with a distribution of securities through a rights or standby underwriting commitment.[888] We are including a "short exempt" marking provision for syndicate and lay-off sales because, as discussed above, we have historically excepted such activity from short sale rules.[889] In addition, we note that the public offering process is key to capital formation. By facilitating price support during the offering process, Rule 201(d)(5) will mitigate the negative effects of Rule 201, if any, on capital formation.

Rule 201(d)(6) allows a broker-dealer to mark as "short exempt" short sale orders where broker-dealers are facilitating customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal.[890] We believe that the riskless principal exception of Rule 201(d)(6) will facilitate broker-dealers' ability to provide best execution to certain customer orders, thus mitigating the negative impact of Rule 201, if any, on execution speed and probability and helping to promote the workability of Rule 201.

Rule 201(d)(7) permits a broker-dealer to mark as "short exempt" certain short sale orders executed on a VWAP basis.[891] We believe that the exception for VWAP short sale transactions

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888 See supra Section III.B.6. (discussing the "short exempt" provision for over-allotments and lay-off sales).

889 See id.

890 See supra Section III.B.7. (discussing the "short exempt" provision for riskless principal transactions).

891 See supra Section III.B.8. (discussing the "short exempt" provision for transactions on a volume weighted average price basis).

will provide an additional source of liquidity for investors' VWAP orders and will help enable investors to achieve their objective of obtaining an execution at the VWAP, thus mitigating the negative impact of Rule 201, if any, on liquidity and execution speed and probability and helping to promote the workability of Rule 201.

b. Implementation and On-going Monitoring and Surveillance Costs

i. Policies and Procedures Requirement under Rule 201

Rule 201 requires a trading center to have written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[892] In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[893] In addition, trading centers are required to regularly surveil to ascertain the effectiveness of the policies and procedures required under the Rule and to take prompt action to remedy deficiencies in such policies and procedures.[894]

As stated previously, we discussed in the Proposal the anticipated costs of the proposed short sale price test restrictions and, in the Proposal and Re-Opening Release, we requested

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892 See Rule 201(b)(1)(i).

893 See Rule 201(b)(1)(ii).

894 See Rule 201(b)(2).

comment on the costs associated with the proposed amendments.[895] In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures.[896]

A number of commenters expressed concerns that the costs of implementing a short sale price test restriction would be significant.[897] However, many of these comments were not specific to the alternative uptick rule.[898] While some commenters discussed the potential implementation costs of the alternative uptick rule, they did not provide specific estimates of such costs.[899] Most commenters compared estimated implementation costs of the alternative uptick rule to the other proposed rules.[900]

As discussed in the PRA section above, we believe that the implementation and on-going monitoring and surveillance costs of the alternative uptick rule will be lower than the implementation and on-going monitoring and surveillance costs that would be associated with adoption of the proposed modified uptick rule or the proposed uptick rule.[901] Unlike the

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895 See Proposal, 74 FR at 18090, 18092-18103; Re-Opening Release, 74 FR at 42037.

896 See Proposal, 74 FR at 18090.

897 See, e.g., letter from NSCP; letter from STANY (June 2009); letter from RBC (June 2009); letter from Wolverine; letter from CPIC (Sept. 2009); letter from EWT (Sept. 2009); letter from RBC (Sept. 2009); letter from STA (Sept. 2009).

898 See, e.g., letter from NSCP; letter from STANY (June 2009); letter from RBC (June 2009); letter from Wolverine.

899 See, e.g., letter from CPIC (Sept. 2009); letter from EWT (Sept. 2009); letter from RBC (Sept. 2009); letter from STA (Sept. 2009).

900 See, e.g., letter from EWT (Sept. 2009) (stating that the net savings of the alternative uptick rule to the broader industry compared to the other proposals would at best be minimal); letter from STA (Sept. 2009); letter from BATS (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from Wells Fargo (Sept. 2009); letter from SIFMA (Sept. 2009); letter from ICI (Sept. 2009); letter from Credit Suisse (Sept. 2009).

901 See supra Section IX.E.1. (discussing estimated burdens on trading centers of the collection of information requirements in connection with Rule 201).

proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price (i.e., whether the current national best bid or last sale price is above or below the previous national best bid or last sale price), the alternative uptick rule references only the current national best bid. In addition, we believe that the implementation and on-going monitoring and surveillance costs of the alternative uptick rule are justified by the benefits provided by preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

A number of commenters stated that because the alternative uptick rule would not require monitoring of the sequence of bids or last sale prices, implementing the alternative uptick rule would be less costly[902] or easier than implementing the proposed modified uptick rule or the proposed uptick rule.[903] In addition, several commenters stated that the alternative uptick rule would be easier to program into trading and surveillance systems than the proposed modified uptick rule or the proposed uptick rule.[904] Another commenter stated, with respect to the alternative uptick rule, that "actual implementation costs in terms of time and capital expenditure would be negligible when compared to those involved in implementing either the uptick rule or modified uptick rule."[905]

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902 See, e.g., letter from BATS (May 2009); letter from BATS (Sept. 2009); letter from GETCO (Sept. 2009); letter from ICI (Sept. 2009); letter from Glen Shipway (Sept. 2009). In addition, several commenters acknowledged that implementation of the alternative uptick rule will likely be less costly, without referencing the sequencing issue. See, e.g., letter from STANY (Sept. 2009).

903 See, e.g., letter from Glen Shipway (Sept. 2009); letter from SIFMA (Sept. 2009); letter from STA (Sept. 2009); see also letter from Credit Suisse (June 2009). In addition, one commenter acknowledged that implementation of the alternative uptick rule will likely be easier, without referencing the sequencing issue. See letter from Allston Trading (Sept. 2009).

904 See, e.g., letter from BATS (May 2009); letter from Glen Shipway (Sept. 2009); letter from ICI (Sept. 2009); see also letter from National Stock Exchange et al.

905 Letter from BATS (Sept. 2009).

Several commenters indicated that implementation of the alternative uptick rule would not be easier or less costly than implementation of the proposed modified uptick rule or the proposed uptick rule.[906] However, we note that some of these commenters presented concerns that were not directly related to the alternative uptick rule[907] or to implementation costs or difficulties.[908] Additionally, one commenter did not provide the reasoning for its belief that the alternative uptick rule would not be easier or less costly to implement.[909]

Several commenters indicated their belief that other commenters' estimates regarding the difficulty or costs of implementing and monitoring the proposed modified uptick rule and the proposed uptick rule were exaggerated.[910] We recognize that some commenters' estimates of the costs of the proposed modified uptick rule or the proposed uptick rule may have been conservative. We also believe that because the alternative uptick rule does not include a sequencing requirement, the implementation and on-going monitoring and surveillance costs of the alternative uptick rule will be less than such costs would be with respect to the other proposed short sale price test restrictions.

One commenter stated that the Commission "underestimate[s] the time and expense that will be required for market participants to comply with the [alternative uptick] rule (or any other of the proposed alternatives)" and that such costs "will include expenses … for the initial

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906 See, e.g., letter from Matlock Capital (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from Knight Capital (Sept. 2009).

907 See, e.g., letter from NYSE Euronext (Sept. 2009) (stating that implementation of the alternative uptick rule would be more difficult on the basis that the alternative uptick rule would be paired with a circuit breaker and attributing implementation difficulties to the circuit breaker approach, not the alternative uptick rule).

908 See, e.g., letter from Knight Capital (Sept. 2009) (characterizing a potential increase in friction, confusion, or inefficiency in the market as an implementation difficulty that may arise from the alternative uptick rule).

909 See letter from Matlock Capital (Sept. 2009).

910 See, e.g., letter from Matlock Capital (Sept. 2009); letter from ISE (Sept. 2009); letter from Bingham McCutchen.

implementation of any restriction."[911] However, this commenter did not specify why or how the implementation cost of the alternative uptick rule may be greater than we estimated.[912]

One commenter indicated that implementation costs would be approximately $500,000 per firm, for a total of $191,000,000 for all non-SRO trading centers subject to Rule 201,[913] including costs for "the purchase of additional costly data feeds" but not including "costs associated with developing appropriate internal supervisory procedures and compliance programs."[914] The implementation cost estimates provided by this commenter, which are significantly higher than our estimate of, on average, $68,381 per non-SRO trading center,[915] were not specific to the alternative uptick rule. Because the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price, we believe that the alternative uptick rule will be easier and less costly to implement and monitor than the proposed modified uptick rule or the proposed uptick rule.[916] In addition, we note that implementation of Rule 201 will not require modifications to how data feeds are currently

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911 Letter from RBC (Sept. 2009).

912 In addition, with respect to the commenter's concern that we underestimated the time required for implementation, we note that, as discussed in Section VII., above, we believe that a six month implementation period is appropriate. This implementation period, which is longer than the implementation periods proposed in the Proposal and the Re-Opening Release, takes into consideration commenters' concerns that implementation of a price test could be complex. We do not believe that a longer implementation time is warranted because, for example, Rule 201 does not require monitoring of the sequence of bids or last sale prices, unlike other proposed price tests, and because Rule 201 requires the implementation of policies and procedures similar to those required for trading centers under Regulation NMS.

913 See letter from Wolverine. In its letter, Wolverine multiplied its implementation cost estimate of $500,000 by 382 non-SRO trading centers for a total of $191,000,000. See id. As indicated above, however, we now estimate that there are 407 non-SRO trading centers. See supra note 686.

914 Id.

915 See infra note 960 and accompanying text (discussing our estimated implementation costs for trading centers).

916 See supra notes 661 to 669 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

received. As discussed above, Rule 201 does not mandate that the receipt of the current national best bid must be from any one particular data feed; thus, trading centers will be able to continue using the data feed they currently use, and for which they currently pay.[917] As a result, we believe this commenter's estimates of the implementation costs are higher than our estimated implementation costs for Rule 201.

Another commenter conducted a survey of firms with respect to implementation cost estimates. Cost estimates in response to the survey indicated that a circuit breaker triggering a short sale price test based on the national best bid would have implementation costs that averaged between $235,000 and $2,000,000 per firm.[918] This estimated implementation cost range is significantly higher than our estimated range of, on average, $68,381 per non-SRO trading center to $86,880 per SRO trading center for implementation.[919] We note that the commenter's survey results covered fifty firms, categorized as large firms, regional firms, and clearing firms, rather than SRO trading centers, non-SRO trading centers and broker-dealers. Thus, it is difficult to determine the implementation costs to trading centers, including non-SRO trading centers, from these survey results. In addition, these cost estimates were based on a circuit breaker triggering the proposed modified uptick rule and, as such, were not specific to the alternative uptick rule. Because the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would

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917 See supra notes 404 to 411 and accompanying text (discussing the use of various data feeds in determining the current national best bid).

918 See letter from SIFMA (June 2009). SIFMA did not categorize estimates of the implementation costs of a circuit breaker triggering a short sale price test based on the national best bid by SRO trading centers, non-SRO trading centers, and other broker-dealers, but categorized responses by larger firms, with implementation cost estimates that averaged $2,000,000 per firm, with the highest estimate at $9,000,000 per firm, regional firms, with estimates that averaged $235,000 per firm, with the highest estimate at $500,000 per firm, and clearing firms, with estimates that averaged $1,200,000 per firm, with the highest estimate at $1,900,000 per firm. SIFMA only provided the average and highest cost estimates per category. See id.

919 See infra note 960 and accompanying text (discussing our estimated implementation costs for trading centers).

have required sequencing of the national best bid or last sale price, we believe that the alternative uptick rule will be easier and less costly to implement and monitor than the proposed modified uptick rule or the proposed uptick rule.[920]

Commenters indicated that implementation costs would include costs for modifications to multiple systems, including blue sheet, OATS, and OTS reporting systems, trading system interfaces, execution management systems, and order management systems; modifications to data feeds;[921] adjustments to data retention capabilities; revisions to written policies and procedures; and personnel training regarding the new requirements.[922] We recognize that implementation of Rule 201 will impose surveillance and reprogramming costs for enforcing, monitoring, and updating trading, order management, execution management, surveillance, and reporting systems under Rule 201, systems changes to computer software, adjustments to data retention capabilities, as well as staff time and technology resources. These costs are included in our estimates of the costs of implementing Rule 201.[923]

In addition, commenters expressed concerns that the costs of on-going monitoring and surveillance of a short sale price test restriction would be significant.[924] Only one commenter specifically discussed concerns about the on-going monitoring and surveillance costs of the

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920 See supra notes 661 to 669 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

921 As discussed above, implementation of Rule 201 will not require modifications to how data feeds are currently received. See supra notes 404 to 411 and accompanying text (discussing the use of various data feeds in determining the current national best bid).

922 See, e.g., letter from NSCP; letter from STANY (June 2009); letter from RBC (June 2009); letter from Wolverine; letter from EWT (Sept. 2009).

923 See infra note 960 and accompanying text (discussing our estimates of the implementation costs of Rule 201 by trading centers).

924 See, e.g., letter from NSCP; letter from RBC (June 2009); letter from SIFMA (June 2009); letter from Wolverine; letter from RBC (Sept. 2009).

alternative uptick rule, and this commenter did not provide specific cost estimates.[925] One commenter stated that the alternative uptick rule would be easier to surveil and monitor than the proposed modified uptick rule or the proposed uptick rule, and thus would present lower on-going costs to the industry.[926] The alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price. Thus, we believe that the alternative uptick rule will be easier and less costly to implement and monitor than the proposed modified uptick rule or the proposed uptick rule.[927]

Another commenter estimated that on-going system maintenance would cost $20,000 annually per firm.[928] This estimate is lower than our estimated total cost of, on average, $121,356 annually per trading center for on-going monitoring and surveillance.[929] This commenter stated that this estimate covers the cost "annually to maintain the system." It is not clear what specific on-going monitoring and surveillance functions are included in the commenter's estimate but we believe that our estimate is more inclusive, in that it specifically takes into account costs for the commitment of resources associated with compliance administration and oversight, response to regulatory inquiries and examinations, response to

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925 See letter from RBC (Sept. 2009).

926 See letter from STA (Sept. 2009).

927 See supra notes 661 to 669 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

928 See letter from Wolverine. Wolverine does not apply this estimate to exchanges and ATSs, but only to other non-SRO trading centers (such as market makers), noting that on-going costs for exchanges and ATSs "should be minimal because they would be limited to system testing and maintenance, not the regulation of hundreds of members' systems, procedures and trading activity." Id.

929 See infra notes 961 to 962 and accompanying text (discussing our estimates of the on-going monitoring and surveillance costs of Rule 201 by trading centers).

internal inquiries, market surveillance, data retention, testing, training, and enforcement, with attendant opportunity costs.[930]

One commenter conducted a survey of fifty firms with respect to on-going monitoring cost estimates. Cost estimates in response to the survey indicated that a circuit breaker triggering a short sale price test based on the national best bid would have on-going monitoring costs that averaged between $45,000 and $175,000 per firm.[931] Although our estimated cost of, on average, $121,356 per trading center for on-going monitoring and surveillance,[932] falls within this commenter's estimated range of on-going monitoring cost, we note that the survey results covered fifty firms, categorized as large firms, regional firms, and clearing firms, rather than SRO trading centers, non-SRO trading centers and broker-dealers. Thus, it is difficult to determine the implementation costs to trading centers, including non-SRO trading centers, from these survey results. In addition, these cost estimates were not specific to the alternative uptick rule. Because the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price, we believe that the alternative uptick rule

930 See infra notes 934 and 935 and accompanying text (discussing the scope of our on-going monitoring and compliance cost estimates).

931 See letter from SIFMA (June 2009). SIFMA did not categorize estimates of the on-going monitoring costs of a circuit breaker triggering a short sale price test based on the national best bid by SRO trading centers, non-SRO trading centers, and other broker-dealers, but categorized responses by larger firms, with on-going monitoring cost estimates that averaged $130,000 per firm, with the highest estimate at $1,500,000 per firm, regional firms, with estimates that averaged $45,000 per firm, with the highest estimate at $350,000 per firm, and clearing firms, with estimates that averaged $175,000 per firm, with the highest estimate at $250,000 per firm. SIFMA only provided the average and highest cost estimates per category. See id.

932 See infra notes 961 to 962 and accompanying text (discussing our estimated on-going monitoring and surveillance costs for trading centers).

will be easier and less costly to implement and monitor than the proposed modified uptick rule or the proposed uptick rule.[933]

Commenters indicated that the on-going costs to trading centers of a short sale price test restriction would include surveillance, testing, training, administration and supervision, data retention, response to regulatory inquiries and examinations, and response to internal inquiries.[934] We agree with these comments and believe that Rule 201 will require the commitment of resources associated with compliance administration and oversight, response to regulatory inquiries and examinations, response to internal inquiries, market surveillance, data retention, testing, training, and enforcement, with attendant opportunity costs. These costs are included in our estimates of the costs of on-going monitoring and surveillance of Rule 201.[935]

In estimating the costs to trading centers of implementing Rule 201, we considered that the policies and procedures required to be implemented for purposes of Rule 201 are similar to those that are required under Regulation NMS.[936] In accordance with Regulation NMS, trading centers must have in place written policies and procedures in connection with that Regulation's Order Protection Rule, which could help form the basis for implementing the policies and procedures for Rule 201.[937] Thus, we believe trading centers may already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.

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[933] See supra notes 661 to 669 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

[934] See, e.g., letter from NSCP; letter from RBC (June 2009); letter from SIFMA (June 2009); letter from Wolverine; letter from RBC (Sept. 2009).

[935] See infra notes 961 to 962 and accompanying text (discussing our estimates of the on-going monitoring and surveillance costs of Rule 201 to trading centers).

[936] See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087; 17 CFR 242.611.

[937] See Regulation NMS Adopting Release, 70 FR 37496; see also 17 CFR 242.611.

We believe this familiarity will reduce the implementation costs of Rule 201 on trading centers and will make Rule 201 less burdensome to implement. Moreover, because trading centers have already developed or modified their surveillance mechanisms in order to comply with Regulation NMS's policies and procedures requirement, trading centers may already have retained and trained the necessary personnel to ensure compliance with that Regulation's policies and procedures requirements and, therefore, may already have in place most of the infrastructure and potential policies and procedures necessary to comply with Rule 201.[938] Further, we believe that the implementation and on-going monitoring and surveillance costs of the alternative uptick rule are justified by the benefits provided in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

Several commenters indicated that the Commission overstated the benefit of previous implementation of Regulation NMS in mitigating the costs of implementing a short sale price test restriction,[939] because, for example, "systems re-written and architected for Reg NMS ... did not include any short sale restrictions,"[940] or because such systems will require modifications in order to be used in the context of a short sale price test restriction.[941] However, we took into account that Regulation NMS was implemented after elimination of the prior short sale price tests when considering the impact of previous experience with the policies and procedures requirement of Regulation NMS's Order Protection Rule. And, although we recognize that

[938] We also believe some trading centers may have retained personnel familiar with the former SRO bid tests, which may make Rule 201 even less burdensome to implement. See, Proposal, 74 FR at 18095, n.393 and 18053, n.125.

[939] See, e.g., letter from FIF (June 2009); letter from NSCP; letter from RBC (June 2009).

[940] Letter from FIF (June 2009); see also letter from RBC (June 2009).

[941] See letter from NSCP; letter from RBC (June 2009).

systems and processes will have to be modified for implementation of Rule 201, we continue to believe that because most trading centers already have in place systems and written policies and procedures in order to comply with Regulation NMS's Order Protection Rule, most trading centers will already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, which will mitigate the burden of implementation of the policies and procedures requirement under Rule 201.

Several commenters agreed, stating that previous experience with the policies and procedures required under Regulation NMS might reduce the implementation and on-going monitoring and compliance burdens on trading centers.[942] One commenter stated that implementation of a circuit breaker approach combined with the alternative uptick rule would be easier to implement than the other proposed short sale price tests or proposed circuit breaker rules, "provided that the Commission permits firms to leverage the numerous systems changes made to facilitate compliance with Regulation NMS (including the use of internal market data rather than consolidated data supplied by the industry plans)."[943] And one commenter stated that prior implementation of Regulation NMS could ease implementation of a short sale price test restriction, "provided that broker-dealers' implementations of Regulation NMS was sufficiently modular and extensible."[944] We believe that Rule 201 is structured so that trading centers will be able to leverage their existing systems and experience with implementing the policies and procedures required by Regulation NMS's Order Protection Rule. For example, Rule 201 does not mandate that the receipt of the current national best bid must be from any one particular data

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942 See, e.g., letter from EWT (Sept. 2009); letter from Goldman Sachs (Sept. 2009); letter from MFA (Oct. 2009).

943 Letter from Goldman Sachs (Sept. 2009); see also letter from MFA (Oct. 2009).

944 Letter from EWT (Sept. 2009).

feed; thus, trading centers will be able to use internal market data if they choose.[945] Thus, as stated above, we believe that familiarity with trading-related policies and procedures under Regulation NMS will mitigate the burden of implementation of the policies and procedures requirement under Rule 201.

Moreover, the written policies and procedures requirement of Rule 201 is designed to provide trading centers with significant flexibility in determining how to comply with the requirements of the Rule. For example, Rule 201 is designed to provide trading centers and their customers with flexibility in determining how to handle orders that are not immediately executable or displayable by the trading center because the order is impermissibly priced. Thus, if an order were impermissibly priced, the trading center could, in accordance with policies and procedures reasonably designed to prevent the execution or display of a short sale at a price that is less than or equal to the current national best bid, re-price the order upwards to the lowest permissible price and hold it for later execution at its new price or better.[946] As quoted prices change, Rule 201 allows a trading center to repeatedly re-price and display an order at the lowest permissible price down to the order's original limit order price (or, if a market order, until the order is filled). Because a trading center could re-price and display a previously impermissibly priced short sale order, Rule 201 may allow for the more efficient functioning of the markets because trading centers do not have to reject or cancel impermissibly priced orders unless instructed to do so by the trading center's customer submitting the short sale order. We note that

[945] See supra notes 404 to 411 and accompanying text (discussing the use of various data feeds in determining the current national best bid).

[946] For example, if a trading center receives a short sale order priced at $47.00 when the current national best bid in the security is $47.00, the trading center could re-price the order at the permissible offer price of $47.01, and display the order for execution at this new limit price.

a number of commenters expressed support for a policies and procedures approach to any short sale price test restriction, in part, because it would add flexibility to the Rule's requirements.[947]

Moreover, while latencies in obtaining data regarding the national best bid from consolidated market data feeds, as discussed in detail above, may impact implementation costs associated with Rule 201, a trading center could have policies and procedures that would provide for a snapshot of the applicable national best bid of the security. We note that some commenters expressed concerns regarding latencies in obtaining data regarding the national best bid disseminated by proprietary data feeds and/or by SIPs.[948] We believe that a policies and procedures approach that provides for a snapshot of the applicable current national best bid will aid trading centers in dealing with time lags in receiving data regarding the national best bid from different data sources, as well as lead to reduced initial and on-going costs associated with Rule 201 for trading centers by facilitating verification of whether a short sale order was executed or displayed at a permissible price.

We considered whether our estimates of the costs to trading centers for implementation and on-going monitoring and surveillance of the proposed modified uptick rule included in the Proposal[949] would change under the circuit breaker approach of Rule 201, but concluded, as discussed below, that these estimates continue to represent reasonable estimates under the circuit breaker approach.

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947 See, e.g., letter from T. Rowe Price (June 2009); letter from AIMA; letter from RBC (June 2009); letter from Citadel et al. (Sept. 2009).

948 See, e.g., letter from Glen Shipway (Sept. 2009); see also letter from Credit Suisse (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009); letter from RBC (June 2009); letter from SIFMA (June 2009); letter from Direct Edge (June 2009); letter from BATS (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Lime Brokerage (Sept. 2009).

949 See Proposal, 74 FR at 18093.

Despite some commenters' concerns regarding the implementation costs of a circuit breaker rule,[950] we believe that the circuit breaker approach will result in largely the same implementation costs as we estimated would be incurred if we adopted a permanent, market-wide short sale price test restriction.[951] As one commenter stated, "[o]nce the price test is in place, there is minimal incremental effort required to add a Circuit Breaker that controls the application of the price test."[952] Similarly, another commenter stated that "[t]he additional coding required to implement a circuit breaker is minimal..."[953] We believe that that there will be only minimal, if any, implementation costs for a circuit breaker approach in addition to the costs that we estimated previously for the implementation of a permanent, market-wide short sale price test rule because trading centers will need to establish written policies and procedures to implement the short sale price test restriction regardless of whether the short sale price test restriction is adopted on a permanent, market-wide basis or, in the case of Rule 201, adopted in conjunction with a circuit breaker. Several other commenters agreed, stating that the costs of the circuit breaker approach would be similar to, or only incrementally higher than, the costs of a permanent, market-wide approach.[954]

In addition, with respect to on-going monitoring and surveillance costs of the circuit breaker approach, we recognize, as noted by one commenter,[955] that trading centers will need to continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be

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950 See supra note 676.

951 See Proposal, 74 FR at 18093.

952 Letter from Nasdaq OMX Group (Oct. 2009).

953 Letter from Credit Suisse (Sept. 2009).

954 See, e.g., letter from STA (June 2009).

955 See letter from Glen Shipway (June 2009).

offset because, under the circuit breaker approach, the alternative uptick rule will be time limited and will only apply on a stock by stock basis, which will reduce our previously estimated costs for on-going monitoring and surveillance. This is because trading centers will only need to monitor and surveil for compliance with the alternative uptick rule during the limited period of time that the circuit breaker is in effect with respect to a specific security. As such, the circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure.[956] Further, although, under the circuit breaker approach, market participants will need to monitor whether a stock is subject to Rule 201 or not, we believe that familiarity with a circuit breaker approach may help mitigate such compliance costs.[957]

On balance, we believe that the estimates of the costs to trading centers for implementation and on-going monitoring and surveillance of the proposed modified uptick rule included in the Proposal[958] are appropriate with respect to Rule 201. Thus, our estimates have not changed from the Proposal, except to the extent that total burden estimates have changed because we have updated the estimated number of trading centers.[959] As detailed in PRA Section IX.E.1., above, we realize that the exact nature and extent of the policies and procedures that a trading center is required to establish likely will vary depending upon the type, size, and nature of the trading center (e.g., SRO vs. non-SRO, full service broker-dealer vs. market maker). Thus, our estimates take into account different types of trading centers and we realize that these

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956 See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

957 See supra notes 292 and 684 and accompanying text (discussing stock exchanges' and FINRA's rules or policies to implement coordinated circuit breaker halts and SRO rules or polices to coordinate individual security trading halts corresponding to significant news events).

958 See Proposal, 74 FR at 18093.

959 See supra note 686 (discussing the change in the estimated number of trading centers).

estimates may be on the low-end for some trading centers while they may be on the high-end for other trading centers.

As detailed in PRA Section IX.E.1., above, we estimate a total one-time initial cost of $28,699,867[960] for all trading centers subject to Rule 201 to establish the written policies and procedures reasonably designed to prevent the execution or display of short sale orders at a price that is less than or equal to the current national best bid.

Once a trading center has established written policies and procedures reasonably designed to prevent the execution or display of a short sale order at a price that is less than or equal to the current national best bid, we estimate a total annual on-going cost of $7,751,196[961] for all trading centers subject to Rule 201 to ensure that their written policies and procedures are up-to-date and remain in compliance with Rule 201. In addition, with regard to on-going monitoring for and enforcement of trading in compliance with Rule 201, as detailed in PRA Section IX.E.1., above, we believe that, once the tools necessary to carry out on-going monitoring have been put in place, a trading center will be able to incorporate on-going

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960 This figure was calculated by adding $20,359,867 and $8,340,000 (for outsourced legal work). The $20,359,867 figure was calculated as follows: (70 legal hours x $305) + (105 compliance hours x $313) + (20 information technology hours x $292) + (25 business operation hours x $273) = $66,880 per SRO x 10 SROs = $668,800 total cost for SROs; (37 legal hours x $305) + (77 compliance hours x $313) + (23 information technology hours x $292) + (23 business operation hours x $273) = $48,381 per broker-dealer x 407 broker-dealers = $19,691,067 total cost for broker-dealers; $668,800 + $19,691,067 = $20,359,867. The $8,340,000 figure for outsourced legal work was calculated as follows: (50 legal hours x $400 x 10 SROs) + (50 legal hours x $400 x 407 broker-dealers) = $8,340,000.

Based on industry sources, we estimate that the average hourly rate for outsourced legal services in the securities industry is $400. For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. The $305/hour figure for an attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. In addition, we estimate that the average hourly rate for an assistant compliance director, a senior computer programmer, and a senior operations manager in the securities industry is approximately $313, $292, and $273 per hour, respectively. These figures are from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

961 This figure was calculated as follows: (2 legal hours x 12 months x $305) x (10 + 407) + (3 compliance hours x 12 months x $313) x (10 + 407) = $7,751,196.

monitoring and enforcement within the scope of its existing surveillance and enforcement policies and procedures without a substantial additional burden. We recognize, however, that this on-going compliance will not be cost-free, and that trading centers will incur some additional annual costs associated with on-going compliance, including compliance costs of reviewing transactions. We estimate that each trading center will incur an average annual on-going compliance cost of $102,768, for a total annual cost of $42,854,256 for all trading centers.[962]

To summarize, we estimate an average one-time initial cost of $86,880 per SRO trading center and $68,381 per non-SRO trading center for a total one-time initial cost of $28,699,867 [963] for all trading centers subject to Rule 201 to establish the written policies and procedures reasonably designed to prevent the execution or display of short sale orders at a price that is less than or equal to the current national best bid. We estimate an average annual on-going cost of $18,588 per trading center for a total annual on-going cost of $7,751,196[964] for all trading centers subject to Rule 201 to ensure that their written policies and procedures are up-to-date and remain

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962 We estimate that each trading center will incur an average annual on-going compliance cost of $102,768 for a total annual cost of $42,854,256 for all trading centers. This figure was calculated as follows: (16 compliance hours x $313) + (8 information technology hours x $292) + (4 legal hours x $305) x 12 months = $102,768 per trading center x 417 trading centers = $42,854,256. As discussed above, we base our burden hour estimates on the estimates used for Regulation NMS because it requires similar on-going monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. The $305/hour figure for an attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. In addition, we estimate that the average hourly rate for an assistant compliance director, a senior computer programmer, and a senior operations manager in the securities industry is approximately $313, $292, and $273 per hour, respectively. These figures are from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

963 See supra note 960.

964 See supra note 961.

in compliance with Rule 201. In addition, we estimate an average annual cost of $102,768 per trading center for a total annual cost of $42,854,256 for all trading centers for on-going monitoring for and enforcement of trading in compliance with Rule 201.[965]

ii. Policies and Procedures Requirement under the Broker-Dealer and Riskless Principal Provisions

A broker-dealer marking an order "short exempt" under Rule 201(c) must identify the order as being at a price above the current national best bid at the time of submission to the trading center[966] and must establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the requirements of Rule 201(c).[967]

Rule 201(d)(6) allows a broker-dealer to mark short sale orders of a covered security "short exempt" where a broker-dealer is facilitating customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal, provided certain conditions are satisfied.[968] A broker-dealer marking an order "short exempt" under this provision is required to have written policies and procedures in place to assure that, at a minimum: (i) the customer order was received prior to the offsetting transaction; (ii) the offsetting transaction is allocated to a riskless principal or customer account within 60

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965 See supra note 962.

966 See Rule 201(c). As a result, a trading center's policies and procedures will need to be reasonably designed to permit the execution or display of such orders without regard to whether the order is at a price that is less than or equal to the current national best bid. See Rule 201(b)(1)(iii).

967 See Rule 201(c)(1). As part of its written policies and procedures, a broker-dealer also is required to regularly surveil to ascertain the effectiveness of its policies and procedures and take prompt remedial steps. See Rule 201(c)(2). This provision is intended to reinforce the on-going maintenance and enforcement requirements of the provision contained in Rule 201(c)(1) by explicitly assigning an affirmative responsibility to broker-dealers to surveil to ascertain the effectiveness of their policies and procedures. See id.

968 See Rule 201(d)(6). As a result, a trading center's policies and procedures must be reasonably designed to permit the execution or display of such orders without regard to whether the order is at a price that is less than or equal to the current national best bid. See Rule 201(b)(1)(iii).

seconds of execution; and (iii) that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[969]

As stated previously, we discussed in the Proposal the anticipated costs of the proposed short sale price test restrictions and we requested comment, in the Proposal and Re-Opening Release, on the costs associated with the proposed amendments.[970] In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures.[971] In response to our request for comment, commenters that specifically addressed the riskless principal provision of Rule 201(d)(6) supported its inclusion.[972]

Several commenters expressed concerns with respect to the costs of the broker-dealer provision of Rule 201(c), but did not provide a specific estimate of such costs.[973] Several commenters stated that the broker-dealer provision would place responsibility for ensuring order compliance with Rule 201 on broker-dealers, rather than exchanges, and noted that this is a significant difference from former Rule 10a-1 and NASD's former bid test.[974] Similarly, one commenter stated that the broker-dealer provision would significantly expand the implementation cost of Rule 201, without providing a specific estimate of such cost.[975] Although

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969 See Rule 201(d)(6).

970 See Proposal, 74 FR at 18090, 18092-18103; Re-Opening Release, 74 FR at 42037.

971 See Proposal, 74 FR at 18090.

972 See, e.g., letter from BATS (May 2009); letter from SIFMA (June 2009); letter from Credit Suisse (June 2009); letter from NYSE Euronext (Sept. 2009).

973 See, e.g., letter from Credit Suisse (June 2009); letter from STANY (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009); letter from NSCP; letter from Direct Edge (June 2009).

974 See, e.g., letter from Credit Suisse (June 2009); letter from STANY (June 2009).

975 See letter from Lime Brokerage (June 2009).

we agree that implementation of the broker-dealer provision of Rule 201(c) will impose costs on broker-dealers who choose to rely on this provision, we note that Rule 201(c) is not a requirement of the Rule, but rather provides that a broker-dealer may mark a sell order for a security that has triggered the circuit breaker as "short exempt," provided that the broker-dealer identifies the order as being at a price above the current national best bid at the time of submission to the trading center and otherwise complies with the requirements of the provision.

In addition, as discussed throughout this adopting release, the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price. In order to rely on the broker-dealer provision, a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being at a price above the current national best bid at the time of submission of the order to the trading center. Because the alternative uptick rule does not require sequencing of the national best bid, we believe that the policies and procedures required in order to rely on the broker-dealer provision under the alternative uptick rule will be easier and less costly to implement and monitor than would be the case under the proposed modified uptick rule or the proposed uptick rule.[976] We note that one of the commenters that expressed concerns about the implementation cost of the broker-dealer provision also acknowledged that a rule "that would not require data centralization and sequencing would be significantly less complex and faster to implement."[977]

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[976] See supra notes 709 to 715 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

[977] Letter from Credit Suisse (June 2009).

We disagree with several commenters who stated that, although implementation and on-going monitoring and surveillance of the alternative uptick rule might be easier and/or less costly for trading centers, this would not hold true for broker-dealers.[978] One of these commenters stated that "in order to avoid rejection of short sale orders under an alternative uptick rule, programming would need to be implemented to anticipate changes in the national best bid between the time a short sale order is entered and the time it reaches the relevant market center."[979] However, the broker-dealer provision of Rule 201(c) is designed specifically to help avoid this result. Under the broker-dealer provision, a broker-dealer may, in accordance with the policies and procedures required by the provision, identify the order as not being at a price that is less than or equal to the current national best bid at the time the order is submitted to the trading center and mark the order "short exempt." Trading centers are required to have written policies and procedures in place to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.[980]

Commenters also expressed concerns about the competitive pressure of the broker-dealer provision, stating either that broker-dealers would feel compelled to undertake implementation of the provision, despite the high cost,[981] which would be particularly burdensome for smaller firms,[982] or that smaller firms would find the costs prohibitive, placing them at a competitive

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[978] See, e.g., letter from Citadel et al. (Sept. 2009); letter from EWT (Sept. 2009); letter Lime Brokerage (Sept. 2009).

[979] Letter from Citadel et al. (Sept. 2009).

[980] See Rule 201(b)(1)(iii).

[981] See, e.g., letter from STANY (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009).

[982] See, e.g., letter from T.D. Pro Ex; letter from Taurus Compliance; letter from Credit Suisse (June 2009).

disadvantage.[983] We recognize that broker-dealers are faced with competitive concerns and that such concerns may influence their decision whether or not to rely on the broker-dealer provision of Rule 201(c). With respect to the cost, as stated above, although we recognize that the broker-dealer provision will impose implementation costs on broker-dealers who choose to rely on this provision, we believe that this cost will not be as great as stated by some commenters because the alternative uptick rule does not require sequencing of the national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price.[984] We believe that, without a sequencing requirement, the policies and procedures required in order to rely on the broker-dealer provision under the alternative uptick rule will be easier and less costly to implement and monitor, for all broker-dealers including smaller broker-dealers, than would be the case under the proposed modified uptick rule or the proposed uptick rule.[985]

Further, we believe that the implementation and on-going monitoring and compliance costs for broker-dealers who choose to rely on the broker-dealer provision are justified by the benefits of providing broker-dealers with the option to manage their order flow, rather than having to always rely on their trading centers to manage their order flow on their behalf.

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[983] See, e.g., letter from Credit Suisse (June 2009); letter from NSCP.

[984] We also note that it is possible that some smaller broker-dealers that determine to rely on the broker-dealer provision may determine that it is cost-effective for them to outsource certain functions necessary to comply with Rule 201(c) to larger broker-dealers, rather than performing such functions in house, to remain competitive in the market. This may help mitigate costs associated with implementing and complying with Rule 201(c). Additionally, they may decide to purchase order management software from technology firms. Order management software providers may integrate changes imposed by Rules 200(g) and 201 into their products, thereby providing another cost-effective way for smaller broker-dealers to comply with the requirement of Rule 201(c).

[985] See supra notes 709 to 715 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs to broker-dealers).

One commenter stated that the broker-dealer provision would impose significant on-going costs in the form of data storage, surveillance, and review, but did not provide a specific estimate of such cost.[986] We agree that broker-dealers who choose to rely on the broker-dealer provision of Rule 201(c) will face on-going costs for data storage, surveillance and review. However, we believe that broker-dealers' on-going monitoring and surveillance costs under Rule 201(c) will be mitigated by the alternative uptick rule, as compared to the proposed modified uptick rule or the proposed uptick rule, because the alternative uptick rule will reference only the current national best bid in determining permissible short sales.[987] In order to rely on the broker-dealer provision, a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being at a price above the current national best bid at the time of submission of the order to the trading center. Under the alternative uptick rule, broker-dealers who choose to rely on Rule 201(c) will need to monitor the current national best bid, but will not be required to monitor the sequence of bids or last sale prices, as would have been required under the proposed modified uptick rule or the proposed uptick rule, respectively. Several commenters noted that the lack of a sequencing requirement would make the alternative uptick rule, in comparison to the other proposed short sale price tests, less costly[988] or easier to monitor on an on-going basis.[989] One commenter stated

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986 See letter from NSCP; see also letter from Credit Suisse (June 2009).

987 See supra notes 709 to 715 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs to broker-dealers).

988 See supra note 661.

989 See, e.g., letter from Glen Shipway (Sept. 2009); letter from SIFMA (Sept. 2009); letter from STA (Sept. 2009); see also letter from Credit Suisse (June 2009). In addition, one commenter acknowledged that monitoring of the alternative uptick rule will likely be easier, without referencing the sequencing issue. See letter from Allston Trading (Sept. 2009).

that the alternative uptick rule would reduce the data retention requirements of a new short sale price test restriction.[990]

Another commenter stated that the "Commission's cost estimates seem to underestimate the cost to large, full service broker-dealers, since the volume of orders handled by these firms are likely to lead to significantly greater technology and storage costs alone as well as more frequent reviews" but did not provide a specific cost estimate.[991] As we stated in the Proposal,[992] we recognize that the exact nature and extent of the required policies and procedures, and thus the costs associated with such policies and procedures, that a broker-dealer is required to establish under the broker-dealer provision in Rule 201(c) likely will vary depending upon the nature of the broker-dealer, and we have taken this into account in our cost estimates.[993]

The following discussion of comments on the costs to broker-dealers includes comments that were discussed above with respect to the costs to trading centers[994] because, in some cases, commenters provided comments and estimates on the costs of establishing and monitoring policies and procedures under the proposed short sale price tests without distinguishing between costs that would be applicable to trading centers as opposed to broker-dealers. One commenter provided a dollar estimate of broker-dealer implementation costs at approximately $500,000 per broker-dealer, for a total of $2,780,500,000 for all broker-dealers subject to Rule 201,[995]

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990 See letter from STA (Sept. 2009).

991 Letter from NSCP.

992 See Proposal, 74 FR at 18093.

993 See infra notes 1022 to 1024 and accompanying text (discussing our estimates of implementation and on-going monitoring and surveillance costs to broker-dealers).

994 See supra Section X.B.1.b.i. (discussing costs to trading centers).

995 See letter from Wolverine. Wolverine provided an estimate of $500,000 per firm for implementation costs, which it applied to both non-SRO trading centers and other registered broker-dealers. In its letter, Wolverine multiplied its implementation cost estimate of $500,000 by 5,561 for a total of $2,780,500,000. See id. As indicated above, the Commission now estimates the number of broker-dealers at 5,178 based on a review of

including costs for "the purchase of additional costly data feeds" but not including "costs associated with developing appropriate internal supervisory procedures and compliance programs."[996] However, we note that this implementation cost estimate for the broker-dealer provision, which is significantly higher than our estimate of, on average, $68,381 per broker-dealer,[997] was not specific to the alternative uptick rule. As discussed above, we believe that the alternative uptick rule will be easier and less costly to monitor than the proposed modified uptick rule or the proposed uptick rule because under the alternative uptick rule, broker-dealers who choose to rely on Rule 201(c) will need to monitor the current national best bid, but will not be required to monitor the sequence of bids or last sale prices, as would have been required under the proposed modified uptick rule or the proposed uptick rule, respectively.[998] In addition, we note that implementation of Rule 201 will not require modifications to how data feeds are currently received. As discussed above, Rule 201 does not mandate that the receipt of the current national best bid must be from any one particular data feed; thus, broker-dealers will be able to continue using the data feed they currently use and for which they currently pay.[999]

Another commenter conducted a survey of fifty firms with respect to implementation and on-going monitoring cost estimates. Cost estimates in response to the survey indicated that a circuit breaker triggering a short sale price test based on the national best bid would have

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2008 FOCUS Report filings reflecting registered broker-dealers, including introducing broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings. See supra note 652.

[996] Letter from Wolverine.

[997] See infra note 1022 and accompanying text (discussing our estimated implementation costs for broker-dealers).

[998] See supra notes 709 to 715 and accompanying text and notes 978 to 980 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

[999] See supra notes 404 to 411 and accompanying text (discussing the use of various data feeds in determining the current national best bid).

implementation costs that averaged between $235,000 and $2,000,000 per firm.[1000] This estimated implementation cost range is significantly higher than our cost estimate of, on average, $68,381 per broker-dealer for implementation.[1001] In addition, cost estimates in response to the survey indicated that a circuit breaker triggering a short sale price test based on the national best bid would have on-going monitoring costs that averaged between $45,000 and $175,000 per firm.[1002] Our estimated cost of $121,356 per broker-dealer for on-going monitoring and surveillance[1003] falls within this commenter's estimated range of on-going monitoring cost. We note that the estimated costs were categorized by large firms, regional firms, and clearing firms, rather than by SRO trading centers, non-SRO trading centers and broker-dealers. As a result, it is difficult to determine the applicability of these cost estimates to the expected implementation and on-going monitoring and compliance costs of Rule 201 to broker-dealers. In addition, this commenter's cost estimates were not specific to the alternative uptick rule. As discussed above, because the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price, we believe that the alternative uptick rule will be easier and less costly to implement and monitor than the proposed modified uptick rule or the proposed uptick rule.[1004]

[1000] See supra note 918 (discussing the results of SIFMA's cost estimate survey with respect to the costs of implementing a circuit breaker triggering a short sale price test based on the national best bid); see also letter from Wolverine.

[1001] See infra note 1022 and accompanying text (discussing our estimated implementation costs for broker-dealers).

[1002] See supra note 931 (discussing the results of SIFMA's cost estimate survey with respect to the on-going monitoring costs of a circuit breaker triggering a short sale price test based on the national best bid).

[1003] See infra note 1022 and accompanying text (discussing our estimated implementation costs for broker-dealers).

[1004] See supra notes 709 to 715 and accompanying text and notes 978 to 980 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

We considered these comments in evaluating the costs of implementation and on-going monitoring and surveillance of the broker-dealer provision of Rule 201(c) and the riskless principal provision of Rule 201(d)(6). We note that the policies and procedures that must be implemented under the broker-dealer provision are similar to those that are required under the Order Protection Rule of Regulation NMS.[1005] Thus, we believe broker-dealers will already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.

Although, as discussed above with respect to trading centers, several commenters stated that previous implementation of Regulation NMS would not mitigate the costs to broker-dealers of implementing a short sale price test restriction,[1006] we considered these comments, as well as comments stating that previous implementation of Regulation NMS could ease implementation provided that broker-dealers could leverage existing systems in implementing Rule 201,[1007] and continue to believe that familiarity with Regulation NMS policies and procedures will reduce the implementation costs of the broker-dealer provision under Rule 201(c) on broker-dealers. Moreover, because broker-dealers may have already developed or modified their surveillance mechanisms in order to comply with the policies and procedures requirement of the Order Protection Rule under Regulation NMS, broker-dealers may already have retained and trained the necessary personnel to ensure compliance with that Regulation's policies and procedures requirements and, therefore, may already have in place most of the infrastructure and potential policies and procedures necessary to comply with the broker-dealer provision of Rule 201(c). In

[1005] See Regulation NMS Adopting Release, 70 FR 37496; see also 17 CFR 242.611.

[1006] See, e.g., letter from FIF (June 2009); letter from RBC (June 2009).

[1007] See, e.g., letter from MFA (Oct. 2009).

addition, one commenter supported using a policies and procedures approach to any short sale price test restriction because it would ease implementation for broker-dealers.[1008]

Moreover, while latencies in obtaining data regarding the national best bid from consolidated market data feeds, as discussed in detail above, may impact implementation costs associated with Rule 201, a broker-dealer could have policies and procedures that would provide for a snapshot of the applicable national best bid of the security. Several commenters expressed concerns that implementing "snapshot" capability to preserve an auditable record of the current national best bid would be difficult and costly for broker-dealers,[1009] particularly because this is not a capability currently supported by many broker-dealers.[1010] Commenters also noted that "snapshot" capability would require increased data storage.[1011]

Although we recognize commenters' concerns that implementing "snapshot" capability could be costly for some broker-dealers, we note that most broker-dealers may already have developed "snapshot" capability in connection with Regulation NMS's Order Protection Rule. We also agree that "snapshot" capability will require data storage by broker-dealers; however, as noted by one commenter,[1012] because the alternative uptick rule does not require sequencing of the national best bid, the data storage requirements under the alternative uptick rule are lower than they would be under the proposed modified uptick rule or the proposed uptick rule. In addition, we believe that the costs of a policies and procedures approach that provides for a

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1008 See, e.g., letter from GE.

1009 See, e.g., letter from Credit Suisse (June 2009); letter from STANY (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009); letter from NSCP.

1010 See, e.g., letter from STANY (June 2009); letter from FIF (June 2009).

1011 See, e.g., letter from STANY (June 2009); letter from FIF (June 2009); letter from NSCP; letter from Direct Edge (June 2009).

1012 See letter from STA (Sept. 2009).

snapshot of the applicable current national best bid of the security are justified because snapshot capability will aid broker-dealers in dealing with time lags in receiving data regarding the national best bid from different data sources and facilitate verification of whether a short sale order was executed or displayed at a permissible price.

We considered whether our estimates of the costs to broker-dealers for implementation and on-going monitoring and surveillance of the proposed modified uptick rule included in the Proposal[1013] would change under the circuit breaker approach of Rule 201, but, as discussed below, concluded that these estimates continue to represent reasonable estimates under the circuit breaker approach combined with the alternative uptick rule.

As discussed previously,[1014] despite some commenters' concerns regarding the implementation costs of a circuit breaker rule,[1015] we believe that the circuit breaker approach will result in largely the same implementation costs as we estimated would be incurred if we adopted a permanent, market-wide short sale price test restriction.[1016] We believe that that there will be only minimal, if any, implementation costs for a circuit breaker approach in addition to the costs we estimated previously for the implementation of a permanent, market-wide short sale price test rule because broker-dealers relying on Rule 201(c) or Rule 201(d)(6) are required to establish written policies and procedures required to comply with those provisions regardless of whether the short sale price test restriction is adopted on a permanent, market-wide basis or, in the case of Rule 201, adopted in conjunction with a circuit breaker. Several other commenters agreed, stating that

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1013 See Proposal, 74 FR at 18093-18094.

1014 See supra Section IX.E.1. (discussing estimated burdens of the collection of information requirements applicable to trading centers under Rule 201).

1015 See supra note 676.

1016 See Proposal, 74 FR at 18093-18094.

the costs of the circuit breaker approach would be similar to, or only incrementally higher than, the costs of a permanent, market-wide approach.[1017]

In addition, with respect to on-going monitoring and surveillance costs of the circuit breaker approach, we recognize, as noted by one commenter,[1018] that broker-dealers relying on Rule 201(c) or Rule 201(d)(6) will need to continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be offset because, under the circuit breaker approach, the alternative uptick rule will be time limited and will only apply on a stock by stock basis, which will reduce our previously estimated costs for on-going monitoring and surveillance. This is because broker-dealers relying on Rule 201(c) will only need to monitor and surveil for compliance with the alternative uptick rule, and broker-dealers relying on Rule 201(d)(6) will only need to monitor for compliance with the requirements of that provision, during the limited period of time that the circuit breaker is in effect with respect to a specific security. As such, the circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure.[1019]

On balance, we believe that the estimates of the costs to broker-dealers for implementation and on-going monitoring and surveillance of the proposed modified uptick rule included in the Proposal[1020] are appropriate with respect to the broker-dealer provision of Rule

[1017] See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from Credit Suisse (Sept. 2009); letter from STA (June 2009).

[1018] See letter from Glen Shipway (June 2009).

[1019] See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

[1020] See Proposal, 74 FR at 18093-18094.

201(c) and the riskless principal provision of Rule 201(d)(6). Thus, our estimates have not changed from the Proposal, except to the extent that total cost estimates have changed because we have updated the estimated number of broker-dealers.[1021] Our estimates of the implementation costs to broker-dealers include the costs of surveillance and reprogramming costs for enforcing, monitoring, and updating trading, execution management, and surveillance systems under Rule 201, systems changes to computer software, as well as staff time and technology resources. Our estimates of the on-going monitoring and surveillance costs include the commitment of resources associated with compliance oversight, market surveillance, data storage and enforcement, with attendant opportunity costs.

As detailed in PRA Section IX.E.2., above, we realize that the exact nature and extent of the required policies and procedures that a broker-dealer is required to establish under the broker-dealer provision in Rule 201(c), as well as under the riskless principal provision in Rule 201(d)(6), likely will vary depending upon the type, size and nature of the broker-dealer (e.g., full service broker-dealer vs. market maker). Thus, our estimates take into account different types of broker-dealers and we realize that these estimates may be on the low-end for some broker-dealers while they may be on the high-end for other broker-dealers.

As detailed in PRA Section IX.E.2., above, we estimate a total one-time initial cost of $354,076,818 for all broker-dealers relying on the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6) to establish written policies and procedures reasonably designed to prevent the incorrect identification of orders as being priced in accordance with the broker-dealer provision or, in the case of the riskless principal provision, to assure that, at a minimum: (i) the customer order was received prior to the offsetting transaction;

[1021] See supra note 729 (discussing the change in the estimated number of broker-dealers).

(ii) the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and (iii) that it has supervisory systems in place to produce records that enable the broker-dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which the broker-dealer relies pursuant to this provision.[1022]

Once a broker-dealer has established written policies and procedures so that it may rely on the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6), we estimate a total annual on-going cost of $96,248,664 for all broker-dealers relying on either of these provisions to ensure that their written policies and procedures are up-to-date and remain in compliance with Rule 201.[1023] In addition, with regard to on-going monitoring for and enforcement of trading in compliance with the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6), as detailed in PRA Section IX.E.2., above, we believe that, once the tools necessary to carry out on-going monitoring have been put in place, a broker-dealer will be able to incorporate on-going monitoring and enforcement within the scope of its existing surveillance and enforcement policies and procedures without a substantial additional burden. We recognize, however, that this on-going compliance will not be cost-free,

[1022] This figure was calculated by adding $250,516,818 and $103,560,000 (for outsourced legal work). The $250,516,818 figure was calculated as follows: (37 legal hours x $305) + (77 compliance hours x $313) + (23 information technology hours x $292) + (23 business operation hours x $273) = $48,381 per broker-dealer x 5,178 broker-dealers = $250,516,818 total cost for broker-dealers. The $103,560,000 figure was calculated as follows: (50 legal hours x $400 x 5,178) = $103,560,000.

Based on industry sources, we estimate that the average hourly rate for outsourced legal services in the securities industry is $400. For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. In addition, we estimate that the average hourly rate for an assistant compliance director, a senior computer programmer, and a senior operations manager in the securities industry is approximately $313, $292, and $273 per hour, respectively. The estimates for in-house legal services, assistant compliance director, senior computer programmer, and senior operations manager are from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[1023] This figure was calculated as follows: (2 legal hours x 12 months x $305) x 5,178 + (3 compliance hours x 12 months x $313) x 5,178 = $96,248,664.

and that broker-dealers will incur some additional annual costs associated with on-going compliance, including compliance costs of reviewing transactions. We estimate that each broker-dealer will incur an average annual on-going compliance cost of $102,768, for a total annual cost of $532,132,704 for all broker-dealers.[1024]

To summarize, we estimate an average one-time initial cost of $68,381 per broker-dealer for a total one-time initial cost of $354,076,818 for all broker-dealers relying on the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6) to establish the written policies and procedures required to rely on the broker-dealer provision or the riskless principal provision.[1025] We estimate an average annual on-going cost of $18,588 per broker-dealer for a total annual on-going cost of $96,248,664 for all broker-dealers relying on either of these provisions to ensure that their written policies and procedures are up-to-date and remain in compliance with Rule 201.[1026] In addition, we estimate an average annual cost of $102,768 per broker-dealer for a total annual cost of $532,132,704 for all broker-dealers for on-going monitoring for and enforcement of trading in compliance with the broker-dealer provision in Rule 201(c) and the riskless principal provision in Rule 201(d)(6).[1027]

[1024] This figure was calculated as follows: (16 compliance hours x $313) + (8 information technology hours x $292) + (4 legal hours x $305) x 12 months = $102,768 per broker-dealer x 5,178 broker-dealers = $532,132,704. As discussed above, we base our estimate of burden hours on the estimates used for Regulation NMS because it requires similar on-going monitoring and surveillance for and enforcement of trading in compliance with that regulation's policies and procedures requirement.

For in-house legal services, we estimate that the average hourly rate for an attorney in the securities industry is approximately $305 per hour. In addition, we estimate that the average hourly rate for an assistant compliance director and a senior computer programmer in the securities industry is approximately $313 and $292 per hour, respectively. These figures are from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[1025] See supra note 1022.

[1026] See supra note 1023.

[1027] See supra note 1024.

2. Circuit Breaker Approach

Under the circuit breaker approach, the alterative uptick rule will apply only if the price of a covered security has declined by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[1028] In addition, this short sale price test restriction will apply for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[1029]

a. Impact on Market Quality

As stated above, in the Proposal and Re-Opening Release, we requested comment on the costs of a circuit breaker rule,[1030] and specifically on the extent to which the proposed amendments to Regulation SHO, including the proposed circuit breaker rules, could impact or lessen some of the benefits of legitimate short selling or could lead to a decrease in market efficiency, price discovery, or liquidity.[1031]

As we stated in the Proposal, we understand that there are concerns about a potential "magnet effect" that could arise as an unintended consequence of a circuit breaker that imposes a short selling price test restriction.[1032] This "magnet effect" could result in short sellers driving down the price of an equity security in a rush to execute short sales before the circuit breaker is

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1028 See Rule 201(b)(i).

1029 See Rule 201(b)(ii).

1030 See Proposal, 74 FR at 18090, 18100; Re-Opening Release, 74 FR at 42037.

1031 See Proposal, 74 FR at 18090.

1032 See Proposal, 74 FR at 18067.

triggered. We are also concerned about short selling demand building until the circuit breaker is lifted.

In response to our requests for comments, several commenters stated that a short sale circuit breaker could exacerbate downward pressure on stocks as their value reached the threshold level.[1033] Commenters also discussed the possibility that short selling demand could be built up until the short selling restriction is lifted.[1034] Other commenters, however, discounted the possibility or impact of a "magnet effect,"[1035] including some commenters who cited empirical studies that question whether a circuit breaker would result in artificial pressure on the price of individual securities.[1036]

After considering the comments, including studies cited by commenters, we do not believe that the evidence is clear regarding a "magnet effect."[1037] In fact, many academic studies that have analyzed circuit breakers in other contexts found no evidence of such trading patterns.[1038] We recognize, however, that some of these studies were conducted in markets dissimilar from the highly automated markets currently existing in the United States and, therefore, that limits their utility in this context. Overall, however, the most relevant studies fail

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[1033] See, e.g., letter from Matlock Capital (May 2009); letter from Schwab; letter from Lime Brokerage (June 2009); letter from STA (June 2009); letter from Glen Shipway (June 2009); letter NYSE Euronext (June 2009); letter from Wolverine; letter from Direct Edge (June 2009); letter from Amer. Bankers Assoc.; letter from NYSE Euronext (Sept. 2009); see also letter from SIFMA (June 2009) (indicating that an "on/off" circuit breaker trigger could dampen any magnet effect); letter from Direct Edge (Mar. 2009).

[1034] See letter from STA (June 2009); letter from Wolverine.

[1035] See letter from BATS (May 2009); letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); letter from Hudson River Trading; letter from Virtu Financial; see also letter from Credit Suisse (Mar. 2009).

[1036] See letter from Credit Suisse (June 2009); letter from Credit Suisse (Sept. 2009); see also letter from Credit Suisse (Mar. 2009); letter from Nasdaq OMX Group (Oct. 2009).

[1037] See supra notes 280 to 285 and accompanying text (discussing comments on the "magnet effect" and our response).

[1038] See supra note 285.

to demonstrate a magnet effect and we believe that adopting the circuit breaker approach best serves our goals.

Commenters also stated that a circuit breaker could have a stigmatizing effect on affected securities by creating the impression that a stock is "down so significantly that the trading rules must change."[1039] Other commenters expressed concerns that the circuit breaker could have a negative effect on affected securities because "if a security has suffered a significant decline, additional constraints that affect the ability of market makers to provide high-quality markets may actually hasten the decline, as decreased size and wider spreads will further undermine the already battered investor confidence in the security."[1040] Another commenter noted that a circuit breaker "may exacerbate market dislocations by suddenly and unexpectedly altering the regulatory regime and liquidity characteristics of a particular security, precisely when it is under duress."[1041]

We recognize that the circuit breaker approach of Rule 201 could result in some perception of stigmatization of stocks that trigger the short sale price test restriction of Rule 201. As discussed above in Section X.B.1.a., we also recognize that imposing a short sale price test restriction may negatively impact market quality with respect to a covered security that has triggered the circuit breaker. In addition, although we agree that a circuit breaker combined with a halt on short selling could cause or exacerbate market dislocations, we do not believe that the circuit breaker approach of Rule 201 will have the same impact because it will continue to allow short selling at a price above the national best bid, even when the short sale price test restriction is in effect. Further, to the extent that the circuit breaker approach results in stigmatization, market dislocations, or other negative

[1039] Letter from Schwab; see also letter from Amer. Bankers Assoc.

[1040] Letter from EWT (June 2009).

[1041] Letter from EWT (June 2009); see also letter from Matlock Capital (May 2009).

impacts on market quality, we believe any such costs are justified by the benefits provided by the Rule.

As discussed in detail in Section III.A.5., above. commenters' estimates and the Staff's analysis show that a 10% circuit breaker threshold generally should affect only a limited percentage of covered securities, thus will not interfere with the smooth functioning of the markets for the majority of covered securities most of the time. And, although a permanent market-wide approach that would apply to all covered securities all the time may, as one commenter stated, provide an element of predictability,[1042] we believe that the circuit breaker approach of Rule 201 is appropriate because it provides a balance between achieving our goals for adopting a short sale price test restriction and limiting impediments to the normal operations of the market. As discussed above, due to the changes in market conditions and erosion of investor confidence that occurred recently, investors have become increasingly concerned about sudden and excessive declines in prices that appear to be unrelated to issuer fundamentals.[1043] We believe that a time-limited circuit breaker that is triggered by a significant intra-day decline in price of an individual security is a targeted response to address these concerns.

Commenters also expressed concerns that, during periods of volatility, "circuit breakers could potentially impact far too many stocks on any given day and damage the benefits of short selling."[1044] Similarly, a number of commenters expressed concerns that, if the trigger level for a circuit breaker were set too low, the circuit breaker would impose a short sale price test restriction that would impair trading in a stock not only due to a price decline that might indicate abusive or

1042 See letter from NYSE Euronext (Sept. 2009).

1043 See supra Section II.C. (discussing investor confidence); see also Proposal, 74 FR at 18046-18049.

1044 Letter from Atherton Lane; see also letter from Citadel et al. (June 2009); letter from Goldman Sachs (June 2009); letter from ISE (June 2009); letter from MFA (June 2009); letter from SIFMA (June 2009); letter from Wells Fargo (June 2009); letter from SIFMA (Sept. 2009).

abnormal trading activity, but also during normal market conditions, thus impairing normal trading activity, further limiting the provision of market benefits such as liquidity and price efficiency, and causing disruptions to investors and markets.[1045]

When the markets experience periods of extreme volatility, we expect that the circuit breaker will be triggered for more securities than during periods of low volatility. We believe this is an appropriate result of Rule 201 because it is designed to impose restrictions on short selling when individual securities are undergoing significant intra-day price declines. In addition, we recognize that a 10% trigger level may capture some "normal" trading activity. However, as discussed in detail in Section III.A.5., above, commenters' estimates and the Staff's analysis show that a 10% circuit breaker threshold generally should affect only a limited percentage of covered securities. This supports the conclusion that Rule 201 provides a tailored approach that reaches a limited subset of covered securities that are experiencing a significant intra-day price decline, while generally not restricting short selling in the majority of covered securities. To the extent that Rule 201 impairs normal trading activity, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

Several commenters expressed concerns that a circuit breaker approach "does not adequately address the negative implications of unregulated short selling" because it would permit relatively unrestricted, and potentially manipulative, short selling up to the trigger point.[1046] One commenter stated that a circuit breaker would not be effective to address manipulative short selling

[1045] See, e.g., letter from Citadel et al. (June 2009); letter from Goldman Sachs (June 2009); letter from MFA (June 2009); letter from SIFMA (June 2009); letter from SIFMA (Sept. 2009).

[1046] Letter from T. Rowe Price (June 2009); see also letter from Atherton Lane; letter from Chlebina (Apr. 2009); letter from Equity Insight; letter from Wells Fargo (June 2009); letter from Glen Shipway (Sept. 2009).

because "predatory short selling is not a one-day event, but the culmination of a series of events."[1047]

While it is true that, under a circuit breaker approach, the short sale price test restriction of Rule 201 will not apply to short selling in a security before the 10% intra-day decline trigger is reached, or after the duration of the restriction has passed, we believe that the circuit breaker approach is designed to strike the appropriate balance between our goal of preventing potential short sale abuse and the need to limit impediments to the normal operations of the market. As we stated in the Proposal, in discussing a short selling circuit breaker, one commenter noted that such a measure could address the issue of "bear raids" while limiting the market impact that may arise from other forms of short sale price test restrictions.[1048] As discussed above, short selling is an important tool in price discovery and the provision of liquidity to the market, and we recognize that imposition of a short selling circuit breaker that when triggered imposes the alternative uptick rule could restrict otherwise legitimate short selling activity during periods of significant volatility. To the extent that Rule 201 permits relatively unrestricted, and potentially manipulative, short selling during times when the circuit breaker has not been triggered for a particular security, we believe that such costs are justified by the benefits provided by the circuit breaker approach in not interfering with the provision of market benefits such as liquidity and price efficiency for the majority of covered securities most of the time.

After considering the comments, as discussed above, that we received with respect to the potential market impacts of a circuit breaker approach, we believe that such potential market impacts do not undermine our goals of preventing potential short sale abuse and addressing

[1047] Letter from Equity Insight.

[1048] See Proposal, 74 FR at 18067, n.252 (noting a letter from Peter Brown, dated Dec. 12, 2008).

investor confidence, while balancing these goals with the need to limit impediments to the normal operations of the market. The Commission has long held the view that circuit breakers may help restore investor confidence during times of substantial uncertainty.[1049] We believe that the requirements of Rule 201 will produce such benefits. By imposing the alternative uptick rule once a security's price is experiencing a significant price decline, the short selling circuit breaker rule in Rule 201(b) is designed to target only those securities that experience significant intra-day price declines and, therefore, will help to prevent short selling from being used as a tool to exacerbate the decline in the price of those securities. This approach establishes a narrowly-tailored Rule that will target only those securities experiencing such a decline. We believe that addressing short selling in connection with such declines in individual securities will help restore investor confidence in the markets generally.

Further, as discussed above, short selling is an important tool in price discovery and the provision of liquidity to the market, and we recognize that imposition of a short selling circuit breaker that when triggered imposes the alternative uptick rule could restrict otherwise legitimate short selling activity during periods of significant volatility. Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day. We believe that the negative impact of Rule 201, if any, on the market will be limited because of the limited scope and duration of Rule 201. Further, to the extent that Rule 201 negatively impacts market quality, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

[1049] See, e.g., 1998 Release, 63 FR 18477; see also Proposal, 74 FR at 18067.

b. Implementation and On-going Monitoring and Surveillance Costs

We discussed in the Proposal and the Re-Opening Release the anticipated costs of the proposed circuit breaker rules[1050] and we requested comment on the costs associated with the proposed circuit breaker rules.[1051] In particular, we requested comment on the potential costs for any modification to both computer systems and surveillance mechanisms and for information gathering, management, and recordkeeping systems or procedures.[1052]

Several commenters expressed concerns regarding the implementation costs of a circuit breaker approach in comparison to the costs of implementing a permanent, market-wide test, but did not provide specific cost estimates.[1053] One commenter stated that "the circuit breaker proposal would be the least cost effective" but did not provide a specific cost estimate with respect to a circuit breaker rule.[1054]

One commenter conducted a survey of fifty firms with respect to implementation cost and on-going monitoring costs estimates of a new short sale price test restriction.[1055] Cost estimates in response to the survey indicated that a permanent, market-wide short sale price test based on the national best bid would have,implementation costs that averaged between $200,000 and $1,100,000 per firm,[1056] while a circuit breaker triggering a short sale price test based on the

[1050] See Proposal, 74 FR at 18097-18100; Re-Opening Release, 74 FR at 42035.

[1051] See Proposal, 74 FR at 18101-18103; Re-Opening Release, 74 FR at 42037.

[1052] See Proposal, 74 FR at 18090.

[1053] See supra note 676.

[1054] Letter from T. Rowe Price (June 2009).

[1055] See letter from SIFMA (June 2009).

[1056] See letter from SIFMA (June 2009). SIFMA did not categorize estimates of the implementation costs of a permanent, market-wide short sale price test based on the national best bid by SRO trading centers, non-SRO trading centers, and other broker-dealers, but categorized responses by larger firms, with implementation cost estimates that averaged $1,000,000 per firm, with the highest estimate at $7,000,000 per firm, regional firms national best bid would have implementation costs that averaged between $235,000 and $2,000,000 per firm.[1057] This represents an estimated increase in implementation costs for a circuit breaker approach, as compared to a permanent, market-wide approach, of $35,000 to $900,000 per firm. However, we note that these cost estimates were based on a circuit breaker triggering the proposed modified uptick rule and, as such, were not specific to the alternative uptick rule.[1058] As discussed throughout this adopting release, because the alternative uptick rule does not require sequencing of the national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price, we believe that the policies and procedures required under the alternative uptick rule will be easier and less costly to implement and monitor than would be the case under the proposed modified uptick rule or the proposed uptick rule.

We recognize that imposing a short sale-related circuit breaker rule when, currently, there is an absence of a short sale-related circuit breaker may result in costs in terms of modifications to systems and surveillance mechanisms, as well as changes to processes and procedures.[1059]

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with estimates that averaged $200,000 per firm, with the highest estimate at $500,000 per firm, and clearing firms, with estimates that averaged $1,100,000 per firm, with the highest estimate at $1,900,000 per firm. SIFMA provided cost estimates in terms of the average estimated cost and the highest estimated cost. See id.

1057 See supra note 918 (discussing SIFMA's survey of cost estimates with respect to the implementation costs of a circuit breaker triggering a short sale price test based on the national best bid).

1058 We also that the commenter's survey results covered fifty firms, categorized as large firms, regional firms, and clearing firms, rather than SRO trading centers, non-SRO trading centers and broker-dealers. Thus it is difficult to determine costs of a circuit breaker approach to trading centers as opposed to broker-dealers from the survey results.

1059 Although under the circuit breaker approach, a price test will not be in place all the time or for all securities, trading centers, and broker-dealers relying on Rule 201(c) or Rule 201(d)(6), will need to establish reasonable policies and procedures in advance to ensure compliance whenever the circuit breaker is triggered. We note that it would not be reasonable for a trading center, or a broker-dealer relying on Rule 201(c) or Rule 201(d)(6) to wait until the circuit breaker is triggered to begin establishing reasonable policies and procedures to prevent the execution or display of the particular covered security at a price that is less than or equal to the current national best bid. Thus, we recognize that the circuit breaker approach will result in immediate upfront costs to trading centers and to broker-dealers intending to rely on Rule 201(c) or Rule 201(d)(6). See supra Section X.B.1. (discussing costs of the alternative uptick rule).

Such costs will include implementation costs for market participants associated with reprogramming trading and surveillance systems to account for the requirements of the short sale related circuit breaker. We also recognize that the circuit breaker approach may impose costs on market participants related to systems changes to computer software, reprogramming costs, and surveillance and compliance costs, as well as staff time and technology resources, associated with monitoring compliance with the short sale related circuit breaker. Moreover, imposing a short sale related circuit breaker rule when there are currently no short sale related circuit breakers in place also may mean that staff (compliance personnel, associated persons, etc.) may need to be trained or re-trained regarding rules related to the circuit breaker requirements.

As discussed previously,[1060] despite some commenters' concerns regarding the implementation costs of a circuit breaker rule, we believe that the circuit breaker approach will result in largely the same implementation costs as we estimated would be incurred if we adopted a permanent, market-wide short sale price test restriction.[1061] We believe that there will be only minimal, if any, implementation costs for a circuit breaker approach in addition to the costs we estimated previously for the implementation of a permanent, market-wide short sale price test rule.[1062]

In addition, with respect to on-going monitoring and surveillance costs of the circuit breaker approach, we recognize, as noted by one commenter,[1063] that market participants will

[1060] See supra notes 676 to 684 and 723 to 727 and accompanying text (discussing the impact of the circuit breaker approach on implementation and on-going monitoring and surveillance costs to trading centers and broker-dealers).

[1061] See Proposal, 74 FR 18093-18094.

[1062] Several commenters agreed, stating that the costs of the circuit breaker approach would be similar to, or only incrementally higher than, the costs of a permanent, market-wide approach. See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from Credit Suisse (Sept. 2009); letter from STA (June 2009).

[1063] See letter from Glen Shipway (June 2009).

need to continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be offset because, under the limited scope and duration of the circuit breaker approach, market participants will only need to monitor and surveil for compliance with the alternative uptick rule during the limited period of time that the circuit breaker is in effect with respect to a specific security. This will reduce our previously estimated costs for on-going monitoring and surveillance.[1064]

In addition, although, under the circuit breaker approach, market participants will need to monitor whether a stock is subject to Rule 201 or not, we believe that familiarity with a circuit breaker approach may help mitigate such compliance costs. As discussed in the Proposal, currently, all stock exchanges and FINRA have rules or policies to implement coordinated circuit breaker halts.[1065] Moreover, SROs have rules or policies in place to coordinate individual security trading halts corresponding to significant news events.[1066]

We also note that one commenter conducted a survey of firms with respect to on-going monitoring costs estimates of a new short sale price test restriction.[1067] Cost estimates in response to the survey indicated that a permanent, market-wide short sale price test based on the national best bid would have on-going monitoring costs that averaged between $50,000 and

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[1064] Commenters noted that the circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure. See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

[1065] See supra note 292.

[1066] See, e.g., FINRA Rule 6120; see also Proposal, 74 FR at 18065-18066 (discussing the background on circuit breakers).

[1067] See letter from SIFMA (June 2009).

$175,000 per firm,[1068] while a circuit breaker triggering a short sale price test based on the national best bid would have on-going monitoring costs that averaged between $45,000 and $175,000 per firm.[1069] This seems to support our view that the on-going monitoring costs of a circuit breaker approach, as compared to a permanent, market-wide approach, would be largely the same.

After considering the comments, we believe that the implementation, on-going monitoring and surveillance costs of a circuit breaker triggering a short sale price test restriction will be similar to the implementation, on-going monitoring and surveillance costs of the same short sale price test restriction on a permanent, market-wide basis. Thus, we believe that our estimates of the implementation and on-going monitoring and surveillance costs of Rule 201 for trading centers and broker-dealers, as reflected in Sections X.B.1.b.i and X.B.1.b.ii., discussing the implementation and on-going monitoring and compliance costs of the alternative uptick rule, are appropriate after taking into consideration the circuit breaker approach of Rule 201. Further, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

Under the circuit breaker approach of Rule 201, the listing market for each covered security must determine whether that covered security is subject to Rule 201.[1070] Once the listing

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1068 See letter from SIFMA (June 2009). SIFMA did not categorize estimates of the on-going costs of a permanent, market-wide short sale price test based on the national best bid by SRO trading centers, non-SRO trading centers, and other broker-dealers, but categorized responses by larger firms, with on-going monitoring cost estimates that averaged $100,000 per firm, with the highest estimate at $1,500,000 per firm, regional firms with estimates that averaged $50,000 per firm, with the highest estimate at $450,000 per firm, and clearing firms, with estimates that averaged $175,000 per firm, with the highest estimate at $250,000 per firm. SIFMA only provided the average and highest cost estimates per category. See id.

1069 See supra note 931 (discussing SIFMA's survey of cost estimates with respect to the on-going monitoring costs of a circuit breaker triggering a short sale price test based on the national best bid).

1070 See Rule 201(b)(3).

market has determined that a security has become subject to the requirements of Rule 201, the listing market shall immediately notify the single plan processor responsible for consolidation of information for the covered security in accordance with Rule 603(b) of Regulation NMS[1071] of this fact. The plan processor must then disseminate this information.[1072] We recognize that these requirements will require changes by the listing markets and single plan processors to systems currently supported by each.[1073] We note that, because listing markets and single plan processors will require time in which to reprogram and test their systems and procedures to comply with Rule 201, the systems and programming costs associated with Rule 201 might be higher without a sufficient implementation period.[1074] We believe that the six month implementation period will provide listing markets and single plan processors with time to make required changes in a measured fashion, which will help alleviate some of the potential disruptions that may be associated with implementing Rule 201.[1075]

While we recognize that listing markets will incur initial up-front costs associated with having to update their systems, including systems changes to computer software, as well as staff time and technology resources to update their systems and surveillance mechanisms to ensure

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1071 See supra note 368 (discussing the single plan processors for NMS stocks).

1072 See Rule 201(b)(3); 17 CFR 242.603(b).

1073 See letter from FIF (June 2009); see also supra Section III.A.6. (discussing the determination regarding securities subject to Rule 201 and dissemination of such information).

1074 For example, commenters indicated that a circuit breaker rule triggering the alternative uptick rule would require an implementation period of between three and twelve months. See letter from NSCP; letter from NYSE Euronext (June 2009); letter from RBC (June 2009); letter from STA (June 2009); letter from FIF (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from EWT (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009); letter from MFA (Oct. 2009); see also letter from Amer. Bankers Assoc.; letter from NYSE Euronext (Sept. 2009); letter from Goldman Sachs (Sept. 2009).

1075 See supra Section VII. (discussing the implementation period for Rule 201); see also supra Section III.A.6.

compliance with the Rule's requirements,[1076] familiarity with a circuit breaker approach may help mitigate the implementation and compliance costs. In addition, we believe that listing markets may be able to leverage some of their existing procedures to ease the implementation of Rule 201's requirements. For example, as discussed in the Proposal, currently, all stock exchanges and FINRA have rules or policies to implement coordinated circuit breaker halts[1077] and listing markets also already send information to single plan processors regarding Regulatory Halts as defined in those plans. Moreover, SROs have rules or policies in place to coordinate individual security trading halts corresponding to significant news events.[1078] In addition, we note that listing markets are familiar with making determinations regarding, and imposing trading restrictions on, individual NMS stocks.[1079] Similarly, in connection with such activities, listing markets currently monitor price changes in covered securities relative to the closing price as of the end of regular trading hours on the prior day.

Further, we note that listing markets are also trading centers, as defined by Rule 201,[1080] and as such, will have costs in connection with systems changes to implement the policies and procedures requirements of Rule 201 applicable to trading centers.[1081] We believe that the costs to listing markets associated with having to update their systems to ensure compliance with the Rule's requirements applicable to listing markets will be an incremental addition to the costs

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[1076] See supra Section X.B.1. (discussing costs of the alternative uptick rule).

[1077] See supra note 292.

[1078] See supra note 684.

[1079] For example, listing markets already have rules or policies in place to coordinate trading suspensions or halts in individual NMS stocks. See, e.g., Nasdaq Rule 4120 (relating to trading halts in Nasdaq-listed securities); NYSE Rule 123D (relating to delayed openings and trading halts in NYSE-listed securities).

[1080] See Rule 201(a)(9).

[1081] See supra Section IX.E.1. (discussing implementation costs to trading centers).

associated with the implementation of the policies and procedures requirements applicable to trading centers.[1082] We believe that the implementation and compliance costs for listing markets are justified by the benefits provided by requiring the listing market for a covered security to determine whether the security has become subject to the short sale price test restrictions of Rule 201 because this will help to ensure consistency for each covered security with respect to such determinations.

We recognize that single plan processors will also incur initial up-front costs associated with having to update their systems, including systems changes to computer software, as well as staff time and technology resources to update their systems and surveillance mechanisms in order to ensure compliance with the circuit breaker requirements.[1083] We believe, however, that the single plan processors' current familiarity with receiving and disseminating information regarding individual NMS stocks will help mitigate these implementation and compliance costs. For example, the single plan processors currently receive information from listing markets regarding trading restrictions, such as Regulatory Halts as defined in those plans, on individual securities and disseminate such information. As a result, the requirements of Rule 201(b)(3) are similar to existing obligations on plan processors pursuant to the requirements of Regulation NMS, the CTA and CQ Plans and the Nasdaq UTP Plan. Two commenters agreed that dissemination of information regarding the triggering of Rule 201 would be a function similar to other functions currently performed by the plan processors.[1084] Further, we believe that the implementation and compliance costs for single plan processors are justified by the benefits provided by requiring the single plan processors to disseminate information on whether a

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1082 See id.

1083 See supra Section X.B.1. (discussing costs of the alternative uptick rule).

1084 See letter from NYSE Euronext (Sept. 2009); letter from Virtu Financial.

security has become subject to the short sale price test restrictions of Rule 201 because the similarity of this function to current functions performed by the single plan processors will help to ensure the workability and smooth functioning of the Rule.

3. Implementation Period

We believe that a six month implementation period will provide trading centers, broker-dealers, listing markets, the single plan processors and other market participants with a sufficient amount of time in which to modify their systems and procedures in order to comply with the requirements of Rule 201.[1085] The six month implementation period will provide market participants with time to make required changes in a measured fashion, which will help alleviate some of the potential disruptions that may be associated with implementing Rule 201. Because trading centers, listing markets, the single plan processors and other market participants will require time in which to reprogram and test their systems and procedures to comply with Rule 201, the systems and programming costs associated with Rule 201 might be higher without a sufficient implementation period. For example, commenters indicated that a circuit breaker rule triggering the alternative uptick rule would require an implementation period of between three and twelve months.[1086]

The six month implementation period, which is longer than the implementation periods proposed in the Proposal and the Re-Opening Release, takes into consideration commenters'

[1085] See supra Section VII. (discussing the implementation period).

[1086] See letter from NSCP; letter from NYSE Euronext (June 2009); letter from RBC (June 2009); letter from STA (June 2009); letter from FIF (Sept. 2009); letter from Citadel et al. (Sept. 2009); letter from Credit Suisse (Sept. 2009); letter from Direct Edge (Sept. 2009); letter from EWT (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009); letter from MFA (Oct. 2009); see also letter from Amer. Bankers Assoc.; letter from NYSE Euronext (Sept. 2009); letter from Goldman Sachs (Sept. 2009).

concerns that implementation of a short sale price test could be complex.[1087] We do not believe that an implementation period longer than 6 months is warranted because Rule 201 does not require monitoring of the sequence of bids or last sale prices, unlike other proposed short sale price tests,[1088] and because Rule 201 requires the implementation of policies and procedures similar to those required for trading centers under Regulation NMS.[1089] In addition, as discussed above, market participants will be able to leverage the numerous systems changes made and current architecture developed to facilitate compliance with Regulation NMS. These factors should reduce implementation time.

4. Marking Requirements

While the current marking requirements in Rule 200(g) of Regulation SHO, which require broker-dealers to mark all sell orders of any equity security as either "long" or "short,"[1090] will remain in effect, the amendments to Rule 200(g) will add a new marking

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1087 See, e.g., letter from NSCP; letter from RBC (June 2009); letter from SIFMA (June 2009); letter from RBC (Sept. 2009); see also letter from Direct Edge (Sept. 2009) (stating that adoption of a circuit breaker approach will add approximately four to six weeks to the implementation time of the alternative uptick rule); letter from NYSE Euronext (Sept. 2009) (stating that "a circuit breaker approach raises significant implementation complexities"). But cf. letter from Credit Suisse (Sept. 2009) (stating that a circuit breaker approach will not significantly increase implementation time); letter from Nasdaq OMX Group (Oct. 2009) (stating that "[o]nce the price test is in place, there is minimal incremental effort required to add a Circuit Breaker that controls the application of the price test").

1088 Several commenters noted that because the alternative uptick rule, unlike the other proposed price tests, does not require sequencing of bids or last sale prices, the alternative uptick rule could be implemented more quickly than the other proposed price tests, in three to six months. See, e.g., letter from Credit Suisse (June 2009); letter from STA (June 2009); letter from Credit Suisse (Sept. 2009); letter from FIF (Sept. 2009). But cf. letter from Citadel et al. (Sept. 2009); letter from NYSE Euronext (Sept. 2009); letter from RBC (Sept. 2009); letter from SIFMA (Sept. 2009).

1089 One commenter stated that implementation concerns with respect to a short sale price test restriction could be mitigated, provided that trading centers "could leverage existing architecture developed to comply with the order protection rule in Reg NMS (Rule 611)." Letter from MFA (Oct. 2009). Another commenter stated that implementation of a circuit breaker triggering the alternative uptick rule would be easier to implement, "provided that the Commission permits firms to leverage the numerous systems changes made to facilitate compliance with Regulation NMS (including the use of internal market data rather than consolidated data supplied by the industry plans)." Letter from Goldman Sachs (Sept. 2009). But cf. letter from FIF (June 2009); letter from NSCP; letter from RBC (June 2009).

1090 17 CFR 242.200(g).

requirement of "short exempt."[1091] In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[1092] We discussed in the Proposal the anticipated costs of the proposed amendments[1093] and, in the Proposal and Re-Opening Release, we requested comment on the costs associated with the proposed amendments.[1094]

Several commenters expressed concerns regarding the implementation costs of the "short exempt" marking requirements.[1095] Several commenters noted that the "short exempt" marking requirements would require modifications to multiple systems, including modifications to blue sheet, OATS and OTS reporting systems.[1096] One commenter noted that such modifications would be in addition to changes to order entry and routing applications.[1097] Another commenter noted that one of its primary implementation concerns was related to "re-implementation of 'Short Sale Exempt' order types in interfaces between [the commenter] and [its] Customers as well as the venues that support such exempt order types."[1098] In contrast, one commenter, in supporting adoption of the "short exempt" marking requirements (in the event that the

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[1091] See Rule 200(g); see also supra Section IV. (discussing the amendments to Rule 200(g)).

[1092] See Rule 200(g)(2).

[1093] See Proposal, 74 FR at 18100.

[1094] See Proposal, 74 FR at 18103; Re-Opening Release, 74 FR at 42037.

[1095] See, e.g., letter from FIF (June 2009); letter from NSCP; letter from RBC (June 2009); letter from Lime Brokerage (Sept. 2009); letter from FIF (Sept. 2009).

[1096] See, e.g., letter from NSCP; letter from RBC (June 2009); letter from FIF (June 2009); letter from FIF (Sept. 2009).

[1097] See letter from FIF (June 2009); letter from FIF (Sept. 2009).

[1098] Letter from Lime Brokerage (Sept. 2009).

Commission decided to adopt a short sale price test restriction), stated that "[t]he costs of marking the orders appropriately will be worth the benefits gained."[1099]

We recognize commenters' concerns with respect to the costs of the "short exempt" marking requirement and we considered these comments in evaluating the costs of the "short exempt" marking requirement. Such costs will include one-time costs for broker-dealers for reprogramming and systems changes, including modifications to reporting systems, order entry and routing applications. In addition, the costs of the "short exempt" marking requirement will include on-going monitoring and surveillance costs for broker-dealers. However, we believe that such costs will be limited because broker-dealers already have established systems, processes, and procedures in place to comply with the current marking requirements of Rule 200(g) of Regulation SHO with respect to marking a sell order either "long" or "short" and, therefore, will likely leverage such systems, processes and procedures to comply with the "short exempt" marking requirements in Rules 200(g) and 200(g)(2). Further, we believe that the implementation and compliance costs of the "short exempt" marking requirements are justified by the benefits provided by the requirements in aiding surveillance by SROs and the Commission for compliance with the provisions of Rule 201 and providing an indication to a trading center regarding when it must execute or display a short sale order without regard to whether the order is at a price that is less than or equal to the current national best bid.

We also considered whether our estimates of the implementation and on-going monitoring and compliance costs associated with the "short exempt" marking requirements under the amendments to Rule 200(g), as proposed in conjunction with the proposed modified

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[1099] Letter from STA (June 2009).

uptick rule[1100] would change under the circuit breaker approach of Rule 201, but concluded, as discussed below, that these estimates continue to represent reasonable estimates under the circuit breaker approach.

We believe that the "short exempt" marking requirements of Rule 200(g), in conjunction with a circuit breaker approach, will result in largely the same implementation costs as we estimated would be incurred if the "short exempt" marking requirements were combined with a market-wide short sale price test restriction.[1101] This is because broker-dealers relying on the provisions of Rule 201(c) or Rule 201(d) will need to make systems changes to implement the "short exempt" marking requirements regardless of whether the short sale price test restriction is adopted on a permanent, market-wide basis or, in the case of Rule 201, adopted in conjunction with a circuit breaker.

In addition, with respect to on-going monitoring and surveillance costs of the "short exempt" marking requirements in conjunction with a circuit breaker approach, we recognize, as noted by one commenter,[1102] that market participants will need to continuously monitor whether a security is subject to the provisions of Rule 201 and that there will be costs associated with such monitoring. However, we believe that these costs will be offset because, under the circuit breaker approach, use of the "short exempt" provisions of Rule 201(c) and Rule 201(d) and the related marking requirements will be time limited and will only apply on a stock by stock basis. As a result, broker-dealers who choose to rely on Rule 201(c) or Rule 201(d) will only need to monitor and surveil for compliance with the requirements of those provisions and will only need to mark qualifying orders "short exempt" during the limited period of time that the circuit

[1100] See Proposal, 74 FR at 18089.

[1101] See Proposal, 74 FR at 18100.

[1102] See letter from Glen Shipway (June 2009).

breaker is in effect with respect to a specific security. The circuit breaker approach will allow regulatory, supervisory and compliance resources to focus on, and to address, those situations where a specific security is experiencing significant downward price pressure.[1103]

On balance, we believe our proposed estimates of the costs associated with the "short exempt" marking requirement[1104] are appropriate with respect to Rule 200(g) as adopted. Thus, our estimates have not changed from the Proposal, except to the extent that total burden estimates have changed because we have updated the estimated number of broker-dealers.[1105]

We believe that the implementation cost of the "short exempt" marking requirement will likely be similar to the implementation cost of the order marking requirements of Rule 200(g) of Regulation SHO, which had originally included the category of "short exempt." Industry sources at that time estimated initial implementation costs for the former "short exempt" marking requirement to be approximately $100,000 to $125,000.[1106] Based on these estimates, as adjusted for inflation, we estimate that the initial implementation cost of the "short exempt" marking requirement will be approximately $115,000 to $145,000 per broker-dealer[1107] for a total initial implementation cost of approximately $595,470,000 to $750,810,000 for all broker-dealers.[1108]

[1103] See, e.g., letter from Nasdaq OMX Group (Oct. 2009); letter from SIFMA (Sept. 2009).

[1104] See Proposal, 74 FR at 18089.

[1105] See supra note 729.

[1106] See 2004 Regulation SHO Adopting Release, 69 FR at 48023.

[1107] The adjustment for inflation was calculated using information in the Consumer Price Index, U.S. Department of Labor, Bureau of Labor Statistics.

[1108] These figures were calculated as follows: ($115,000 x 5,178) = $595,470,000 and ($145,000 x 5,178) = $750,810,000.

We recognize that there will be an on-going paperwork burden cost associated with adding the "short exempt" marking requirements. For example, as detailed in PRA Section IX.E.3., above, we estimate that the total annual cost for each broker-dealer subject to the "short exempt" marking requirements will be $93,420[1109] for a total annual on-going cost of $483,728,760 for all broker-dealers subject to the "short exempt" marking requirements.[1110]

To provide market participants with the time needed to make the changes required to comply with Rule 200(g), we are adopting an implementation period under which market participants will have to comply with these requirements six months following the effective date of the adoption of these amendments. In the Proposal, we proposed a three month implementation period for the "short exempt" marking requirements under Rule 200(g). In response to our request for comment, several commenters stated that the "short exempt" marking requirement would require systems changes.[1111] Another commenter stated that the "short exempt" marking requirement would require coding for new fields in order records, which should be accomplished in approximately three months.[1112]

We are sensitive to commenters' concerns that implementation of the "short exempt" marking requirement could be complex, and believe that a six month implementation period, which is longer than the 3 month implementation period proposed in the Proposal, will afford

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[1109] This figure was calculated as follows: (346 hours x $270) = $93,420 per broker-dealer. The 346 hour estimate was calculated as follows: 12.9 billion "short exempt" orders / 5,178 broker-dealers = 2,491,309 annual responses by each broker-dealer. Each response of marking sell orders "short exempt" will take approximately .000139 hours (.5 seconds) to complete. (2,491,309 responses x 0.000139 hours) = 346 burden hours.

Based on industry sources, we estimate that the average hourly rate for compliance attorneys is $270. The $270/hour figure for compliance attorneys is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[1110] This figure was calculated as follows: ($93,420 x 5,178) = $483,728,760.

[1111] See, e.g., letter from RBC (June 2009); letter from NSCP; letter from FIF (June 2009).

[1112] See letter from STA (June 2009).

market participants sufficient time to make the necessary modifications to their systems and procedures. In addition, we believe that because it will provide broker-dealers with time to make required changes in a measured fashion, the six month implementation period will help alleviate some of the potential disruptions that may be associated with implementing the "short exempt" marking requirements.

XI. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation.[1113] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition.[1114] 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.

A number of commenters noted concerns about the impact of a short sale price test restriction on efficiency, competition and capital formation.[1115] One commenter stated that "the empirical evidence from the many academic and Commission studies and experiences of [the commenters] … raise a substantial question about whether the proposed short sale restrictions

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[1113] 15 U.S.C. 78c(f).

[1114] 15 U.S.C. 78w(a)(2).

[1115] See, e.g., letter from Joseph A. Dear, Chief Investment Officer, California Public Employees' Retirement System, dated June 19, 2009; letter from Citadel et al. (June 2009); letter from Pershing Square; letter from Vanguard (June 2009); letter from Amer. Bar Assoc. (July 2009); letter from Amer. Bar Assoc. (Sept. 2009); letter from MFA (Oct. 2009).

can satisfy these standards."[1116] Another commenter noted the beneficial impact of short selling on efficiency and competition, quoting the Commission's statements that short selling provides the market with liquidity and pricing efficiency.[1117] As discussed below, we considered these concerns, and took them into account in formulating Rules 200(g) and 201, as adopted, to address, to the extent possible, these concerns.

A. Competition

We begin our consideration of potential competitive impacts with observations of the current structure of the markets with respect to trading centers and broker-dealers, mindful of the statutory requirements regarding competition. Based on our experience in regulating the securities markets, including reviewing information provided by trading centers and broker-dealers in their registrations and filings with us, and approving such registration applications, we discuss below the basic framework of the markets they comprise.

1. Market Structure for Trading Centers and Broker-Dealers

Trading centers include national securities exchanges or national securities associations that operate an SRO trading facility, ATSs,[1118] exchange market makers and OTC market makers, and any other broker-dealer that executes orders internally, whether as agent or principal.[1119] All of these entities will be required to alter their trading mechanisms to comply with Rule 200(g) and Rule 201.

1116 Letter from Citadel et al. (June 2009).

1117 See letter from Pershing Square (citing 2006 Price Test Elimination Proposing Release, 71 FR at 75069-75070).

1118 Under Regulation ATS, any entity that falls within the definition of a securities exchange must apply to be a securities exchange or must register as an ATS, subject to certain exceptions. See 17 CFR 242.300, 301; see also 15 U.S.C. 78c(a)(1); 17 CFR 240.3b-16.

1119 See 17 CFR 242.600(b)(78). Currently, no national securities association is a trading center, as that term is defined in Rule 600(b)(78) of Regulation NMS.

The equity trading industry is a competitive one, with reasonably low barriers to entry. The intensity of competition across trading platforms in this industry has increased in the past decade as a result of a number of factors, including market reforms and technological advances. This increase in competition has resulted in decreases in market concentration, more competition among trading centers, a proliferation of trading platforms competing for order flow, and decreases in trading fees.

The reasonably low barriers to entry for trading centers are evidenced, in part, by the fact that new entities, primarily ATSs, continue to enter the market.[1120] For example, currently there are approximately 50 registered ATSs that trade covered securities. In addition, the Commission within the past few years has approved applications by two entities – BATS and Nasdaq – to become registered as national securities exchanges for trading equities, and approved proposed rule changes by two existing exchanges – ISE and CBOE – to add equity trading facilities to their existing options business. We believe that competition among trading centers has been facilitated by Rule 611 of Regulation NMS,[1121] which encourages quote-based competition between trading centers; Rule 605 of Regulation NMS,[1122] which empowers investors and broker-dealers to compare execution quality statistics across trading centers; and Rule 606 of Regulation NMS,[1123] which enables customers to monitor order routing practices.

Broker-dealers are required to register with the Commission and at least one SRO. The broker-dealer industry, including market makers, is a competitive industry, with most trading

[1120] See Exchange Act Release No. 60997 (Nov. 13, 2009), 74 FR 61208, 61234 (Nov. 23, 2009) (discussing the reasonably low barriers to entry for ATSs and that these reasonably low barriers to entry have generally helped to promote competition and efficiency).

[1121] 17 CFR 242.611.

[1122] 17 CFR 242.605.

[1123] 17 CFR 242.606.

activity concentrated among several dozen larger participants and with thousands of smaller participants competing for niche or regional segments of the market.

There are 5,178 registered broker-dealers, of which 890 are small broker-dealers.[1124] Larger broker-dealers often enjoy economies of scale over smaller broker-dealers and compete with each other to service the smaller broker-dealers, who are both their competitors and customers. The reasonably low barriers to entry for broker-dealers are evidenced, for example, by the fact that the average number of new broker-dealers entering the market each year between 2001 and 2008 was 389.[1125]

2. Discussion of Impacts of Rules 200(g) and 201 on Competition

We believe that the estimated costs associated with implementing and complying with Rules 200(g) and 201 are not so large as to raise significant barriers to entry, or otherwise significantly alter the competitive landscape of the industries involved. In industries characterized by reasonably low barriers to entry and intense competition, the viability of some of the less successful competitors may be sensitive to regulatory costs. Nonetheless, given the reasonably low barriers to entry into the market for execution services, we believe that the trading center and broker-dealer industries will remain competitive, despite the costs associated with implementing and complying with Rules 200(g) and 201, even if those costs influence to some degree the entry or exit decisions of individual trading centers or broker-dealers at the margin.

[1124] These numbers are based on a review of 2007 and 2008 FOCUS Report filings reflecting registered broker-dealers, and discussions with SRO staff. The number does not include broker-dealers that are delinquent on FOCUS Report filings. We discuss the impact of Rule 201 on small broker-dealers in Section XII.B., below.

[1125] This number is based on a review of FOCUS Report filings reflecting registered broker-dealers from 2001 through 2008. The number does not include broker-dealers that are delinquent on FOCUS Report filings. New registered broker-dealers for each year during the period from 2001 through 2008 were identified by comparing the unique registration number of each broker-dealer filed for the relevant year to the registration numbers filed for each year between 1995 and the relevant year.

Several commenters expressed concerns about the impact of a short sale price test restriction on competition among broker-dealers.[1126] For example, one commenter noted concerns with respect to decreased competition and increased broker-dealer "internalization."[1127] Specifically, this commenter stated that, as a result of short sale price test restrictions, "a widening of bid/offer spreads and decrease in liquidity provided by professional market makers could reverse the consolidation of liquidity in the public markets, permitting some brokers once again to take advantage of decreased competition in price discovery and offer substantially inferior (but still technically legal) internalization prices to their customers."[1128] Although we considered this commenter's concerns, we note that, as discussed above, due to the circuit breaker approach of Rule 201, as well as findings by the Pilot Results regarding the market impact of former Rule 10a-1, we believe that the short sale price test restrictions of Rule 201 will have a limited, if any, negative market impact, such as widening of bid/offer spreads or decreased liquidity.[1129] Thus, we do not believe that Rule 201 will result in decreased competition in price discovery or increased internalization.

Another commenter stated that "while it will not be mandated that firms avail themselves of the [broker-dealer provision], competitive pressure is likely to mean that broker dealers will need to invest resources and time in building this functionality."[1130] We recognize that broker-

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[1126] See, e.g., letter from Credit Suisse (June 2009); letter from EWT (June 2009); letter from FIF (June 2009); letter from NSCP.

[1127] Letter from EWT (June 2009).

[1128] Id.

[1129] See supra Section X.B.1.a. (discussing the impact of Rule 201 on liquidity, market volume, bid-ask spreads, price discovery and volatility).

[1130] Letter from FIF (June 2009). In addition, some commenters raised concerns with respect to competitive pressure on smaller broker-dealers, in particular, in connection with a short sale price test restriction. As noted above, we discuss the impact of Rule 201 on small broker-dealers in Section XII.B., below.

dealers are faced with competitive concerns and that such concerns may influence their decision whether or not to rely on the broker-dealer provision of Rule 201(c). We also recognize that if a broker-dealer chooses to rely on the broker-dealer provision it will impose costs on such broker-dealers, and we considered these costs in determining to adopt in Rule 201 the alternative uptick rule rather than a rule that requires sequencing of the national best bid.[1131] Although commenters expressed concerns with respect to the costs of the broker-dealer provision of Rule 201(c) and the resulting impact on competition, many of these comments were not specific to the alternative uptick rule.[1132] Without a sequencing requirement under the alternative uptick rule, we believe that the policies and procedures required to rely on the broker-dealer provision under Rule 201(c) will be easier and less costly to implement and monitor than the cost concerns and estimates provided by some commenters.

Other commenters noted concerns regarding reduced competition among market makers in the absence of a bona fide market making exception.[1133] We believe, however, that due to the approach of Rule 201, that is, the combination of a circuit breaker with the alternative uptick rule, the lack of such a bona fide market maker exception will have minimal, if any, impact on competition among market makers. This is because, as noted by some commenters, equity market makers for the most part sell at their offer quote.[1134] Thus, the short sale price test

[1131] See supra Section IX.E.2. (discussing the implementation and on-going monitoring and compliance costs of the broker-dealer provision).

[1132] See, e.g., letter from STANY (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009); letter from T.D. Pro Ex; letter from Taurus Compliance; letter from Credit Suisse (June 2009); letter from NSCP.

[1133] See, e.g., letter from EWT (June 2009); letter from EWT (Sept. 2009); letter from GETCO (June 2009); letter from Goldman Sachs (June 2009); but cf. letter from Dr. Jim DeCosta (noting that there are currently few barriers to entry for market makers and abuse can arise from small market makers, who are in need of business, being willing to misuse a bona fide market making exemption in exchange for order flow). See also supra Section III.B.9. (discussing the decision not to include an exemption for bona fide market making).

[1134] See, e.g., letter from CBOE (June 2009).

restriction of Rule 201, which requires short selling at a price above the national best bid and only if the circuit breaker has been triggered, is consistent with equity market making strategies because these market makers generally sell at prices above the national best bid.[1135] This is particularly true where a security's price is declining, as market makers often provide liquidity on the opposite side of price moves to help reduce volatility. Thus, even during times when a covered security is undergoing significant downward price pressure, market makers are generally required to provide liquidity in that security.[1136]

Weighing against the competitive concerns for the trading center and broker-dealer industries, Rule 201 will advance the purposes of the Exchange Act in a number of significant ways. It will help benefit the market for a particular security by allowing market participants, when a security is undergoing a significant intra-day price decline, an opportunity to re-evaluate circumstances and respond to volatility in that security. It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors. We also believe that a circuit

[1135] See letter from Direct Edge (Sept. 2009); see also supra note 532 (discussing a 1997 study indicating that during a sample month in 1997, market maker short sales at or below the inside bid accounted for only 2.41% of their total share volume).

[1136] See, e.g., NYSE Rule 104(f) (stating that "it is commonly desirable that a member acting as [a designated market maker] engage to a reasonable degree under existing circumstances in dealings for the [designated market maker's] own account when lack of price continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated"); CBOE Rule 53.23(a)(1) (stating that "[w]ith respect to each security for which it holds an Appointment, a CBSX Remote Market Maker has a continuous obligation to engage, to a reasonable degree under the existing circumstances, in dealings for its own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, or a temporary disparity between the supply of and demand for a particular security").

breaker will better target short selling that may be related to potential bear raids[1137] and other forms of manipulation that may be used to exacerbate a price decline in a covered security.

At the same time, however, we recognize the benefits to the market of legitimate short selling, such as the provision of liquidity and price efficiency, and considered these benefits in adopting the circuit breaker approach of Rule 201. Under the circuit breaker approach, the alternative uptick rule will only be imposed when a covered security has experienced an intra-day price decline of 10% or more and will only apply for the remainder of the day and the following day. We believe that because of the limited scope and duration of Rule 201, it will not interfere with the smooth functioning of the markets for the majority of securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising. To the extent that Rule 201 impacts the benefits of legitimate short selling, such as the provision of liquidity and price efficiency, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

After due consideration of all these factors and the comments we have received, we have determined that any burden on competition that Rules 200(g) and 201 may impose is necessary or appropriate in the furtherance of the purposes of the Exchange Act noted above.

B. Capital Formation

A purpose of Rule 201 is to strengthen investor confidence in the markets we regulate which should help make investors more willing to invest, resulting in the promotion of capital formation. Fair and robust secondary markets, in which legitimate short selling can play a positive role, supports the public offerings by which issuers raise capital and, as a result,

[1137] See supra note 36 and accompanying text.

investors who provided private capital realize profits and obtain liquidity. In addition, long holdings are integral to capital formation. By placing long holders ahead of short sellers in the execution queue under certain limited circumstances, Rule 201 promotes capital formation, since investors should be more willing to hold long positions if they know they may have a preferred position over short sellers when they wish to sell in the market for that security during a significant price decline in that security.

In addition, paragraphs (c) and (d) of Rule 201 include provisions that are designed to limit any adverse effects on the public offering process, which is necessary to capital formation, while at the same time not undermining the goals of Rule 201.[1138] In particular, Rule 201(d)(5) is designed to facilitate price support during the offering process by allowing broker-dealers to mark short sale orders "short exempt" if the short sale is by an underwriter or syndicate member participating in a distribution in connection with an over-allotment or if the short sale order is by an underwriter or syndicate member for purposes of a lay-off sale in connection with a distribution of securities through a rights or standby underwriting commitment.[1139]

We note that short sales can facilitate convertible securities offerings, and, as stated by some commenters,[1140] we recognize that hedges for this subset of offerings may become more expensive under Rule 201 due to the absence of an exception from Rule 201 for short selling in connection with convertible instruments. In this regard, however, we note that as adopted, as

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1138 See supra Section III.B. (discussing "short exempt" provisions to Rule 201). Under these provisions, if a broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."

1139 See Rule 201(d)(5).

1140 See supra notes 425 to 426 and accompanying text (noting requests by commenters for exceptions for short sales in connection with the facilitation of capital raising transactions through convertible instruments by issuers and selling shareholders, and to allow investors purchasing a convertible instrument to hedge their long exposure).

opposed to some of our alternative proposals, Rule 201 will not prohibit short selling to hedge a position, although it could marginally increase the cost of adjusting a hedge after a significant market decline. Even if these indirect costs could, at the margin, reduce the attractiveness and, therefore, the volume of certain types of offerings, we do not believe that any such reduction will be significant because short sellers will be able to sell at a price above the national best bid even during the limited time the circuit breaker is in effect. Moreover, as described above, Rule 201 includes an exception for short selling in connection with certain types of capital-raising structures. Thus, while there may be a change in the total mix of offering types, we have no reason to believe that, in light of the anticipated positive effect of Rule 201 on investor confidence, particularly confidence in long holdings, that there will be any overall negative effect on capital formation as a result of our adoption of this Rule.

We believe, and commenters agreed, that by helping to prevent short selling, including manipulative or abusive short selling, from driving down further the price of a security that has already experienced a significant intra-day price decline, Rule 201 will help restore and maintain investor confidence in the securities markets.[1141] Bolstering investor confidence in the markets will help to encourage investors to be more willing to invest in the markets, including during times of substantial uncertainty, thereby adding depth and liquidity to the markets and promoting capital formation.

[1141] See supra Section II.C. (discussing restoring investor confidence); see also letter from Edward C. Springer, dated May 3, 2009; letter from Richard Anderson, dated May 5, 2009; letter from Mike Pascale, dated May 11, 2009; letter from Sigmon Wealth Management (June 2009); form letter type C, a petition drafted by Jim Cramer, William Furber, Eric Oberg, and Scott Rothbort and signed by 5,605 investors. Another commenter stated that adoption of the alternative uptick rule would have a beneficial impact on capital formation, stating that "[t]he most important function of the capital markets is to raise capital for American corporations," and that "by adopting the alternative uptick rule, the Commission will have chosen the best approach to deal with the loss of confidence by Congress and most importantly the investing public." Letter from Glen Shipway (Sept. 2009). We note, however, that this commenter did not support adoption of the alternative uptick rule in conjunction with a circuit breaker.

C. Efficiency

Rule 201 is designed to achieve the appropriate balance between our goal of preventing short selling, including manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets. By not allowing short sellers to sell at or below the current national best bid while the circuit breaker is in effect, the short sale price test restriction in Rule 201 will allow long sellers in certain limited circumstances, by selling at the bid, to sell first in a declining market for a particular security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of such restrictions is to allow long sellers to sell first in a declining market.[1142]

The term "price efficiency" has a technical meaning in financial economics, which is not the only way the term can be interpreted in the Exchange Act.[1143] We have, nonetheless, considered the effect of Rule 201 on price efficiency in terms of financial economic theory.[1144]

We have structured Rule 201 to mitigate its impact on price efficiency. In response to the Proposal and Re-Opening Release, several commenters cited empirical evidence showing that short selling contributes to price efficiency and that restrictions on short selling, particularly bans on short selling, may negatively impact price efficiency.[1145] We note, however, that empirical

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[1142] See supra note 17.

[1143] See supra note 18 (defining the term "price efficiency").

[1144] See, e.g., Edward M. Miller, 1977, Risk, uncertainty, and divergence of opinion, Journal of Finance 32, 1151-1168; Douglas W. Diamond and Robert E. Verrecchia, 1987, Constraints on short-selling and asset price adjustment to private information, Journal of Financial Economics 18, 277-311.

[1145] See, e.g., letter from Pershing Square (citing 2006 Price Test Elimination Proposing Release, 71 FR at 75069-75070); letter from CPIC (June 2009) (citing Pedro A. C. Saffi and Kari Sigurdson, Price Efficiency and Short Selling, IESE Business School Working Paper No. 748 (Apr. 2008); letter from Citadel et al. (June 2009).

evidence on former Rule 10a-1 suggests that the former rule, which applied to all short selling all the time unless an exception or exemption applied, had minimal effect on price efficiency.[1146] Due to differences in the operation of former Rule 10a-1 and Rule 201, when it applies, the alternative uptick rule under Rule 201 will be more restrictive than former Rule 10a-1 in some circumstances and less restrictive in others.[1147] As discussed above, however, due to the circuit breaker approach in Rule 201, the alternative uptick rule of Rule 201 generally will apply to a limited number of covered securities[1148] and will apply only to a particular security for a limited period of time when the circuit breaker has been triggered for a covered security. As such, it will not be triggered for the majority of covered securities at any given time and, when triggered, will remain in effect for a short duration – that day and the following day. Thus, consistent with the empirical evidence on former Rule 10a-1, we expect that the alternative uptick rule will have a minimal impact on price efficiency.

Moreover, paragraphs (c) and (d) of Rule 201 include provisions designed to limit any adverse effects on price efficiency and liquidity, while at the same time not undermining the goals of Rule 201.[1149] In particular, paragraphs (d)(3) and (d)(4) of Rule 201 are designed to facilitate pricing efficiency through certain domestic and international arbitrage transactions. As stated above, allowing arbitrage at a price that is less than or equal to the current national best bid will potentially promote market efficiency. In addition, paragraph (d)(6) of Rule 201, which relates to riskless principal transactions, is designed to facilitate liquidity.

1146 See, e.g., supra Section II.B. (discussing the Pilot Results).

1147 See, e.g., supra note 242 and accompanying text (discussing automated trade matching systems).

1148 See supra notes 305 to 311 and accompanying text (discussing data reflecting that, on average, a limited number of covered securities would hit a 10% trigger level each day).

1149 See supra Section III.B. (discussing "short exempt" provisions to Rule 201); see also supra note 1138.

XII. Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act.[1150] This FRFA relates to the amendments to Rules 200(g) and 201 of Regulation SHO under the Exchange Act. Rule 201 of Regulation SHO implements a short sale-related circuit breaker that, if triggered, will impose a short sale price test restriction. Specifically, Rule 201 requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[1151] In addition, Rule 201 provides that the listing market for each covered security must determine whether that covered security is subject to Rule 201.[1152] Once the listing market has determined that a security has become subject to the requirements of Rule 201, the listing market shall immediately notify the single plan processor responsible for consolidation of information for the covered security in accordance with Rule 603(b) of

[1150] 5 U.S.C. 604.

[1151] See Rule 201(b); see also supra Section III.A.7. (discussing the policies and procedures approach).

[1152] See Rule 201(b)(3).

Regulation NMS[1153] of the fact that a covered security has become subject to the short sale price test restriction of Rule 201. The plan processor must then disseminate this information.[1154] The amendments to Rule 200(g) of Regulation SHO add a new marking requirement of "short exempt."[1155] In particular, if the broker-dealer chooses to rely on its own determination that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order as "short exempt."[1156]

A. Need for and Objectives of the Rule

We believe it is appropriate to adopt a circuit breaker in combination with the alternative uptick rule because, when triggered, it will prevent short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and will facilitate the ability of long sellers to sell first upon such decline. This approach establishes a narrowly-tailored Rule that will target only those securities that are experiencing significant intra-day price declines. We believe that addressing short selling in connection with such declines in individual securities will help address erosion of investor confidence in our markets generally. We are also adopting amendments to Rule 200(g) of Regulation SHO in order to aid surveillance by SROs and the Commission for compliance with the provisions of Rule 201.

[1153] Rule 603(b) of Regulation NMS provides that "[e]very national securities exchange on which an NMS stock is traded and national securities association shall act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including a national best bid and national best offer, on quotations for and transactions in NMS stocks. Such plan or plans shall provide for the dissemination of all consolidated information for an individual NMS stock through a single plan processor." 17 CFR 242.603(b).

[1154] See Rule 201(b)(3); 17 CFR 242.603(b).

[1155] See Rule 200(g); see also supra Section IV. (discussing the amendments to Rule 200(g)).

[1156] See Rule 200(g)(2).

As discussed above, following changes in market conditions since the elimination of former Rule 10a-1, including marked increases in market volatility in the U.S. and in every major stock market around the world, we proposed to re-examine and seek comment on whether to impose short sale price test restrictions or circuit breaker restrictions on short selling.[1157] Although in recent months there has been an increase in stability in the securities markets, we remain concerned that excessive downward price pressure on individual securities accompanied by the fear of unconstrained short selling can undermine investor confidence in our markets generally. In addition, we are concerned about potential future market turmoil, including significant increases in market volatility and steep price declines. Thus, as discussed in more detail throughout this adopting release, after considering the comments, we have determined that it is appropriate to adopt in Rule 201 a targeted short sale price test restriction that will apply the alternative uptick rule for the remainder of the day and the following day if the price of an individual security declines intra-day by 10% or more from the prior day's closing price for that security as determined by the covered security's listing market.

By not allowing short sellers to sell at or below the current national best bid while the circuit breaker is in effect, the short sale price test restriction in Rule 201 will allow long sellers, by selling at the bid, to sell first in a declining market for a particular security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of such restrictions is to allow long sellers to sell first in a declining market.[1158] A short seller that is seeking to profit quickly from accelerated, downward market moves may find it advantageous to be able to short sell at the current national best bid. In addition, by making bids accessible

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1157 See Proposal, 74 FR at 18043, 18046; see also supra Section II.C. (discussing the Proposal).

1158 See supra note 17.

only by long sellers when a security's price is undergoing significant downward price pressure, Rule 201 will help to facilitate and maintain stability in the markets and help ensure that they function efficiently. It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors.

In addition, combining the alternative uptick rule with a circuit breaker strikes the appropriate balance between our goal of preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets. The circuit breaker approach of Rule 201 will help benefit the market for a particular security by allowing participants, when a security is undergoing a significant intra-day price decline, an opportunity to re-evaluate circumstances and respond to volatility in that security. We also believe that a circuit breaker will better target short selling that may be related to potential bear raids[1159] and other forms of manipulation that may be used as a tool to exacerbate a price decline in a covered security.

At the same time, however, we recognize the benefits to the market of legitimate short selling, such as the provision of liquidity and price efficiency. Thus, by imposing a short sale price test restriction only when an individual security is undergoing significant price pressure, rather than on all securities all the time, the short sale price test restrictions of Rule 201 will

[1159] See supra note 36 and accompanying text.

apply to a limited number of securities and for a limited duration.[1160] Rule 201 is structured so that generally it will not be triggered for the majority of covered securities at any given time and, thereby, will not interfere with the smooth functioning of the markets for those securities, including when prices in such securities are undergoing minimal downward price pressure or are stable or rising. If the short sale price test restrictions of Rule 201 apply to a covered security it will be because and when that security is undergoing significant downward price pressure. To the extent that Rule 201 negatively affects the benefits of legitimate short selling, such as the provision of liquidity and price efficiency, we believe that such costs are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

In addition, to help ensure the Rule's workability, we are amending Rule 200(g) of Regulation SHO, as proposed, to provide that, once the circuit breaker has been triggered for a covered security, if a broker-dealer chooses to rely on its own determination that it is submitting a short sale order to a trading center at a price that is above the current national best bid at the time of submission or to rely on an exception specified in the Rule, it must mark the order "short exempt." The short sale price test restriction of Rule 201 generally will apply to a small number of securities for a limited duration, and will continue to permit short selling rather than, for example, halting short selling when the restriction is in place. As such, we believe that the circumstances under which a broker-dealer may need to mark a short sale order "short exempt" under Rule 201 are limited.

[1160] See supra Section III.A.5. (discussing the circuit breaker trigger level).

B. Significant Issues Raised by Public Comment

In the Initial Regulatory Flexibility Analysis included in the Proposal, we requested comment on the number of small entities that would be affected by the proposed amendments and on the impact the proposed amendments would have on small entities and how to quantify the impact.[1161] The Commission did not receive any comment letters addressing the number of small entities that would be affected by the proposed amendments.

Several commenters stated that the costs of implementing and complying with the broker-dealer provision of Rule 201(c) could be particularly burdensome for smaller broker-dealers, but did not provide a cost estimate of such burdens.[1162] One commenter stated that this burden would "adversely affect the ability of smaller broker-dealers to compete or the level of service that they can provide to their customers,"[1163] while another stated that a short sale price test would "disproportionately burden smaller broker-dealers, who would likely be forced to route their flow through a handful of larger brokers, impeding competition and adding to systemic risk as flow is consolidated among fewer players."[1164]

Although we agree that implementation of the broker-dealer provision of Rule 201(c) will impose costs on broker-dealers who choose to rely on this provision, we note that Rule 201(c) is not a requirement of the Rule, but rather provides that a broker-dealer may mark a sell order for a security that has triggered the circuit breaker as "short exempt," provided that the broker-dealer identifies the order as being at a price above the current national best bid at the time of submission to the trading center and otherwise complies with the requirements of the provision.

[1161] See Proposal, 74 FR at 18107.

[1162] See, e.g., letter from Credit Suisse (June 2009); letter from NSCP; letter from T.D. Pro Ex.

[1163] Letter from NSCP.

[1164] Letter from Credit Suisse (June 2009).

In addition, as discussed throughout this adopting release, the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price. Although commenters expressed concerns with respect to the costs of the broker-dealer provision of Rule 201(c), these comments were not specific to the alternative uptick rule.[1165] In order to rely on the broker-dealer provision, a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being at a price above the current national best bid at the time of submission of the order to the trading center. Without a sequencing requirement under the alternative uptick rule, we believe that the policies and procedures required to rely on the broker-dealer provision under Rule 201(c) will be easier and less costly to implement and monitor than would be the case under the proposed modified uptick rule or the proposed uptick rule,[1166] and, therefore, lower than the cost concerns and estimates provided by commenters. We note that one of the commenters that expressed concerns about the implementation cost of the broker-dealer provision acknowledged that a rule "that would not require data centralization and sequencing would be significantly less complex and faster to implement."[1167]

We disagree with several commenters who stated that, although implementation and on-going monitoring and surveillance of the alternative uptick rule might be easier and/or less costly for trading centers, this would not hold true for broker-dealers.[1168] One of these commenters

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[1165] See, e.g., letter from Credit Suisse (June 2009); letter from NSCP; letter from T.D. Pro Ex.

[1166] See supra notes 709 to 715 and accompanying text (discussing comments on the impact of the alternative uptick rule on implementation and on-going monitoring and compliance costs).

[1167] Letter from Credit Suisse (June 2009).

[1168] See, e.g., letter from Citadel et al. (Sept. 2009); letter from EWT (Sept. 2009); letter Lime Brokerage (Sept. 2009).

stated that "in order to avoid rejection of short sale orders under an alternative uptick rule, programming would need to be implemented to anticipate changes in the national best bid between the time a short sale order is entered and the time it reaches the relevant market center."[1169] However, the broker-dealer provision of Rule 201(c) is designed specifically to avoid this result. Under the broker-dealer provision, a broker-dealer may, in accordance with the policies and procedures required by the provision, identify the order as being at a price above the current national best bid at the time the order is submitted to the trading center and mark the order "short exempt." Trading centers are required to have written policies and procedures in place to permit the execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.[1170]

Commenters also expressed concerns about the competitive pressure of the broker-dealer provision, stating either that broker-dealers would feel compelled to undertake implementation of the provision, despite the high cost,[1171] which would be particularly burdensome for smaller firms,[1172] or that smaller firms would find the costs prohibitive, placing them at a competitive disadvantage.[1173] We recognize that broker-dealers are faced with competitive concerns and that such concerns may influence their decision whether or not to rely on the broker-dealer provision of Rule 201(c).

1169 Letter from Citadel et al. (Sept. 2009).

1170 See Rule 201(b)(1)(iii).

1171 See, e.g., letter from STANY (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009).

1172 See, e.g., letter from T.D. Pro Ex; letter from Taurus Compliance; letter from Credit Suisse (June 2009).

1173 See, e.g., letter from Credit Suisse (June 2009); letter from NSCP.

However, with respect to the cost, although we recognize that the broker-dealer provision will impose implementation costs on broker-dealers who choose to rely on this provision, we believe that this cost will not be as great as stated by some commenters because the alternative uptick rule does not require sequencing of the national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price.[1174] We believe that, without a sequencing requirement, the policies and procedures required in order to rely on the broker-dealer provision under the alternative uptick rule will be easier and less costly to implement and monitor than would be the case under the proposed modified uptick rule or the proposed uptick rule.

In addition, we note that it is possible that some smaller broker-dealers that determine to rely on the broker-dealer provision may determine that it is cost-effective for them to outsource certain functions necessary to comply with Rule 201(c) to larger broker-dealers, rather than performing such functions in house, to remain competitive in the market. This may help mitigate costs associated with implementing and complying with Rule 201(c). Additionally, they may decide to purchase order management software from technology firms. Order management software providers may integrate changes imposed by Rules 200(g) and 201 into their products, thereby providing another cost-effective way for smaller broker-dealers to comply with the requirements of Rule 201(c).

Although we agree that the broker-dealer provision will impose costs for implementation and on-going monitoring and surveillance, we note that the policies and procedures that are required to be implemented under the broker-dealer provision are similar to those that are

[1174] See supra note 1165 and accompanying text (discussing impact of the alternative uptick rule on commenters' cost concerns with respect to the broker-dealer provision of Rule 201(c)).

required under the Order Protection Rule of Regulation NMS.[1175] In order to rely on the broker-dealer provision, a broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to prevent the incorrect identification of orders as being at a price above the current national best bid at the time of submission of the order to the trading center. Because some broker-dealers, including small broker-dealers, may have already developed or modified their surveillance mechanisms in order to comply with the policies and procedures requirement of the Order Protection Rule under Regulation NMS, broker-dealers may already have retained and trained the necessary personnel to ensure compliance with that Regulation's policies and procedures requirements and, therefore. may already have in place most of the infrastructure and potential policies and procedures necessary to comply with the broker-dealer provision of Rule 201(c). In addition, one commenter supported using a policies and procedures approach to any short sale price test restriction because it would ease implementation for broker-dealers.[1176] Thus, we believe broker-dealers will already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.

Although several commenters stated that previous implementation of Regulation NMS would not mitigate the costs to broker-dealers of implementing a short sale price test restriction,[1177] we considered these comments, as well as comments stating that previous implementation of Regulation NMS could ease implementation provided that broker-dealers could leverage existing systems in implementing Rule 201,[1178] and continue to believe that

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[1175] See Regulation NMS Adopting Release. 70 FR 37496; see also 17 CFR 242.611.

[1176] See, e.g., letter from GE.

[1177] See, e.g., letter from FIF (June 2009); letter from RBC (June 2009).

[1178] See, e.g., letter from MFA (Oct. 2009).

familiarity with Regulation NMS policies and procedures will reduce the implementation costs of the broker-dealer provision under Rule 201(c) on broker-dealers.[1179]

Further, we believe that the implementation and on-going monitoring and compliance costs for broker-dealers who choose to rely on the broker-dealer provision are justified by the benefits of providing broker-dealers with the option to manage their order flow, rather than having to always rely on their trading centers to manage their order flow on their behalf.

C. Small Entities Affected by the Rule

Rule 201 requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day. In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[1180] Rule 201(a)(9) states that the term "trading center" shall have the same meaning as in Rule 600(b)(78) of Regulation NMS, which defines a "trading center" as "a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange

[1179] See supra Section X.B.1.b.ii. (discussing implementation and on-going monitoring and surveillance costs to broker-dealers under Rule 201(c) and Rule 201(d)(6)).

[1180] See Rule 201(b)(1).

market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent."[1181]

Rule 0-10(e) under the Exchange Act provides that the term "small business" or "small organization," when referring to an exchange, means any exchange that: (i) has been exempted from the reporting requirements of Rule 601 under the Exchange Act;[1182] and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0-10.[1183] No national securities exchanges are small entities because none meets these criteria. Thus, the current national securities exchanges that are subject to Rule 201 are not "small entities" for purposes of the Regulatory Flexibility Act.

The remaining non-SRO trading centers that are subject to Rule 201 are registered broker-dealers. The Commission has determined that there are approximately 407 broker-dealers registered with the Commission that may meet the definition of a trading center,[1184] which includes broker-dealers operating as equity ATSs, broker-dealers registered as market makers or specialists in covered securities, and any broker-dealer that is in the business of executing orders internally in covered securities. Pursuant to Rule 0-10(c) under the Exchange Act, a broker-dealer is defined as a small entity for purposes of the Exchange Act and the Regulatory Flexibility Act if the broker-dealer had a 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, and it is not affiliated with any person (other than a natural person) that is not a

1181 See Rule 201(a)(9); see also 17 CFR 242.600(b)(78).

1182 See 17 CFR 242.601.

1183 See 17 CFR 240.0-10(e); 13 CFR 121.201 (setting size standards to define small business concerns).

1184 See supra note 651.

small entity.[1185] Of these 407 non-SRO trading centers, only five[1186] are "small entities" for purposes of the Regulatory Flexibility Act.

In addition, the broker-dealer provision of Rule 201(c) and the riskless principal provision of Rule 201(d)(6) include policies and procedures requirements to help prevent incorrect identification of orders by broker-dealers for purposes of the provisions. The entities covered by the broker-dealer provision of Rule 201(c), the riskless principal provision of Rule 201(d)(6) and the marking requirements of Rule 200(g) include small broker-dealers. Paragraph (c)(1) of Rule 0-10 under the Exchange Act, as mentioned above, states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker-dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared, and is not affiliated with any person (other than a natural person) that is not a small entity.[1187] We estimate that as of 2008 there were approximately 890 broker-dealers that are "small entities" for purposes of the Regulatory Flexibility Act.[1188]

In addition, Rule 201(b)(3) provides that the listing market for each covered security must determine whether that covered security is subject to Rule 201 and must notify the single plan processor responsible for that covered security that the covered security has become subject to the short sale price test restriction of Rule 201. The plan processor must then disseminate this

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1185 See 17 CFR 240.0-10(c)(1).

1186 This number was derived from a review of 2008 FOCUS Report filings and discussion with SRO staff.

1187 17 CFR 240.0-10(c)(1).

1188 These numbers are based on a review of 2008 FOCUS Report filings reflecting registered broker-dealers, including introducing broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

information.[1189] As discussed below, the entities covered by the determination and dissemination requirements of Rule 201(b)(3) do not include small entities.

Rule 201(a)(3) defines the term "listing market" to have the same meaning as defined in the effective transaction reporting plan for the covered security.[1190] Under the definitions of "listing market" of the two effective transaction reporting plans, the CTA Plan and the Nasdaq UTP Plan, "listing markets" are national securities exchanges.[1191] Rule 0-10(e) under the Exchange Act provides that the term "small business" or "small organization," when referring to an exchange, means any exchange that: (i) has been exempted from the reporting requirements of Rule 601 under the Exchange Act;[1192] and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0-10.[1193] No national securities exchanges are small entities because none meets these criteria. Thus, the listing markets that are subject to Rule 201 are not "small entities" for purposes of the Regulatory Flexibility Act.

There are two effective transaction reporting plans, the CTA Plan and the Nasdaq UTP Plan. In accordance with Rule 603(b) of Regulation NMS,[1194] these plans, together with the CQ Plan, provide for the dissemination of all consolidated information for individual NMS stocks through a single plan processor. The plan processor for the CTA Plan is SIAC and the plan processor for the Nasdaq UTP Plan is Nasdaq. Rule 201(a)(6) defines the term "plan processor"

1189 See Rule 201(b)(3).

1190 See Rule 201(a)(3). Rule 201(a)(2) provides that "[t]he term effective transaction reporting plan for a covered security shall have the same meaning as in §242.600(b)(22)." Rule 201(a)(2); 17 CFR 600(b)(22).

1191 See supra note 364 (discussing the definition of "listing market" in the CTA Plan and the Nasdaq UTP Plan).

1192 See 17 CFR 242.601.

1193 See 17 CFR 240.0-10(e); 13 CFR 121.201.

1194 See 17 CFR 242.603(b).

to have the same meaning as in Rule 600(b)(55) of Regulation NMS[1195]. Under Rule 600(b)(55), the term "plan processor" means "any self-regulatory organization or securities information processor acting as an exclusive processor in connection with the development, implementation and/or operation of any facility contemplated by an effective national market system plan."[1196] Paragraph (g) of Rule 0-10 defines the term "small business" or "small organization," when referring to a securities information processor, to mean a securities information processor that had gross revenues of less than $10 million during the preceding fiscal year; provided service to fewer than 100 interrogation devices or moving tickers at all times during the preceding fiscal year; and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[1197] Neither SIAC nor Nasdaq meet these criteria. Thus, the plan processors that are subject to Rule 201 are not "small entities" for purposes of the Regulatory Flexibility Act.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

Rule 201 imposes some new or additional reporting, recordkeeping, or compliance costs on trading centers and other broker-dealers that are small entities. Rule 201 focuses on a trading center's written policies and procedures as the mechanism through which to help prevent the execution or display of short sale orders at a price that is less than or equal to the current national best bid, unless an exception applies. In addition, the broker-dealer provision of Rule 201(c) and the riskless principal provision of Rule 201(d)(6) include policies and procedures requirements to help prevent incorrect identification of orders by broker-dealers for purposes of those provisions.

1195 See Rule 201(a)(6); 17 CFR 242.600(b)(55).

1196 17 CFR 242.600(b)(55).

1197 See 17 CFR 240.0-10(g).

In regard to implementation and on-going monitoring and surveillance costs of Rule 201 on trading centers that are small entities,[1198] we considered commenters' concerns that the cost and time required for trading centers' implementation and on-going monitoring and surveillance of a short sale price test restriction could be high.[1199] However, we note that the alternative uptick rule references only the current national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price. Thus, we believe that the alternative uptick rule will be easier and less costly to implement and monitor for trading centers that are small entities than the proposed modified uptick rule or the proposed uptick rule.[1200]

In addition, we note that the policies and procedures required to be implemented for purposes of Rule 201 are similar to those that trading centers are required to have in place under the Order Protection Rule of Regulation NMS.[1201] Thus, we believe trading centers that are small entities may already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.

Although, as discussed above, several commenters stated that previous implementation of Regulation NMS would not mitigate the costs of implementing a short sale price test

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[1198] As discussed above, there are no SRO trading centers that are "small entities" for purposes of the Regulatory Flexibility Act. Of the estimated 407 non-SRO trading centers (which include broker-dealers operating as equity ATSs, broker-dealers registered as market makers or specialists in covered securities, and any broker-dealer that is in the business of executing orders internally in covered securities) we estimate that there are only 5 non-SRO trading centers that are "small entities" for purposes of the Regulatory Flexibility Act. See supra Section XII.C.

[1199] See supra Section X.B.1.b.i. (discussing comments on the implementation and on-going monitoring and compliance costs of the policies and procedures requirement of Rule 201).

[1200] See supra notes 661 to 669 and accompanying text (discussing comments on the effect of the alternative uptick rule on implementation and on-going monitoring and surveillance costs).

[1201] See Regulation NMS Adopting Release, 70 FR 37496; see also Proposal, 74 FR at 18087; 17 CFR 242.611.

restriction,[1202] we considered these comments, as well as comments stating that previous implementation of Regulation NMS could ease implementation provided that trading centers could use existing systems in implementing Rule 201,[1203] and continue to believe that familiarity with Regulation NMS policies and procedures will reduce the implementation costs for trading centers of the policies and procedures requirement under Rule 201.

Further, we believe that the implementation and on-going monitoring and compliance costs for trading centers are justified by the benefits provided by the Rule in preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security.

In regard to implementation and on-going monitoring and surveillance costs of the broker-dealer provision of Rule 201(c) or the riskless principal provision of Rule 201(d)(6) on small broker-dealers,[1204] as discussed in Section XII.B., above, several commenters stated that the costs of implementing and complying with the broker-dealer provision of Rule 201(c) could be particularly burdensome for smaller broker-dealers.[1205] Commenters also expressed concerns about the competitive pressure of the broker-dealer provision, stating either that broker-dealers would feel compelled to undertake implementation of the provision, despite the high cost,[1206]

[1202] See supra notes 939 to 941 and accompanying text (discussing comments that prior implementation of Regulation NMS would not mitigate the costs of implementing a short sale price test restriction).

[1203] See supra notes 942 to 945 and accompanying text (discussing comments that prior implementation of Regulation NMS could mitigate the costs of implementing a short sale price test restriction).

[1204] As discussed above, we estimate that as of 2008 there were approximately 890 broker-dealers that are "small entities" for purposes of the Regulatory Flexibility Act. See supra Section XII.C.

[1205] See supra notes 1162 to 1173 and accompanying text (discussing comments on the costs of the broker-dealer provision of Rule 201(c) for smaller broker-dealers).

[1206] See, e.g., letter from STANY (June 2009); letter from FIF (June 2009); letter from Lime Brokerage (June 2009).

which would be particularly burdensome for smaller firms,[1207] or that smaller firms would find the costs prohibitive, placing them at a competitive disadvantage.[1208]

We considered these comments in evaluating the costs of implementation and on-going monitoring and surveillance of the broker-dealer provision of Rule 201(c) on small broker-dealers. Although we agree that implementation of the broker-dealer provision of Rule 201(c) will impose costs on broker-dealers who choose to rely on this provision, we note that Rule 201(c) is not a requirement of the Rule, but rather provides that a broker-dealer may mark a sell order for a security that has triggered the circuit breaker as "short exempt," provided that the broker-dealer identifies the order as being at a price above the current national best bid at the time of submission to the trading center and otherwise complies with the requirements of the provision. We recognize, however, that broker-dealers are faced with competitive concerns and that such concerns may influence their decision whether or not to rely on the broker-dealer provision of Rule 201(c).

With respect to the cost, although we recognize that the broker-dealer provision will impose implementation costs on broker-dealers who choose to rely on this provision, we believe that this cost will not be as great as stated by some commenters because the alternative uptick rule does not require sequencing of the national best bid, unlike the proposed modified uptick rule and the proposed uptick rule, which would have required sequencing of the national best bid or last sale price.[1209] We believe that, without a sequencing requirement, the policies and procedures required in order to rely on the broker-dealer provision under the alternative uptick

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[1207] See, e.g., letter from T.D. Pro Ex; letter from Taurus Compliance; letter from Credit Suisse (June 2009).

[1208] See, e.g., letter from Credit Suisse (June 2009); letter from NSCP.

[1209] See supra notes 1165 to 1167 and accompanying text (discussing impact of the alternative uptick rule on commenters' cost concerns with respect to the broker-dealer provision of Rule 201(c)).

rule will be easier and less costly to implement and monitor than would be the case under the proposed modified uptick rule or the proposed uptick rule.[1210]

In addition, we note that it is possible that some smaller broker-dealers that determine to rely on the broker-dealer provision may determine that it is cost-effective for them to outsource certain functions necessary to comply with Rule 201(c) to larger broker-dealers, rather than performing such functions in house, to remain competitive in the market. This may help mitigate costs associated with implementing and complying with Rule 201(c). Additionally, they may decide to purchase order management software from technology firms. Order management software providers may integrate changes imposed by Rules 200(g) and 201 into their products, thereby providing another cost-effective way for smaller broker-dealers to comply with the requirement of Rule 201(c).

In addition, we note that the policies and procedures that are required to be implemented under the broker-dealer provision are similar to those that are required under the Order Protection Rule of Regulation NMS.[1211] Thus, we believe broker-dealers will already be familiar with establishing, maintaining, and enforcing trading-related policies and procedures, including programming their trading systems in accordance with such policies and procedures.

Although several commenters stated that previous implementation of Regulation NMS would not mitigate the costs to broker-dealers of implementing a short sale price test restriction,[1212] we considered these comments, as well as comments stating that previous implementation of Regulation NMS could ease implementation provided that broker-dealers

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[1210] See supra notes 709 to 715 and accompanying text (discussing comments on the effect of the alternative uptick rule on implementation and on-going monitoring and surveillance costs).

[1211] See Regulation NMS Adopting Release, 70 FR 37496; see also 17 CFR 242.611.

[1212] See, e.g., letter from FIF (June 2009); letter from RBC (June 2009).

could leverage existing systems in implementing Rule 201,[1213] and continue to believe that familiarity with Regulation NMS policies and procedures will reduce the implementation costs of the broker-dealer provision under Rule 201(c) on broker-dealers.

Further, we believe that the implementation and on-going monitoring and compliance costs for broker-dealers who choose to rely on the broker-dealer provision are justified by the benefits of providing broker-dealers with the option to manage their order flow, rather than having to always rely on their trading centers to manage their order flow on their behalf.

The amendments to Rule 200(g), to add a new marking requirement of "short exempt"[1214] and to provide that a broker-dealer may mark a sell order "short exempt" only if the provisions in paragraph (c) or (d) of Rule 201 are met,[1215] may impose some new or additional reporting, recordkeeping, or compliance costs on broker-dealers that are small entities. We recognize commenters' concerns with respect to the costs of the "short exempt" marking requirement and we considered these comments in evaluating the costs of the "short exempt" marking requirement.[1216] However, we believe that such costs will be limited because small broker-dealers already have established systems, processes, and procedures in place to comply with the current marking requirements of Rule 200(g) of Regulation SHO with respect to marking a sell order either "long" or "short" and, therefore, will likely leverage such systems, processes and procedures to comply with the "short exempt" marking requirements in Rules 200(g) and 200(g)(2).[1217] Further, we believe that the implementation and compliance costs of the "short

[1213] See, e.g., letter from MFA (Oct. 2009).

[1214] See Rule 200(g); see also supra Section IV. (discussing the amendments to Rule 200(g)).

[1215] See Rule 200(g)(2).

[1216] See supra notes 582 to 588 (discussing comments on the costs of the "short exempt" marking requirement).

[1217] See supra notes 747 to 752 (discussing estimated costs of the amendment to Rule 200(g)(2)).

exempt" marking requirements are justified by the benefits provided by the requirements in aiding surveillance by SROs and the Commission for compliance with the provisions of Rule 201 and providing an indication to a trading center regarding when it must execute or display a short sale order without regard to whether the order is at a price that is less than or equal to the current national best bid.

In addition, to provide market participants with the time needed to make the changes required to comply with Rule 200(g), we are adopting an implementation period under which market participants will have to comply with these requirements six months following the effective date of the adoption of these amendments. We are sensitive to commenter's concerns that implementation of the "short exempt" marking requirement could be complex,[1218] and believe that a six month implementation period, which is longer than the 3 month implementation period proposed in the Proposal, will afford market participants sufficient time to make the necessary modifications to their systems and procedures. In addition, we believe the six month implementation period will help alleviate some of the potential disruptions that may be associated with implementing the "short exempt" marking requirements.

E. Agency Action to Minimize Effect on Small Entities

As required by the Regulatory Flexibility Act, we have considered alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. As noted above, Rule 201 imposes some new or additional reporting, recordkeeping, or compliance costs on trading centers and other broker-dealers that are small entities. However, we expect the impact of the new or additional reporting, recordkeeping, or compliance costs will be limited by the similarity of the policies and procedures requirements of Rule 201 to the

[1218] See supra notes 582 to 588 and accompanying text (discussing comments on the implementation time for the "short exempt" marking requirement).

policies and procedures requirement of the Order Protection Rule under Regulation NMS. Although, as discussed above, several commenters stated that previous implementation of Regulation NMS would not mitigate the costs of implementing a short sale price test restriction,[1219] we considered these comments, as well as comments stating that previous implementation of Regulation NMS could ease implementation provided that firms could use existing systems in implementing Rule 201,[1220] and continue to believe that familiarity with Regulation NMS policies and procedures will reduce the implementation costs of the broker-dealer provision under Rule 201(c) on broker-dealers.

Thus, the five non-SRO trading centers that qualify as small entities and the approximately 890 broker-dealers that qualify as small entities should already have in place most of the infrastructure necessary to comply with Rule 201. The marking requirements of the amendments to Rule 200(g) are not expected to adversely affect small entities because they impose minimal reporting, recordkeeping, or compliance requirements. Rule 200(g) currently requires that broker-dealers mark all sell orders of any equity security as either "long" or "short."[1221] Broker-dealers that are small entities should already be familiar with the current marking requirements and should already have in place mechanisms that could be used to comply with the new "short exempt" marking requirement of Rule 200(g). Moreover, it is not appropriate to develop separate requirements for small entities under either Rule 201 or Rule 200(g) because we believe that to accomplish the Commission's goals, as well as to avoid the possibility of regulatory arbitrage that would undermine the Commission's goals, all trading

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[1219] See supra notes 939 to 941 and accompanying text (discussing comments that prior implementation of Regulation NMS would not mitigate the costs of implementing a short sale price test restriction).

[1220] See supra notes 942 to 944 and accompanying text (discussing comments that prior implementation of Regulation NMS could mitigate the costs of implementing a short sale price test restriction).

[1221] See 17 CFR 242.200(g).

centers and broker-dealers, regardless of size, should be subject to the same circuit breaker short sale price test restrictions and all broker-dealers, regardless of size, should be subject to the same order marking requirements.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.[1222] In connection with Rules 201 and 200(g), we considered the following alternatives: (i) establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance and reporting requirements under the Rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the Rule, or any part of the Rule. First, we note that Rule 201 as adopted and the amendments to Rule 200(g) use performance standards, which we believe will help to minimize any significant adverse impact on small entities.

A primary goal of the short sale-related circuit breaker under Rule 201 is to help restore investor confidence by not allowing sellers to sell short at or below the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day, unless an exception applies. Rule 201 will allow long sellers, by selling at the bid, to sell first in a declining market for a particular security. As the Commission has noted previously in connection with short sale price test restrictions, a goal of

[1222] See 5 U.S.C. 603(a)(5).

such restrictions is to allow long sellers to sell first in a declining market.[1223] A short seller that is seeking to profit quickly from accelerated, downward market moves may find it advantageous to be able to short sell at the current national best bid. In addition, by making bids accessible only by long sellers when a security's price is undergoing significant downward price pressure, Rule 201 will help to facilitate and maintain stability in the markets and help ensure that they function efficiently. It will also help restore investor confidence during times of substantial uncertainty because, once the circuit breaker has been triggered for a particular security, long sellers will have preferred access to bids for the security, and the security's continued price decline will more likely be due to long selling and the underlying fundamentals of the issuer, rather than to other factors.

In addition, combining the alternative uptick rule with a circuit breaker strikes the appropriate balance between our goal of preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security and the need to allow for the continued smooth functioning of the markets, including the provision of liquidity and price efficiency in the markets. The circuit breaker approach of Rule 201 will help benefit the market for a particular security by allowing participants, when a security is undergoing a significant intra-day price decline, an opportunity to re-evaluate circumstances and respond to volatility in that security. We also believe that a circuit breaker will better target short selling that may be related to potential bear raids[1224] and other forms of manipulation that may be used as a tool to exacerbate a price decline in a covered security.

[1223] See supra note 17.

[1224] See supra note 36 and accompanying text.

As discussed throughout this adopting release, we have designed Rule 201 to accomplish its objectives with lower costs to trading centers and broker-dealers than some of the alternatives we proposed and considered. We believe the alternative uptick rule will require less time and less costs for implementation because it does not require sequencing of bids or last sale prices.[1225] In addition, we believe that the circuit breaker approach, which limits the short sale price test restriction for an individual security to a two-day period following a significant intra-day decline in share price in that security, will also limit compliance costs for all participants.[1226]

The costs of compliance with Rules 201 and 200(g) are likely to vary among individual trading centers and broker-dealer firms. As detailed in PRA Section IX.E.1., above, we realize that the policies and procedures that a trading center is required to establish will likewise vary depending upon the type, size, and nature of the trading center. In addition, as detailed in PRA Section IX.E.2., above, we note that the nature and extent of policies and procedures that a broker-dealer must establish under Rule 201(c) or 201(d)(6), if it determines to rely on either provision to mark an order "short exempt," likely will vary based upon the type, size, and nature of the broker-dealer.[1227] Our estimates take into account different types of trading centers and broker-dealers (including large versus small), and we realize that the applicable estimates may be on the low-end for some trading centers and broker-dealers while they may be on the high-end for others.

[1225] See supra Section X.B.1. (discussing the costs of the alternative uptick rule).

[1226] See supra Section III.A.4. (discussing the circuit breaker approach).

[1227] We note that one commenter stated that the "Commission's cost estimates seem to underestimate the cost to large, full service broker-dealers, since the volume of orders handled by these firms are likely to lead to significantly greater technology and storage costs alone as well as more frequent reviews" but did not provide a specific cost estimate. See letter from NSCP.

Although we recognize that the costs of the Rules may vary based upon the type, size, and nature of the trading center or broker-dealer, we believe that uniform application of Rules 201 and 200(g) to all trading centers and broker-dealers is necessary to prevent damaging opportunities for regulatory arbitrage and to avoid confusion in the markets. In addition, different application of the Rules' requirements for small entities could undermine the goals of the short sale related circuit breaker by potentially providing an avenue for short sellers to evade the requirements of Rule 201. Further, in relation to the already-mentioned concerns, we believe that our goal of restoring investor confidence could be undermined by actual or perceived regulatory arbitrage, market confusion, and/or evasion of Rule 201's requirements as a result of different requirements for different market participants in Rules 201 and 200(g).

Due to these concerns, we have concluded that in order for Rules 201 and 200(g) to be effective in helping to restore investor confidence by preventing short selling, including potentially manipulative or abusive short selling, from being used as a tool to exacerbate a declining market in a security, the Rules' requirements must apply uniformly to all trading centers and broker-dealers. Thus, we have determined not to adopt different compliance requirements or a different timetable for compliance requirements for small entities. In addition, and for the same reasons, we have determined not to clarify, consolidate, simplify, or otherwise modify Rules 201 and 200(g) for small entities. Finally, we believe that it is inconsistent with the purposes of the Exchange Act and the goals of adopting Rules 201 and 200(g) to except small entities from having to comply with Rules 201 and 200(g).

XIII. Statutory Authority

Pursuant to the Exchange Act and, particularly, Sections 2, 3(b), 6, 9(h), 10, 11A, 15, 15A, 17, 19, 23(a), and 36 thereof, 15 U.S.C. 78b, 78c(b), 78(f), 78i(h), 78j, 78k-1, 78o, 78o-3, 78q, 78s, 78w(a), and 78mm, the Commission is amending §§ 242.200 and 242.201 of Regulation SHO.

XIV. Text of the Amendments to Regulation SHO

List of Subjects

17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II, Part 242, of the Code of Federal Regulations is 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 as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-l(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. Section 242.200 is amended by revising paragraph (g) introductory text and adding paragraph (g)(2) to read as follows:

§242.200 Definition of "short sale" and marking requirements.

*****

(g) A broker or dealer must mark all sell orders of any equity security as "long," "short," or "short exempt."

(1) * * *

(2) A sale order shall be marked "short exempt" only if the provisions of § 242.201(c) or (d) are met.

*****

3. Section 242.201 is revised to read as follows:

§242.201 Circuit breaker.

(a) Definitions. For the purposes of this section:

(1) The term covered security shall mean any NMS stock as defined in §242.600(b)(47).

(2) The term effective transaction reporting plan for a covered security shall have the same meaning as in §242.600(b)(22).

(3) The term listing market shall have the same meaning as the term "listing market" as defined in the effective transaction reporting plan for the covered security.

(4) The term national best bid shall have the same meaning as in §242.600(b)(42).

(5) The term odd lot shall have the same meaning as in §242.600(b)(49).

(6) The term plan processor shall have the same meaning as in §242.600(b)(55).

(7) The term regular trading hours shall have the same meaning as in §242.600(b)(64).

(8) The term riskless principal shall mean a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee, or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee.

(9) The term trading center shall have the same meaning as in §242.600(b)(78).

(b) (1) A trading center shall establish, maintain, and enforce written policies and procedures reasonably designed to:

(i) Prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day; and

(ii) Impose the requirements of paragraph (b)(1)(i) of this section for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.

(iii) Provided, however, that the policies and procedures must be reasonably designed to permit:

(A) The execution of a displayed short sale order of a covered security by a trading center if, at the time of initial display of the short sale order, the order was at a price above the current national best bid; and

(B) The execution or display of a short sale order of a covered security marked "short exempt" without regard to whether the order is at a price that is less than or equal to the current national best bid.

(2) A trading center shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (b)(1) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(3) The determination regarding whether the price of a covered security has decreased by 10% or more from the covered security's closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day shall be made by the listing market for the covered security and, if such decrease has occurred, the listing market shall immediately notify the single plan processor responsible for consolidation of information for the

covered security pursuant to §242.603(b). The single plan processor must then disseminate this information.

(c) Following any determination and notification pursuant to paragraph (b)(3) of this section with respect to a covered security, a broker or dealer submitting a short sale order of the covered security in question to a trading center may mark the order "short exempt" if the broker or dealer identifies the order as being at a price above the current national best bid at the time of submission; provided, however:

(1) The broker or dealer that identifies a short sale order of a covered security as "short exempt" in accordance with this paragraph (c) must establish, maintain, and enforce written policies and procedures reasonably designed to prevent incorrect identification of orders for purposes of this paragraph; and

(2) The broker or dealer shall regularly surveil to ascertain the effectiveness of the policies and procedures required by paragraph (c)(1) of this section and shall take prompt action to remedy deficiencies in such policies and procedures.

(d) Following any determination and notification pursuant to paragraph (b)(3) of this section with respect to a covered security, a broker or dealer may mark a short sale order of a covered security "short exempt" if the broker or dealer has a reasonable basis to believe that:

(1) The short sale order of a covered security is by a person that is deemed to own the covered security pursuant to §242.200, provided that the person intends to deliver the security as soon as all restrictions on delivery have been removed.

(2) The short sale order of a covered security is by a market maker to offset customer odd-lot orders or to liquidate an odd-lot position that changes such broker's or dealer's position by no more than a unit of trading.

(3) The short sale order of a covered security is for a good faith account of a person who then owns another security by virtue of which he is, or presently will be, entitled to acquire an equivalent number of securities of the same class as the securities sold; provided such sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such securities of the issuer.

(4) The short sale order of a covered security is for a good faith account and submitted to profit from a current price difference between a security on a foreign securities market and a security on a securities market subject to the jurisdiction of the United States, provided that the short seller has an offer to buy on a foreign market that allows the seller to immediately cover the short sale at the time it was made. For the purposes of this paragraph (d)(4), a depository receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(5) (i) The short sale order of a covered security is by an underwriter or member of a syndicate or group participating in the distribution of a security in connection with an over-allotment of securities; or

(ii) The short sale order of a covered security is for purposes of a lay-off sale by an underwriter or member of a syndicate or group in connection with a distribution of securities through a rights or standby underwriting commitment.

(6) The short sale order of a covered security is by a broker or dealer effecting the execution of a customer purchase or the execution of a customer "long" sale on a riskless principal basis. In addition, for purposes of this paragraph (d)(6), a broker or dealer must have written policies and procedures in place to assure that, at a minimum:

(i) The customer order was received prior to the offsetting transaction;

(ii) The offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution; and

(iii) The broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders on which a broker or dealer relies pursuant to this exception.

(7) The short sale order is for the sale of a covered security at the volume weighted average price (VWAP) that meets the following criteria:

(i) The VWAP for the covered security is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system for the security during the regular trading session, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of reported shares for that day in the security.

(ii) The transactions are reported using a special VWAP trade modifier.

(iii) The VWAP matched security:

(A) Qualifies as an "actively-traded security" pursuant to §242.101 and §242.102; or

(B) The proposed short sale transaction is being conducted as part of a basket transaction of twenty or more securities in which the subject security does not comprise more than 5% of the value of the basket traded.

(iv) The transaction is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.

(v) A broker or dealer shall be permitted to act as principal on the contra-side to fill customer short sale orders only if the broker's or dealer's position in the covered security, as committed by the broker or dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume.

(e) No self-regulatory organization shall have any rule that is not in conformity with, or conflicts with, this section.

(f) Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any person or class of persons, to any transaction or class of transactions, or to any security or class of securities to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: February 26, 2010