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 **October 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

(41 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3093 / September 29, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14079

In the Matter of **SYSTEMATIC FINANCIAL ASSOCIATES, INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(e) 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(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Systematic Financial Associates, Inc. ("SFA" 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 203(e) 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. SFA is a New Jersey corporation with its principal place of business in Branchburg, New Jersey. SFA is wholly owned by Sandra Venetis ("Venetis") and is an investment adviser registered with the Commission.

2. On September 2, 2010, a judgment was entered by consent against SFA, permanently enjoining it from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Sandra Venetis, et al., Civil Action Number 10-cv-4493-JAP, in the United States District Court for the District of New Jersey.

3. The Commission's complaint alleged, among other things, that, since at least 1997, Venetis designed and orchestrated an offering fraud and multi-million dollar Ponzi scheme, whereby she fraudulently obtained over $11 million from at least 100 investors. The complaint further alleged that Venetis, operating through SFA and two other entities, fraudulently offered and sold promissory note securities in unregistered transactions. In connection with the sale of the notes, Venetis falsely stated to investors that the notes funded loans to doctors, the investments would generate tax-free annual returns, and the doctors receiving the loans acknowledged their repayment obligations by co-signing the notes. The complaint also alleged that Venetis systematically misappropriated and misused investor funds, falsely stated to investors that their funds were invested, sent out false account statements indicating that investor funds earned the promised returns, and otherwise engaged in a variety of conduct 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 sanctions agreed to in Respondent SFA's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(e) of the Advisers Act, that the investment adviser registration of Respondent SFA be, and hereby is, revoked.

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. 63030 / October 4, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3096 / October 4, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3194 / October 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14084

In the Matter of

Altschuler, Melvoin and Glasser LLP, and
G. Victor Johnson, II, CPA,

Respondents.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Altschuler, Melvoin and Glasser LLP and G. Victor Johnson, II, CPA (the "Respondents") pursuant to Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), Section 4C[1] of the

[1] Section 4C provides that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . "(1) not to possess the requisite qualifications to represent others (2) to be lacking in character or integrity, or to have engaged in unethical

Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

II.

In anticipation of the institution of these proceedings, the Respondents have each submitted an Offer of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over the Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934, Section 203(k) of the Investment Advisers Act of 1940 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and the Respondents' Offers, the Commission finds[3] that:

A. SUMMARY

This matter concerns the roles of audit firm Altschuler, Melvoin and Glasser LLP ("Altschuler") and engagement partner George Victor Johnson, II ("Johnson") in violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 (the "Custody Rule") under the Advisers Act by Sentinel Management Group, Inc. ("Sentinel"), a registered investment adviser. At the relevant time, 2002 through 2006, Sentinel was required by the Custody Rule to have an independent public accountant verify all client funds and securities by surprise examination at least once each calendar year. Altschuler was the independent public accounting firm that Sentinel retained to perform its surprise examinations from 2002 through 2006, and Johnson was the engagement partner at Altschuler overseeing the Sentinel surprise examinations for every year except 2004.[4] The Respondents negligently failed to conduct the examinations in accordance with the professional standards applicable to examinations under Advisers Act Rule 206(4)-2, thereby causing Sentinel's violations of the Custody Rule and Section 206(4) of the

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or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder."

[2] Rule 102(e)(1)(ii) provides, in relevant part, that:

> The Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before it ... to any person ... who is found ... to have engaged in improper professional conduct.

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

[4] Johnson did not act as the engagement partner for 2004 because Johnson and Altschuler, without admitting or denying its findings, consented in June 2005, to the entry of an order, which required Johnson to refrain from serving as an engagement partner in any audit of any CFTC registrant for six months. *See In the Matter of G. Victor Johnson and Altschuler, Melvoin and Glasser*, LLP, CFTC Docket No. 04-29 (June 13, 2005).

Advisers Act. The conduct related to the exams also constituted improper professional conduct pursuant to Section 4C(b)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

B. RESPONDENTS

Altschuler, Melvoin and Glasser LLP is an Illinois limited liability partnership that maintained its principal place of business in Chicago, Illinois. Altschuler performed annual Advisers Act surprise examinations for Sentinel, a registered investment adviser, for the years 2002 through 2006 and also served as Sentinel's independent auditor from 2002 through 2005. On November 1, 2006, Altschuler sold most of its assets to another public accounting firm and is now in liquidation. Altschuler is, however, contractually required to complete any pending engagements, sign-off on report reissuance and consents, and defend malpractice claims.

George Victor Johnson, II, CPA age 69, of Arlington Heights, Illinois is a certified public accountant licensed in Illinois and currently a director of a public accounting firm. Johnson served as the engagement partner for the 2002, 2003, 2005 and 2006 Advisers Act surprise examinations of Sentinel and the 2002 through 2005 financial statement audits of Sentinel on behalf of Altschuler.

C. OTHER RELEVANT ENTITY

Sentinel Management Group, Inc. (SEC File No. 801-15642) is an Illinois corporation based in Northbrook, Illinois, that has been registered with the Commission as an investment adviser since 1980. Sentinel is registered with the Commodity Futures Trading Commission as a futures commission merchant. On August 17, 2007, Sentinel filed for Chapter 11 bankruptcy. At the time of Sentinel's bankruptcy, Sentinel managed approximately 180 accounts for around 70 clients and had approximately $1.4 billion in assets under management.

D. FACTS

1. The Commission's Action Against Sentinel

a. Prior to its bankruptcy on August 17, 2007, Sentinel primarily managed investments of short-term cash for advisory clients, including futures commission merchants, hedge funds, financial institutions, pension funds, and individuals. Sentinel purported to invest all of its clients' assets in pooled investment vehicles (the "Securities Pools") [5] and to hold the underlying securities in three segregated accounts at a qualified custodian bank (the "Custodian").

b. Sentinel obtained a loan, for its own benefit, from the Custodian and established a collateral account at the Custodian to maintain securities pledged as collateral for this loan. During the relevant period, the loan from the Custodian to Sentinel was similar to a line of credit in that it fluctuated on a daily basis. The outstanding balance of the loan grew significantly from when Altschuler first began performing Advisers Act surprise examinations for Sentinel to the days leading up to Sentinel's bankruptcy. For example, the loan balance was approximately

[5] Advisory clients owned *pro-rata*, undivided interests in the Securities Pools.

$20 million at December 31, 2002, approximately $120 million at December 31, 2004, and approximately $230 million at December 31, 2006. On August 20, 2007, the Commission filed an emergency enforcement action against Sentinel in the United States District Court in Illinois alleging multiple violations of the antifraud provisions of the Advisers Act. According to the Commission's complaint against Sentinel, Sentinel misused Securities Pools' securities to collateralize the loan. When Sentinel collapsed in August 2007, the Custodian claimed ownership of several hundred million dollars in Securities Pool securities that had been improperly held in Sentinel's account to collateralize the loan made by the Custodian to Sentinel for the benefit of Sentinel. On December 17, 2008, the court entered a judgment by consent against Sentinel permanently enjoining it from violating the antifraud provisions of the federal securities laws.

2. Altschuler's and Johnson's Unreasonable Advisers Act Surprise Examinations Caused Sentinel's Violations of the Custody Rule

a. Section 206(4) of the Advisers Act prohibits investment advisers from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," as defined by the Commission by rule. During the relevant period, Rule 206(4)-2 stated in pertinent part that it constitutes a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 206(4) of the Advisers Act for any registered investment adviser to have custody of client funds or securities unless a qualified custodian or the adviser sends a quarterly account statement to each of the clients for which it maintains funds or securities, or to each beneficial owner of a pooled investment vehicle, identifying the amount of funds and of each security in the account at the end of the period and setting forth all transactions in the account during the period.[6] If the adviser sends the quarterly account statements itself, which Sentinel did, an independent public accountant generally must verify all of the funds and securities by actual examination at least once during each calendar year on a date chosen by the accountant without prior notice to the investment adviser (a "surprise examination").[7]

b. The Commission provided guidance for accountants conducting surprise examinations in Accounting Series Release No. 103[8] which indicates, among other things, that the accountant should express an opinion as to whether the investment adviser was in compliance with Rule 206(4)-2(a)(1) as of the examination date. Rule 206(4)-2(a)(1) requires, among other things, client assets of which the adviser has custody to be maintained by a qualified custodian (i) in a separate account for each client under that client's name or (ii) in accounts that contain only [the adviser's] clients' funds and securities, under [the adviser's] name as agent or trustee for the clients.

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[6] Prior to the effectiveness of the 2003 amendments to Rule 206(4)-2, Rule 206(4)-2 was not materially different with regard to those parts of the rule relevant to the violations at issue in this matter.

[7] Rule 206(4)-2(b)(3) provided an exception from the surprise examination requirement for a pooled investment vehicle if certain criteria were met, including, among other things, a financial-statement audit of the pool. This provision, however, is not relevant here because the Securities Pools were not audited.

[8] *Statement of the Commission describing nature of examination required to be made of all funds and securities held by an investment adviser and the content of related accountant's certificate*, Accounting Series Release No. 103, Investment Advisers Act Release No. 201 (May 26, 1966) ("ASR No. 103").

c. During the relevant period, Sentinel was required to undergo surprise examinations by an independent public accountant.[9] To conduct an appropriate examination under Rule 206(4)-2, an accountant should have, among other things:[10]

- Confirmed all Securities Pool securities held by the Custodian.
- Reconciled *all* securities between the Custodian's records and the adviser's records of the client accounts.
- Conducted the examination by "*surprise*."
- Completed the surprise examination in accordance with U.S. Generally Accepted Auditing or Attestation Standards as established by the American Institute of Certified Public Accountants ("AICPA Attest Standards")(emphasis added).

d. Rule 206(4)-2 also states that the accountant is to transmit to the Commission, within 30 days after the completion of the examination, a certificate, attached to a Form ADV-E, stating that an examination of such funds and securities has been made, and describing the nature and extent of the examination.

e. The AICPA also provided guidance concerning the examination and reporting requirements of Rule 206(4)-2 in the AICPA Audit and Accounting Guide: *Audits of Investment Companies* ("AICPA Guide"). The AICPA Guide contained an illustrative attestation report for independent public accountants for surprise examinations performed pursuant to Rule 206(4)-2.[11] According to the AICPA Guide, the attestation report should, if applicable, include specific references to the following procedures performed by the independent accountant in connection with the surprise examination: (1) confirmation of all cash and securities held by a third party, such as a custodian bank or broker, in the name of the investment adviser as agent or trustee for clients; and (2) reconciliation of all such cash and securities to books and records of client accounts maintained by the investment adviser. These procedures were applicable to the Sentinel surprise examinations. Additionally, the illustrative attestation report contained an opinion on management's assertion regarding compliance with, among other things, Rule 206(4)-2(a)(1) based on the aforementioned procedures.

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[9] Prior to Nov. 5, 2003, the Custody Rule required all registered advisers to have surprise examinations. *See* Advisers Act Release No. 2176 (Sept. 25, 2003) (amending the rule). Thus, Sentinel was required to have the Securities Pools' assets verified by surprise examination under the Custody Rule, as it existed prior to Nov. 5, 2003. It also was required to have surprise examinations after the rule's amendment in 2003 because it, not its custodian, sent account statements to the investors in the Securities Pools. *See* Rule 206(4)-2(a)(3)(iii) (the account statements required to be sent under Paragraph (a)(3)(ii) of the Rule must be sent to each beneficial owner of a pooled investment vehicle). The Commission amended Rule 206(4)-2 in December 2009 to require registered investment advisers with custody of client assets to have surprise examinations annually, subject to certain exceptions, as well as require that qualified custodians holding those assets send out account statements. *See* Advisers Act Release No. 2968 (Dec. 30, 2009). Unless otherwise noted, references to the Rule refer to its provisions as it existed prior to its most recent amendment.

[10] *See* Rule 206(4)-2; ASR No. 103 and Advisers Act Release No. 2176 (Sept. 25, 2003).

[11] *See, e.g.*, paragraph 11.12 of the AICPA Audit and Accounting Guide, *Audits of Investment Companies,* with conforming changes as of May 1, 2002.

f. While conducting these examinations, Altschuler and Johnson negligently failed to meet the AICPA attestation standard requiring "due professional care." *See AT 101A.39 (AICPA 2002).* For example, Johnson knew in 2002 of Sentinel's loan from the Custodian. He also was informed that Sentinel regularly transferred securities, originally purchased for the Securities Pools, from segregated accounts held at the Custodian to Sentinel's collateral account at the Custodian. In addition, Altschuler and Johnson obtained documents from the Custodian during each of the surprise examinations (e.g., collateral account statement confirmations from the Custodian) that reflected securities purportedly owned by the Securities Pools were held in Sentinel's collateral account at the Custodian, which Johnson knew or should have known also contained Sentinel owned securities. Although the collateral account statements they received from the Custodian were in Sentinel's name and the securities in the account were not marked for the benefit of the Securities Pools, Altschuler and Johnson included the securities in this account in their reconciliations of the Custodian's records to the Adviser's records. Altschuler and Johnson should have recognized that Sentinel was holding some securities purportedly owned by the Securities Pools in a Sentinel account at the Custodian and that such practice did not comply with Rule 206(4)-2(a)(1). Moreover, certain securities were shown in Sentinel's records as being held in the Securities Pools' segregated accounts, whereas such securities were shown in the Custodian's records as being held only in Sentinel's collateral account. The examination work papers further reveal that Altschuler and Johnson obtained certain schedules (including account statements of investors in the Securities Pools) that showed Sentinel was using as collateral for its loan certain Securities Pools' securities which were maintained in Sentinel's collateral account, commingled with Sentinel's own assets.

g. Nonetheless, based primarily on oral statements from Sentinel's management, Altschuler and Johnson had reached the conclusion that Sentinel owned the securities used to collateralize the loan, contrary to certain documentary evidence in the examination work papers and elsewhere, and therefore they failed to follow up adequately on the inconsistencies or to design procedures to discover whether the Securities Pools' securities were being commingled.

h. In addition, from 2002-2006, Johnson (for every year other than 2004) and Altschuler issued unqualified attestation opinions that stated that Sentinel's assertions regarding its compliance with Rule 206(4)-2(a)(1) for the examination periods were fairly stated in all material respects. However, as a result of procedures performed and evidence obtained, Altschuler and Johnson should have known that Sentinel was not complying with Rule 206(4)-2(a)(1) because Sentinel was commingling the Securities Pools' securities in its collateral account. Therefore, Altschuler and/or Johnson should not have issued unqualified attestation opinions.

i. In addition, contrary to the Custody Rule, Altschuler and Johnson failed to conduct all of their examinations of Sentinel by surprise either by providing prior notice of the examination or in one instance allowing Sentinel to choose the date of the exam.

j. Finally, Johnson also failed to provide sufficient supervision to the Altschuler staff members that were tasked to complete the surprise examinations. Johnson billed only 1.5 hours a year on the examinations and during that time provided little apparent guidance to the staff members carrying out the examinations. Such inadequate guidance and poor supervision fall short of the requirement of the AICPA Attestation Standards' first standard of field work that "assistants, if any, shall be properly supervised." *See AT 101A.42 (AICPA 2002).*

3. Altschuler and Johnson Engaged in Improper Professional Conduct

a. During the examinations of Sentinel from 2002 through 2006, the Respondents engaged in improper professional conduct.

b. During each examination conducted, the Respondents (1) failed to recognize that certain custodial-client securities (i.e., some of those of the Securities Pools) were held in accounts that did not comply with subparagraph (a)(1) of Rule 206(4)-2 because such securities were in Sentinel's collateral account which was not marked as for the benefit of the custodial clients (i.e., the Securities Pools); (2) failed to properly reconcile Sentinel's Securities Pool accounts to the account statements received directly from the Custodian; (3) inaccurately stated in their opinions that Sentinel complied with subparagraph (a)(1) of Rule 206(4)-2; (4) failed to conduct all of their examinations on a surprise basis; and (5) failed to file the examination report within 30 days of completing the examinations. The Respondents also failed to appreciate that heightened scrutiny was warranted in connection with their examinations of Sentinel because of the growing size of Sentinel's loan from the Custodian, which resulted in Sentinel transferring securities from the Securities Pools' segregated accounts to its collateral account to collateralize its loan.

c. The Respondents failed to conduct the examinations in accordance with the AICPA Attestation Standards, which are the professional standards applicable to the examinations performed under Advisers Act Rule 206(4)-2.

d. Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide that the Commission may censure or temporarily or permanently deny an accountant the privilege of appearing or practicing before it if it finds, after notice and opportunity for hearing, that the accountant engaged in "improper professional conduct." In relevant part, Section 4C(b) and Rule 102(e)(1)(iv) define 'improper professional conduct' to include either of the following two types of negligent conduct:

> (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant, or a person associated with a registered public accounting firm, knows, or should know, that heightened scrutiny is warranted, or
>
> (2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

4. **FINDINGS**

a. Based on the foregoing, the Commission finds that Altschuler and Johnson caused Sentinel's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

b. Based on the foregoing, the Commission finds that Altschuler and Johnson engaged in improper professional conduct pursuant to Section 4C(b)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

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

Accordingly, Pursuant to Sections 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and 4C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice, it is hereby ORDERED, effective immediately, that:

A. Altschuler and Johnson shall cease and desist from causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

B. Altschuler is censured.

C. Johnson is denied the privilege of appearing or practicing before the Commission as an accountant.

D. Altschuler shall within 7 days of the entry of this Order, pay disgorgement of $18,700.00 in fees collected during the 2002 through 2006 Advisers Act examinations and prejudgment interest of $5,476.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Altschuler 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 John Dugan, Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, Boston, MA, 02110.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Disapproved

U.S. SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9149 / October 4, 2010

Securities Exchange Act of 1934
Release No. 63031 / October 4, 2010

Investment Company Act of 1940
Release No. 29456 / October 4, 2010

File No. S7-10-09

In the Matter of the Motion of **Business Roundtable and the Chamber of Commerce of the United States of America** **For Stay of Effect of Commission's Facilitating Shareholder Director Nominations Rules**	**ORDER GRANTING STAY**

On September 29, 2010, Business Roundtable and the Chamber of Commerce of the United States of America filed a petition with the United States Court of Appeals for the District of Columbia Circuit seeking review of recent changes to the Commission's proxy and related rules.[1] On the same date, petitioners filed with the Commission a motion to stay the effect of newly adopted Rule 14a-11 and associated amendments to the Commission's rules[2] pending such review. Petitioners have not sought a stay of the amendment to Rule 14a-8 that the Commission adopted at the same time as Rule 14a-11. Petitioners represent in their stay motion that, if the Commission were to grant a stay, they would join in a motion seeking expedited review of their petition in the Court of Appeals.

The Commission has discretion to grant a stay of its rules pending judicial review if it finds that "justice so requires."[3] Without addressing the merits of petitioners'

[1] Business Roundtable, et al. v. SEC, No. 10-1305 (D.C. Cir., filed Sept. 29, 2010).

[2] These associated amendments include new Schedule 14N, new Rule 14a-18, and amendments to Rule 14a-2, among others.

[3] Exchange Act Section 25(c)(2), 15 U.S.C. 78y(c)(2). Section 705 of the Administrative Procedure Act likewise provides that an agency may stay its own action pending judicial review when it finds that "justice so requires." 5 U.S.C. 705.

challenge to the rules, the Commission has determined to exercise its discretion to stay Rule 14a-11 and related amendments to the Commission's rules, including the amendment to Rule 14a-8, pending resolution of petitioners' petition for review by the Court of Appeals.

The Commission finds that, under all of the circumstances of this matter, a stay of Rule 14a-11 and related rule amendments is consistent with what justice requires. Among other things, a stay avoids potentially unnecessary costs, regulatory uncertainty, and disruption that could occur if the rules were to become effective during the pendency of a challenge to their validity. Because the Commission and petitioners will seek expedited review of petitioners' challenge, questions about the rules' validity will be resolved as quickly as possible.

The Commission further finds that, under all of the circumstances of this matter, it is consistent with what justice requires to stay the effectiveness of the amendment to Rule 14a-8 adopted contemporaneously with Rule 14a-11 because the amendment to Rule 14a-8 was designed to complement Rule 14a-11 and is intertwined, and there is a potential for confusion if the amendment to Rule 14a-8 were to become effective while Rule 14a-11 is stayed.

Accordingly, it is ORDERED, pursuant to Exchange Act Section 25(c)(2) and Administrative Procedure Act Section 705, that the motion of petitioners filed on September 29, 2010 for a stay of the effect of Commission Rule 14a-11 and related amendments pending resolution of petitioners' petition for review by the Court of Appeals be, and hereby is, granted; and it is further

ORDERED, pursuant to Exchange Act Section 25(c)(2) and Administrative Procedure Act Section 705, that the amendment to Commission Rule 14a-8 adopted on August 25, 2010 is stayed pending resolution of petitioners' petition for review by the Court of Appeals.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 240 and 249

Release Nos. 33-9148; 34-63029; File No. S7-24-10

RIN 3235-AK75

DISCLOSURE FOR ASSET-BACKED SECURITIES REQUIRED BY SECTION 943 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

AGENCY: Securities and Exchange Commission

ACTION: Proposed rule.

SUMMARY: Pursuant to Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] we are proposing rules related to representations and warranties in asset-backed securities offerings. Our proposals would require securitizers of asset-backed securities to disclose fulfilled and unfulfilled repurchase requests across all transactions. Our proposals would also require nationally recognized statistical rating organizations to include information regarding the representations, warranties and enforcement mechanisms available to investors in an asset-backed securities offering in any report accompanying a credit rating issued in connection with such offerings, including a preliminary credit rating.

DATES: Comments should be received on or before November 15, 2010.

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);

1 Pub. L. No. 111-203 (July 21, 2010).

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-24-10 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File Number S7-24-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website 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: Rolaine Bancroft, Attorney-Advisor, in the Office of Rulemaking, at (202) 551-3430, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628 or, with respect to proposed Rule 17g-7, Joseph I. Levinson, Special Counsel, at (202) 551-5598; Division of Trading and Markets, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are proposing amendments to Items 1104 and 1121[2] of Regulation AB[3] (a subpart of Regulation S-K) under the Securities Act of 1933 ("Securities Act").[4] We also are proposing to add Rules 15Ga-1[5] and 17g-7[6] and Form ABS-15G[7] under the Securities Exchange Act of 1934 ("Exchange Act").[8]

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2 17 CFR 229.1104 and 17 CFR 229.1121.

3 17 CFR 229.1100 through 17 CFR 229.1123.

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

5 17 CFR 240.15Ga-1.

6 17 CFR 240.17g-7.

7 17 CFR 249.1300.

8 15 U.S.C. 78a et seq.

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I. Background

This release is one of several that the Commission is required to issue to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") related to asset-backed securities ("ABS"). In this release, we propose rules to implement Section 943 of the Act, which requires the Commission to prescribe regulations on the use of representations and warranties in the market for asset-backed securities:

(1) to require any securitizer to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by securitizer, so that investors may identify asset originators with clear underwriting deficiencies; and

(2) to require each nationally recognized statistical rating organization ("NRSRO") to include, in any report accompanying a credit rating for an asset-backed securities offering, a description of (A) the representations, warranties and enforcement mechanisms available to investors; and (B) how they differ from the representations, warranties and enforcement mechanisms in issuances of similar securities.[9]

The Act requires us to adopt these rules within 180 days of enactment of the Act.

In April of 2010, we proposed rules that would revise the disclosure, reporting and offering process for asset-backed securities (the "2010 ABS Proposing Release").[10] Among other things, the 2010 ABS Proposing Release proposed new disclosure requirements with respect to repurchase requests. Specifically, we proposed that issuers disclose in

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[9] See Section 943 of the Act.

[10] See Asset Backed Securities, SEC Release No. 33-9117 (April 7, 2010) [75 FR 23328] (the "2010 ABS Proposing Release").

prospectuses the repurchase demand and repurchase and replacement activity for the last three years of sponsors of asset-backed transactions or originators of underlying pool assets if they are obligated to repurchase assets pursuant to the transaction agreements.[11] These disclosure requirements would apply to offerings of ABS registered under the Securities Act or ABS offered and sold without registration in reliance upon Securities Act rules, which includes both offerings eligible for Rule 144A resales and other offerings conducted in reliance on exemptions from registration. We also proposed that issuers disclose the repurchase demand and repurchase and replacement activity concerning the asset pool on an ongoing basis in periodic reports.[12] As described in Section II.B. below, we are re-proposing the disclosure requirements with respect to repurchase requests in Regulation AB in order to conform the disclosures to those required by Section 943 of the Act.

In the underlying transaction agreements for an asset securitization, sponsors or originators typically make representations and warranties relating to the pool assets and their origination, including about the quality of the pool assets. For instance, in the case of residential mortgage-backed securities, one typical representation and warranty is that each of the loans has complied with applicable federal, state and local laws, including truth-in-lending, consumer credit protection, predatory and abusive laws and disclosure laws. Another representation that may be included is that no fraud has taken place in connection with the origination of the assets on the part of the originator or any party involved in the origination of the assets. Upon discovery that a pool asset does not comply with the

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11 Depending on the transaction, the originator of the assets or, most typically, the sponsor of the securities — who could also function as the originator — would be the obligated party. See previously proposed Items 1104(f) and 1110(c) of Regulation AB in the 2010 ABS Proposing Release.

12 See previously proposed Item 1121(c) of Regulation AB in the 2010 ABS Proposing Release.

representation or warranty, under transaction covenants, an obligated party, typically the sponsor, must repurchase the asset or substitute a different asset that complies with the representations and warranties for the non-compliant asset. The effectiveness of the contractual provisions related to representations and warranties has been questioned and lack of responsiveness by sponsors to potential breaches of the representations and warranties relating to the pool assets has been the subject of investor complaint.[13]

II. Discussion of Proposals

A. Proposed Disclosure Requirements for Securitizers

We are proposing to add new Rule 15Ga-1 to implement Section 943(2) of the Act. This proposed rule would require any securitizer of asset-backed securities to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by securitizer, so that investors may identify asset originators with clear underwriting deficiencies. Under our proposals, a securitizer would provide the disclosure by filing new proposed Form ABS-15G.

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13 As we noted in the 2010 ABS Proposing Release, transaction agreements typically have not included specific mechanisms to identify breaches of representations and warranties or to resolve a question as to whether a breach of the representations and warranties has occurred. Thus, these contractual agreements have frequently been ineffective because, without access to documents relating to each pool asset, it can be difficult for the trustee, which typically notifies the sponsor of an alleged breach, to determine whether or not a representation or warranty relating to a pool asset has been breached. In the 2010 ABS Proposing Release, the Commission proposed a condition to shelf eligibility that would require a provision in the pooling and servicing agreement that would require the party obligated to repurchase the assets for breach of representations and warranties to periodically furnish an opinion of an independent third party regarding whether the obligated party acted consistently with the terms of the pooling and servicing agreement with respect to any loans that the trustee put back to the obligated party for violation of representations and warranties and which were not repurchased. See Section II.A.3.b. of the 2010 ABS Proposing Release. See also the Committee on Capital Markets Regulation, The Global Financial Crisis: A Plan for Regulatory Reform, May 2009, at 135 (noting that contractual provisions have proven to be of little practical value to investors during the crisis); see also Investors Proceeding with Countrywide Lawsuit, Mortgage Servicing News, Feb. 1, 2009 (describing class action investor suit against Countrywide in which investors claim that language in the pooling and servicing agreements requires the seller/servicer to repurchase loans that were originated with "predatory" or abusive lending practices) and American Securitization Forum, ASF Releases Model Representations and Warranties to Bolster Risk Retention and Transparency in Mortgage Securitizations, (Dec. 15, 2009), available at http://www.americansecuritization.com. It has been reported that only large ABS investors, such as Fannie Mae and Freddie Mac, have been able to effectively exercise repurchase demands. See Aparajita Saha-Bubna, "Repurchased Loans Putting Banks in Hole," Wall Street Journal (Mar. 8, 2010)(noting that most mortgages put back to lenders are coming from Fannie Mae and Freddie Mac).

1. Definition of Exchange Act-ABS for Purposes of Rule 15Ga-1

The Act amended the Exchange Act to include a definition of an "asset-backed security" and Section 943 of the Act references that definition.[14] The statutory definition of an asset-backed security ("Exchange Act-ABS") is much broader than the definition of an asset-backed security in Regulation AB ("Reg AB-ABS").[15] The definition of an Exchange Act-ABS includes securities that are typically sold in transactions that are exempt from registration under the Securities Act, such as collateralized debt obligations ("CDOs"), as well as securities issued or guaranteed by a government sponsored entity, such as Fannie Mae and Freddie Mac.[16] Similarly, if a municipal entity issues securities collateralized by a self-liquidating pool of loans that allow holders of the securities to receive payments that depend primarily on cash flow from those loans, that security would fall within the definition

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14 Section 3(a)(77) of the Exchange Act provides that the term "asset backed security":

> (A) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including— (i) a collateralized mortgage obligation; (ii) a collateralized debt obligation; (iii) a collateralized bond obligation; (iv) a collateralized debt obligation of asset-backed securities; (v) a collateralized debt obligation of collateralized debt obligations; and (vi) a security that the Commission, by rule, determines to be an asset-backed security for purposes of this section; and (B) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company. Section 3(a)(77) of the Exchange Act, as amended by the Act.

15 In 2004, we adopted the definition of "asset-backed security" in Regulation AB. The definition and our interpretations of it are intended to establish parameters for the types of securities that are appropriate for the alternate disclosure and regulatory regime provided in Regulation AB and the related rules for Form S-3 registration of ABS. The definition does not mean that public offerings of securities outside of these parameters, such as synthetic securitizations, may not be registered with the Commission, but only that the alternate regulatory regime is not designed for those securities. The definition does mean that such securities must rely on non-ABS form eligibility for registration, including shelf registration. See Section III.A.2 of Asset-Backed Securities, SEC Release 33-8518 (January 7, 2005) [70 FR 1506] (the "2004 ABS Adopting Release") and Item 1101(c) of Regulation AB [17 CFR 1101(c)].

16 Government sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac purchase mortgage loans and issue or guarantee mortgage-backed securities (MBS). MBS issued or guaranteed by these GSEs have been and continue to be exempt from registration under the Securities Act and reporting under the Exchange Act. For more information regarding GSEs, see Task Force on Mortgage-Backed Securities Disclosure, "Staff Report: Enhancing Disclosure in the Mortgage-Backed Securities Markets" (Jan. 2003) available at http://www.sec.gov/news/studies/mortgagebacked.htm.

of an Exchange Act-ABS.[17] Since Section 943 uses the broader Exchange Act-ABS definition, our proposed Rule 15Ga-1 would require a securitizer to provide disclosures relating to all asset-backed securities that fall within the statutory definition, whether or not sold in Securities Act registered transactions. However, as we discuss further below, even if a security meets the definition of an Exchange Act-ABS, the new disclosure requirement would not be triggered if the underlying transaction agreements do not contain a covenant to repurchase or replace an asset.

Request for Comment:

1. Is it clear what types of securities a securitizer would have to provide representation and warranty repurchase disclosure about under proposed Rule 15Ga-1? If not, please identify which securities are not clearly covered and the reasons why those securities are not clearly included or excluded by the proposal.
2. Should we provide further guidance regarding the application of proposed Rule 15Ga-1 to securities issued by municipal entities that would fall within the definition of Exchange Act-ABS? Is it clear what types of municipal securities a municipal securitizer would have to provide representation and warranty repurchase disclosure about under proposed Rule 15Ga-1? If not, please identify those types of municipal securities that are not clearly covered and explain why they are not clearly included or excluded by the proposal.

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17 For a discussion of municipal ABS, see generally Robert A. Fippinger, The Securities Law of Public Finance vol. 1, §1:6.2[B], 1-70- 1-72 (2d ed., Practicing Law Institute 2009).

2. Definition of Securitizer for Purposes of Rule 15Ga-1

Section 943 and proposed Rule 15Ga-1 impose the disclosure obligation on a "securitizer" as defined in the Exchange Act. The Act amended the Exchange Act to include the definition of a "securitizer". Under the Exchange Act, a securitizer is either:

(A) an issuer of an asset-backed security; or

(B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer.[18]

The definition of securitizer is not specifically limited to entities that undertake transactions that are registered under the Securities Act or conducted in reliance upon any particular exemption. Consequently, we believe it is intended to apply to any entity or person that issues or organizes an Exchange Act-ABS as specified in Section 15G(a)(3) of the Exchange Act. As a result, proposed Rule 15Ga-1 would require any entity coming within the Section 15G(a)(3) definition of securitizer, including government sponsored entities such as Fannie Mae, Freddie Mac, or a municipal entity, to provide the proposed disclosures. Further, as noted above, Section 943 and Section 15G(a)(3) do not distinguish between securitizers of Exchange Act-ABS in registered or unregistered transactions, and our proposed Rule 15Ga-1 would apply equally to registered and unregistered transactions.

With respect to registered transactions and the definitions of transaction parties in Regulation AB, sponsors and depositors[19] both fall within the statutory definition of securitizer. A sponsor typically initiates a securitization transaction by selling or pledging to

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18 See Section 15G(a)(3) of the Exchange Act, as amended by the Act.

19 Securities Act Rule 191 [17 CFR 230.191] generally defines an issuer as the depositor.

a specially created issuing entity a group of financial assets that the sponsor either has originated itself or has purchased in the secondary market.[20] In some instances, the transfer of assets is a two-step process: the financial assets are transferred by the sponsor first to an intermediate entity, often a limited purpose entity created by the sponsor for a securitization program and commonly called a depositor, and then the depositor will transfer the assets to the issuing entity for the particular asset-backed transaction.[21] Because both sponsors and depositors fit within the statutory definition of securitizers, both entities would have the disclosure responsibilities under proposed Rule 15Ga-1. However, if a sponsor filed all disclosures proposed to be required under Rule 15Ga-1, which would include disclosures of the activity of affiliated depositors, Rule 15Ga-1 would provide that those affiliated depositors would not have to separately provide and file the same disclosures. Such disclosure would be duplicative and would not provide any additional useful information, since as noted above, the depositor usually serves as an intermediate entity of a transaction initiated by a sponsor.[22]

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[20] A sponsor, as defined in Regulation AB, is the person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity. <u>See</u> Item 1101(l) of Regulation AB [17 CFR 229.1101(l)]. Sponsors of asset-backed securities often include banks, mortgage companies, finance companies, investment banks and other entities that originate or acquire and package financial assets for resale as ABS. <u>See</u> Section II. of the 2004 ABS Adopting Release.

[21] A depositor receives or purchases and transfers or sells the pool assets to the issuing entity. <u>See</u> Item 1101(e) of Regulation AB [17 CFR 229.1101(e)]. For asset-backed securities transactions where there is not an intermediate transfer of assets from the sponsor to the issuing entity, the term depositor refers to the sponsor. For asset-backed securities transactions where the person transferring or selling the pool assets is itself a trust, the depositor of the issuing entity is the depositor of that trust.

[22] There may be other situations where multiple affiliated securitizers would have individual reporting obligations under proposed Rule 15Ga-1 with respect to a particular transaction. Therefore, we propose that if one securitizer has filed all the disclosures required in order to meet the obligations under Rule 15Ga-1, which would include disclosures of the activity of affiliated securitizers, those affiliated securitizers would not be required to separately provide and file the same disclosures.

Request for Comment:

3. Is it clear which entities or persons would have disclosure responsibilities under proposed Rule 15Ga-1? If not, please identify those possible entities or persons, describe their role in the transaction, and explain why they are not clearly included or excluded by the definition of a securitizer.
4. Should we provide further guidance regarding the application of proposed Rule 15Ga-1 to municipal issuers that are within the definition of securitizers? Is it clear which municipal entities would have disclosure responsibilities under proposed Rule 15Ga-1? If not, please identify those municipal entities that are not clearly covered and explain why they are not clearly included or excluded by the proposal.

3. Disclosures Required by Proposed Rule 15Ga-1

In accordance with Section 943 of the Act, we are proposing new Rule 15Ga-1[23] to require any securitizer of an Exchange Act-ABS to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by securitizer, so that investors may identify asset originators with clear underwriting deficiencies. We are proposing that, if the underlying transaction agreements provide a covenant to repurchase or replace an underlying asset for breach of a representation or warranty, then a securitizer would be required to provide the information described below for all assets originated or sold by the securitizer that were the subject of a demand for repurchase or replacement with respect to all outstanding Exchange Act-ABS held by non-affiliates of the securitizer. If the underlying agreements of an Exchange Act-ABS do not contain a covenant to repurchase or replace an

[23] We propose to adopt this rule as an Exchange Act rule because of the relationship with other requirements under the Exchange Act and other statutory requirements we are implementing.

underlying asset, then no transaction party would be entitled to demand repurchase or replacement. Requiring securitizers to report the activity of those Exchange Act-ABS with no demands might give an incorrect impression of sound underwriting. As discussed further below, initially, we are proposing that a securitizer provide the repurchase history for the last five years by filing Form ABS-15G at the time a securitizer first offers an Exchange Act-ABS or organizes and initiates an offering of Exchange Act-ABS, registered or unregistered, after the effective date of the proposed rules, as adopted. Going forward, a securitizer would be required to provide the disclosures for all outstanding Exchange Act-ABS on a monthly basis by filing Form ABS-15G. Information would not be required for the time period prior to the five-year look back period of the initial filing.

Section 943(2) requires disclosure of fulfilled and unfulfilled repurchase requests. It does not limit the required disclosure to those relating only to demands successfully made by the trustee. Therefore our proposal would require tabular disclosure of assets subject to any and all demands for repurchase or replacement of the underlying pool assets as long as the transaction agreements provide a covenant to repurchase or replace an underlying asset. For instance, we note that demands for repurchase may not ultimately result in a repurchase or replacement pursuant to the terms of the transaction agreement, either because of withdrawn demands or incomplete demands that did not meet the requirements of a valid demand pursuant to the transaction agreements.[24] Furthermore, it may be the case that a repurchase or replacement may occur whether or not it is determined that the obligated party was

[24] See e.g., comment letters of ASF, Bank of America, Community Mortgage Banking Project, CRE Finance Council and Mortgage Bankers Association on the 2010 ABS Proposing Release. The public comments are available at http://www.sec.gov/comments/s7-08-10/s70810.shtml.

required to repurchase the asset pursuant to the terms of the transaction agreement.[25] Securitizers would be permitted to footnote the table to provide additional explanatory disclosures to describe the data disclosed. We also note that investors have demanded that trustees enforce repurchase covenants because transaction agreements do not typically contain a provision for an investor to directly make a repurchase demand.[26] As we stated earlier, Section 943(2) does not limit the required disclosures to those demands successfully made by the trustee; therefore our proposals would require investor demands upon a trustee be included in the table, irrespective of the trustee's determination to make a repurchase demand on a securitizer based on the investor request. We are concerned, however, that initially a securitizer may not be able to obtain complete information from a trustee because it may not have tracked investor demands. Because securitizers may not have access to historical information about investor demands made upon the trustee prior to the effective date of the proposed rules, we are proposing an instruction that a securitizer may disclose in a footnote, if true, that a securitizer requested and was able to obtain only partial information

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25 See Section XI.C.2. of the 2010 ABS Proposing Release where we note that disclosures about an originator's or sponsor's refusal to repurchase or replace assets put back to them for breach of representations and warranties might create incentives for originators to agree to repurchase or replace such assets even in cases where these assets were not in breach. We explained that if investors regard such disclosures as indicative of a willingness to comply with representations and warranties in the future, then originators and sponsors might try to preserve their reputation by taking back assets even when they do not have to do so. This might create an incentive for sponsors and possibly trustees to ask for repurchase or replacement of poorly performing assets that represent no breach of representations and warranties. However, a commentator on the 2010 ABS Proposing Release stated that in certain situations, it may have the opposite effect, where the threat of a disclosure requirement may make a sponsor worry that a large number of successful repurchase claims could indicate that its initial due diligence, or the originator's loan quality was poor. See letter from Commonwealth of Massachusetts Attorney General.

26 See Jody Shenn, "BNY Won't Investigate Countrywide Mortgage Securities," Bloomberg Business Week (Sep. 13, 2010) available at http://www.businessweek.com/news/2010-09-13/bny-won-t-investigate-countrywide-mortgage-securities.html (noting the difficulties that investors are facing to enforce contracts with respect to repurchase demands) and Al Yoon, "NY Fed joins other investors on loan repurchase bid," Reuters (Aug. 4, 2010) available at http://www.reuters.com/article/idUSTRE6736DZ20100804 (noting that investors have been frustrated with trustees and servicers and are banding together to force trustees to act on repurchase requests). See also Kevin J. Buckley, "Securitization Trustee Issues," The Journal of Structured Finance (Summer 2010) (discussing investors demands upon trustees to enforce sellers' repurchase obligations).

or unable to obtain any information with respect to investor demands to a trustee that occurred prior to the effective date of the proposed rules and state that the disclosures do not contain all demands made prior to the effective date.[27]

We are proposing that securitizers provide the information in the following tabular format in order to aid understanding:

Name of Issuing Entity	Check if Regis-tered	Name of Originator	Assets That Were Subject of Demand			Assets That Were Repurchased or Replaced			Assets That Were Not Repurchased or Replaced			Assets Pending Repurchase or Replacement		
			(#)	($)	(% of pool)	(#)	($)	(% of pool)	(#)	($)	(% of pool)	(#)	($)	(% of pool)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)	(o)
Asset Class X														
Issuing Entity A CIK #	X	Originator 1												
		Originator 2												
Issuing Entity B		Originator 3												
Total			#	$		#	$		#	$		#	$	
Asset Class Y														
Issuing Entity C		Originator 2												
		Originator 3												
Issuing Entity D CIK#	X	Originator 1												
Total			#	$		#	$		#	$		#	$	

A single securitizer may have several securitization programs to securitize different types of asset classes. Therefore, in order to organize the information in a manner that would be useful for investors, we are proposing that the securitizer disclose the asset class and group the information in the table by asset class (column (a)). We are also proposing that

[27] This situation, as well as others, may arise where the disclosures required by proposed Rule 15Ga-1 alone may necessitate the disclosure of additional information in order to render the information not misleading. Securitizers would need to consider the antifraud provisions under the federal securities laws to determine what other information, if any, may need to be provided in offering materials given to an investor.

securitizers list the names of all the issuing entities[28] of Exchange Act-ABS, listed in order of the date of formation of the issuing entity in column (a) so that investors may identify the securities that contain the assets subject to the demands for repurchase and when the issuing entity was formed.[29] Because the Act requires disclosure with respect to all Exchange Act-ABS, Rule 15Ga-1 would require securitizers to provide disclosure for all Exchange Act-ABS where the underlying agreements include a repurchase covenant, regardless of whether the transaction was registered with the Commission. Additionally, if any of the Exchange Act-ABS of the issuing entity were registered under the Securities Act, the Central Index Key ("CIK") number of the issuing entity would be required so that investors may locate additional publicly available disclosure, if applicable.

So that investors may distinguish between transactions that were registered, and those that were not, we are also proposing that securitizers check the box in column (b) to indicate whether any Exchange Act-ABS of the issuing entity were registered under the Securities Act. We believe this indicator would provide important information so an investor may locate additional publicly available disclosure for registered transactions, if applicable.

The Act also provides that the disclosure is required "so that investors may identify asset originators with clear underwriting deficiencies."[30] Therefore, we are proposing that

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28 Issuing entity is defined in Item 1101(f) of Regulation AB [17 CFR 229.1101(f)] as the trust or other entity created at the direction of the sponsor or depositor that owns or holds the pool assets and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

29 In a stand-alone trust structure, usually backed by a pool of amortizing loans, a separate issuing entity is created for each issuance of ABS backed by a specific pool of assets. The date of formation of the issuing entity would most likely be at the same time of the issuance of the ABS. In a securitization using a master trust structure, the ABS transaction contemplates future issuances of ABS by the same issuing entity, backed by the same, but expanded, asset pool. Master trusts would organize the data using the date the issuing entity was formed, which would most likely be earlier than the date of the most recent issuance of securities.

30 See Section 943(2) of the Act.

securitizers further break out the information by originator of the underlying assets in column (c).

Because the Act requires disclosure of all "fulfilled and unfulfilled" repurchase requests, we are proposing in Rule 15Ga-1 that securitizers disclose the assets that were subject of the demand, the assets that were repurchased or replaced and the assets that were not repurchased or replaced. In order to provide investors with useful information about the repurchase requests in relation to the overall pool of assets, we are proposing that securitizers present the number, outstanding principal balance and percentage by principal balance of the assets that were subject of demand to repurchase or replace for breach of representations and warranties (columns (d) through (f)); the number, outstanding principal balance and percentage by principal balance of assets that were repurchased or replaced for breach of representations and warranties (columns (g) through (i)); and the number, outstanding principal balance and percentage by principal balance of assets that were not repurchased or replaced for breach of representations and warranties (columns (j) through (l)).[31]

Additionally, we are proposing to require disclosure of the number, outstanding principal balance and percentage by principal balance of the assets that are pending repurchase or replacement and proposing an instruction to include a footnote to the table that provides narrative disclosure of the reasons why repurchase or replacement is pending (columns (m) through (o)). For example, the securitizer would indicate by footnote if

[31] If the ABS were offered in a registered transaction, an investor may be able to locate additional detailed information. In the 2010 ABS Proposing Release, the Commission also proposed that issuers be required to provide loan-level disclosure of repurchase requests on an ongoing basis. Under the proposal, an issuer, with each periodic report on a Form 10-D, would have to indicate whether a particular asset has been repurchased from the pool. If the asset has been repurchased, then the registrant would have to indicate whether a notice of repurchase has been received, the date the asset was repurchased, the name of the repurchaser and the reason for the repurchase. See previously proposed Item 1(i) of Schedule L-D [Item 1121A of Regulation AB] in the 2010 ABS Proposing Release.

pursuant to the terms of a transaction agreement, assets have not been repurchased or replaced pending the expiration of a cure period. Without these additional columns, the disclosures about fulfilled and unfulfilled repurchase requests of a securitizer alone may not provide clear and complete disclosure about the repurchase request history. For instance, some transaction agreements specify a cure period that typically lasts 60-90 days.[32] Including those repurchase requests that are within a cure period as assets that were not repurchased or replaced (columns (j) through (l)) would provide inaccurate disclosure about the current pending status of those repurchase requests.

Lastly, we are proposing that the table include totals by asset class for columns that require numbers of assets and principal amounts (columns (d), (e), (g), (h), (j), (k), (m) and (n)).[33]

The Act does not specify when the disclosure should first be provided, or the frequency with which it should be updated. We are proposing to require that securitizers first be required to file Form ABS-15G at the time a securitizer first offers an Exchange Act-ABS or organizes and initiates an offering of Exchange Act-ABS, registered or unregistered, after the effective date of the proposed rules, as adopted.[34] The initial filing would include the

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32 In response to our ABS 2010 Proposing Release, some commentators expressed concern about the timing of providing repurchase disclosures, noting that the person preparing repurchase disclosures may not be in a position to know what percentage of demands made in a period did not result in repurchase due to cure periods provided in the transaction agreements that typically last 60-90 days. See letters from the American Securitization Forum ("ASF") and Wells Fargo & Company on the 2010 ABS Proposing Release.

33 See letter from Association of Mortgage Investors on the 2010 ABS Proposing Release (requesting that disclosure of information regarding claims made and satisfied under representation and warranties provisions of the transaction documents be broken down by securitization and then aggregated).

34 Filing proposed Form ABS-15G would not foreclose the reliance of an issuer on the private offering exemption in the Securities Act of 1933 and the safe harbor for offshore transactions from the registration provisions in Section 5 [15 U.S.C. 77e]. However, the inclusion of information beyond that required in proposed Rule 15Ga-1 may jeopardize such reliance by constituting a public offering or conditioning the market for the ABS being offered under an exemption.

repurchase demand and repurchase and replacement history of all outstanding Exchange Act-ABS of the securitizer with respect to which the underlying transaction agreements provide a covenant to repurchase or replace an underlying asset for breach of a representation or warranty for the last five years. The initial filing would be required to include all of the information in proposed Rule 15Ga-1, even if there had been no demands to repurchase or replace assets to report with respect to any issuing entity of an Exchange-Act ABS securitized by a securitizer. We believe that the ability to compare all issuing entities and the originators of the underlying pools would provide useful information for investors by making the disclosures comparable across securitizers, so that consistent with the purposes of Section 943, an investor may identify originators with clear underwriting deficiencies.

While Section 943 does not limit the time period for disclosure, we have proposed in Rule 15Ga-1 to limit the disclosure to Exchange Act-ABS that remain outstanding and are held by non-affiliates because we believe securitizers would more likely have ready access to this information, and it is more likely to be relevant to investors than information about securities that are no longer outstanding and held by non-affiliates. While we believe that Congress intended to provide investors with historical information about repurchase activity so that investors may identify asset originators with clear underwriting deficiencies,[35] we also recognize that securitizers may not have historically collected the information required under our proposal.[36] We are proposing that the initial disclosures be limited to the last five years of activity in order to balance the requirements of Section 943 and the burden on securitizers

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35 See letter from Securities Industry Financial Markets Association ("SIFMA") on the 2010 ABS Proposing Release (noting that their investor members believe that issuers should be required to make disclosures about repurchase requests regardless of the date of the securitization).

36 See e.g., comment letters from ASF, Bank of America, Financial Services Roundtable and the Mortgage Bankers Association on the 2010 ABS Proposing Release.

to provide the historical disclosures. Therefore, any demand, repurchase or replacement that had occurred within the five years immediately preceding the initial filing, as of the end of the preceding month, would need to be disclosed in the table. [37]

We are also proposing that securitizers file proposed Form ABS-15G, periodically on a monthly basis with updated information so that, consistent with the purpose of Section 943 of the Act, an investor may monitor the demand, repurchase and replacement activity across all Exchange Act-ABS issued by a securitizer.[38] For registered transactions, most ABS distribute payments monthly and file Forms 10-D on a monthly basis. Similarly, given the established frequency of reporting, we believe proposed Rule 15Ga-1 disclosure should be provided to investors on a monthly basis and filed on Form ABS-15G on EDGAR within 15 calendar days after the end of each calendar month. [39]

Under the proposal, securitizers would be required to continue periodic reporting through and until the last payment on the last Exchange Act-ABS outstanding held by a non-affiliate that was issued by the securitizer or an affiliate. We are also proposing that securitizers be required to file Form ABS-15G to provide a notice to terminate the reporting obligation and disclose the date the last payment was made.

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37 For the initial filing, we recognize that demands may have been made prior to the initial five-year look back date and that resolution may have occurred after that date. In this case, a securitizer would need to disclose that a demand was made, even though it occurred prior to the five-year look back date.

38 See letter from Prudential Fixed Income Management on the 2010 ABS Proposing Release (noting that claims made against a sponsor should be included in offering materials and regularly reported, together with detail that clarifies the number of such claims that were accepted by the sponsor and the number of claims that were and were not approved).

39 Form 10-Ds are required to be filed within 15 days of each required distribution date on the asset-backed securities. See General Instruction A.2. of Form 10-D [17 CFR 249.312]. Because securitizers may sponsor various asset classes, we believe it would be difficult to tie the timing requirements of Rule 15Ga-1 disclosure to the timing of payments on the securities.

Request for Comment:

5. Is the proposed requirement to require that any securitizer of an Exchange Act-ABS transaction disclose fulfilled and unfulfilled repurchase requests in a table appropriate? Would another format be more appropriate or useful to investors?
6. Should we require, as proposed, that securitizers list all previous issuing entities with currently outstanding ABS where the underlying transaction agreements include a repurchase covenant, even if there were no demands to repurchase or replace assets in that particular pool? Should we require, as proposed, that securitizers with currently outstanding Exchange Act-ABS held by non-affiliates list all originators related to every issuing entity even if there were no demands to repurchase or replace assets related to that originator for that particular pool? Put another way, would it be useful for investors to compare all the issuing entities and originators, related to one securitizer, listed in the table, so that investors may identify asset originators with clear underwriting deficiencies, as provided in the Act?
7. Would it be appropriate for securitizers to omit the table if a securitizer had no prior demands for repurchases or replacements? If so, how would an investor be able to know why the securitizer omitted the disclosure? In lieu of a table that displayed no demands for repurchases or replacements, would it be appropriate for a securitizer to provide narrative or check box disclosure stating that no demands were made for any asset securitized by the securitizer?
8. Is it appropriate to limit disclosure to Exchange Act-ABS that remain outstanding and held by non-affiliates, as proposed? Would such a limitation be consistent with the Act? Alternatively, should disclosure be required with respect to Exchange Act-ABS

that are no longer outstanding? Would such disclosure reveal potentially important information? Would it be appropriate to require disclosure regarding Exchange Act-ABS that were outstanding during a recent period, such as one, three, or five years?

9. Should the disclosure requirement only be applied prospectively, i.e., disclosure would be required only with respect to repurchase demands and repurchases and replacements beginning with Exchange Act-ABS issued after the effective date of the rule? Should disclosure only be required with respect to repurchase activity after the effective date? If so, please explain why limiting disclosure to activity regarding Exchange Act-ABS issued after the effective date would be consistent with the Act, as it specifies that the disclosure be provided by any securitizer across all trusts.

10. In implementing the requirements of Section 943, should the disclosure requirement initially be limited to the last five years, as proposed? Would a different time frame be more appropriate, e.g., the last three, seven or ten years of activity? Underwriting standards of originators may change over time. While information regarding repurchases within a recent time period may assist investors in identifying originators with current underwriting deficiencies, is older information, such as information about repurchases within a time period of ten years, less useful in identifying current underwriting deficiencies?[40] Would information that covers the last three, five, seven or ten years of repurchase activity provide investors with the information they need so that they "may identify asset originators with clear underwriting deficiencies"? To

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[40] In a response to our 2010 ABS Proposing Release, the ASF noted in its comment letter that "the requirement to report three years worth of repurchase activity would potentially result in a flood of unhelpful disclosure about transactions involving unrelated asset classes, particularly with respect to sponsors or originators that are large, diversified financial institutions engaging in securitization and sales of multiple asset classes through affiliated but often separately managed business units."

what extent would disclosure older than such a period add significant burdens and costs and produce information that would be of marginal utility to investors?

11. Is our proposed instruction to permit securitizers to omit disclosure of investor demands made upon the trustee prior to the effective date of the proposed rules if the information is unavailable and provide footnote disclosure, if true, that the table omits such demands and that the securitizer requested and was unable to obtain the information appropriate? If not, how would securitizers obtain the information about investor demands upon a trustee prior to the effective date of the proposed rules, as adopted?
12. Should the requirement only cover the last three, five, seven or ten years of repurchase requests on an ongoing basis? Would this format on an ongoing basis provide information in a more easily understandable manner? Would it still allow an investor to "identify asset originators with clear underwriting deficiencies"?
13. Are there any other agreements, outside of the related transaction agreements for an asset-backed security that provide for repurchase demands and repurchases and replacements? If so, please tell us what those agreements are and why securitizers should be required to report the information, including why that information would be material to an investor in a particular asset-backed security.[41]
14. Is the information proposed to be required in the table appropriate? Is there any other information that should be presented in the table that would be useful to investors? Is the proposed disclosure regarding pending repurchase requests appropriate? Should

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[41] See comment letter from Massachusetts Office of Attorney General on the 2010 ABS Proposing Release (noting that side letter agreements between a sponsor and an originator may contain early payment default warranties and that the existence of such warranties often have an effect upon the performance of a securitization).

we specify that securitizers provide more detail about the reasons why the assets were not repurchased or why the assets are pending repurchase or replacement? For example, should we require more detail such as the date of claim, the date of repurchase, whether claims have been referred to arbitration, whether the claims are in a cure period, and the costs associated and expenses born by each issuing entity?[42] Should we require securitizers to provide narrative disclosure of the reasons why repurchase or replacement is pending, as proposed? If so, should we specify the level of detail to be provided regarding pending asset repurchase or replacement requests? For instance, should we specify categories for the reasons why the request is pending, e.g., cure period, arbitration, etc.

15. Section 943 of the Act requires that "all fulfilled and unfulfilled repurchase requests across all trusts" be disclosed. Should we require, as proposed, that all demands for repurchase be disclosed in the table? Some commentators on the 2010 ABS Proposing Release expressed concerns about disclosing demands for repurchase that ultimately did not result in a repurchase or replacement pursuant to the terms of the transaction agreement, either because of withdrawn demands or incomplete demands that did not meet the requirements of the transaction agreements.[43] In order to address commentator's concerns, should we also require, by footnote to the table, disclosure of whether the repurchase or replacement was required by the transaction agreements or whether it occurred for some other reason? Should the disclosure

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[42] See e.g., comment letters of Metropolitan Life Insurance Company and the SIFMA on the 2010 ABS Proposing Release.

[43] See e.g., comment letters of ASF, Bank of America, Community Mortgage Banking Project, CRE Finance Council and Mortgage Bankers Association on the 2010 ABS Proposing Release.

indicate the type of representation or warranty that led to the repurchase or replacement?

16. Is our proposal to require a securitizer to file its initial Form ABS-15G at the time it first offers Exchange-Act ABS or organizes and initiates an offering of Exchange Act-ABS after the implementation date of the proposed rules appropriate? What are other possible alternatives to trigger the initial filing obligation?
17. Is our proposal to require the disclosure on a monthly basis appropriate? If not, what would be the appropriate interval for the disclosures, e.g., quarterly or annually?
18. Is our proposal to require that Form ABS-15G be filed within 15 calendar days after the end of each calendar month appropriate? If not, would a shorter or longer timeframe be more appropriate, e.g., four days or twenty days? Please tell us why.
19. We note that the transaction agreements for certain types of ABS, such as CDOs, may not typically contain a covenant to repurchase or replace an underlying asset. Is it appropriate to exclude, as proposed, those Exchange Act-ABS with transaction agreements that do not contain a covenant to repurchase or replace the underlying assets?
20. Should the data in the table be tagged? If so, should the tagging be in XML or is a different tagging schema appropriate? If tagging is appropriate, would a phase-in period in which the disclosure would be provided without tagging pending completion of necessary technical specifications be appropriate? In order to tag the data, we would need to develop definitions that would result in consistent and comparable data across all issuing entities of all securitizers. For instance, how should we specify that securitizers tag the identity of an originator to provide

consistency across disclosures provided by all securitizers? Should we assign codes that would specifically identify each originator? Or would text entry of the name of the originator be sufficient? Similarly, should we specify a unique code for all the issuing entities? For example, registered transactions would have a CIK number assigned for the issuing entity; however, unregistered transactions may not have a unique method of identification. What other definitions or responses would we need to specify in order to make the disclosure comparable across originators and securitizers?

4. Proposed Form ABS-15G

The disclosures required by proposed Rule 15Ga-1 do not fit neatly within the framework of existing Securities Act and Exchange Act Forms because those forms relate to registered ABS transactions and unregistered ABS transactions are not required to file those forms.[44] Therefore, we are proposing new Form ABS-15G to be filed on EDGAR so that parties obligated to make disclosures related to Exchange Act-ABS under Rule 15Ga-1 could file the disclosures on EDGAR. As discussed above, proposed Rule 15Ga-1 would require securitizers to disclose repurchase demand and repurchase and replacement history with respect to registered and unregistered Exchange Act-ABS transactions for as long as the securitizer has ABS outstanding and held by non-affiliates. Consistent with current filing practices for other ABS forms,[45] we are proposing, for purposes of making the disclosures

44 However, a portion of the information required by proposed Rule 15Ga-1 would be required in a registration statement and in periodic reports. We discuss those proposals below.

45 The Form 10-K report for ABS issuers must be signed either on behalf of the depositor by the senior officer in charge of securitization of the depositor, or on behalf of the issuing entity by the senior officer in charge of the servicing. See General Instruction J.3. of Form 10-K [17 CFR 249.310] In addition, the certifications for ABS issuers that are required under Section 302 of the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7241] must be signed either on behalf of the depositor by the senior officer in charge of securitization of the

required by Rule 15Ga-1, that Form ABS-15G be signed by the senior officer of the securitizer in charge of the securitization.

Request for Comment:

21. Is our proposal to require proposed Rule 15Ga-1 disclosures on new Form ABS-15G appropriate?

22. Securitizers would be required, as proposed, to file Form ABS-15G on EDGAR. If a securitizer has already been issued a CIK number, we would expect Form ABS-15G to be filed under that number. However, a securitizer may already be a registrant that has other reporting requirements under the Securities Act or the Exchange Act. Should we assign a different file number to Form ABS-15G filings in order to differentiate Form ABS-15G filings made by a registrant in its capacity as a securitizer, from other filings made pursuant to its own reporting requirements under the Securities Act and the Exchange Act? Should we also provide on the SEC website the ability to exclude, include or show only Form ABS-15G for a particular CIK number in order make it easier to locate these filings on EDGAR?

23. Instead of requiring, as proposed, that securitizers provide the Rule 15Ga-1 disclosures on Form ABS-15G, should we instead require that securitizers provide all the disclosures required by Section 943 of the Act in a manner consistent with disclosures in prospectuses and ongoing reports in a registered transaction? For instance, for registered offerings, would it be appropriate to permit issuers to satisfy

depositor if the depositor is signing the Form 10–K report, or on behalf of the issuing entity by the senior officer in charge of the servicing function of the servicer if the servicer is signing the Form 10-K report. In our 2010 ABS Proposing Release, we also proposed to require that the senior officer in charge of securitization of the depositor sign the registration statement (either on Form SF-1 or Form SF-3) for ABS issuers. See Section II.F. of the 2010 ABS Proposing Release.

their disclosure obligation by including all of the information required by proposed Rule 15Ga-1 in prospectuses and periodic reports on behalf of the securitizer for all of the affiliated trusts of a securitizer? Assuming that some securitizers offer several ABS across many asset classes, would taking this approach result in a prospectus that would be unwieldy considering the volume of information that would be required? If we took this approach, then how would that information be conveyed to investors in unregistered offerings, both initially and on an ongoing basis? Would securitizers be able to identify all of the investors that would be entitled to receive the information pursuant to Section 943 of the Act? How often should the information be conveyed to investors? What method would be used to convey the information to investors? Would securitizers post the disclosures on a website?

24. We are proposing that for purposes of making the disclosures required by Rule 15Ga-1 that Form ABS-15G be signed by the senior officer in charge of the securitization of the securitizer. Is there a more appropriate party to sign the form? If so, please tell us who and why.

5. Offshore Sales of Exchange-Act ABS

The market for Exchange Act-ABS is global.[46] Securitizers in the United States may sell ABS to offshore purchasers as part of a registered or unregistered offering. Under the proposal, these transactions would be subject to the requirements of proposed Rule 15Ga-1. In addition, U.S. investors may participate in offerings of ABS that primarily are offered by

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46 Indeed, the International Organization of Securities Commissions (IOSCO) cites the recent crisis in the subprime markets, stemming from defaulted mortgage loans in the United States and affected by issues related to liquidity and transparency, as evidence of the interrelation of today's global markets. See the *Report on the Subprime Crisis – Final Report*, Report of the Technical Committee of IOSCO, May 2008, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf

foreign securitizers to purchasers outside of the United States. For example, a small proportion of a primarily offshore offering of ABS may be made available to U.S. investors pursuant to Section 4(2) of the Securities Act[47] or Securities Act Rule 144A.[48]

We recognize that Section 943 does not specify how its requirements apply to offshore transactions. As noted, consistent with Section 943, proposed Rule 15Ga-1 would require securitizers to disclose information about unregistered transactions, including those sold in unregistered transactions outside the United States. Securities that are sold in foreign markets and assets originated in foreign jurisdictions may be subject to different laws, regulations, customs and practices which can raise questions as to the appropriateness of the disclosures called for under Form ABS-15G. Although our proposed rules are required by the Act, and we believe the added protections of our rules would benefit investors who purchase securities in these offerings, we are mindful that the imposition of a filing requirement in connection with private placements of ABS in the United States may result in foreign securitizers seeking to avoid the filing requirement by excluding U.S. investors from purchasing portions of ABS primarily offered outside the United States, thus depriving U.S. investors of diversification and related investment opportunities.

Request for Comment:

25. Are there any extra or special considerations relating to these circumstances that we should take into account in our rules? Should our rules permit securitizers to exclude information from Form ABS-15G with respect to "foreign-offered ABS," and if so,

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47 15 U.S.C. 77d(2). Section 4(2) provides an exemption from registration for transactions by an issuer not involving any public offering.

48 Securities Act Rule 144A [17 CFR 230.144A] provides a safe harbor for a reseller of securities from being deemed an underwriter within the meaning of Sections 2(a)(11) and 4(1) of the Securities Act for the offer and sale of non-exchange listed securities to "qualified institutional buyers" (QIBs), as defined in Rule 144A.

should foreign-offered ABS be defined to include Exchange Act-ABS that were initially offered and sold in accordance with Regulation S, the payment to holders of which are made in non-U.S. currency, and have foreign assets (i.e., assets that are not originated in the U.S.) that comprise at least a majority of the value of the asset pool? For this purpose, should the foreign asset composition threshold be higher or lower (e.g., 40%, 60%, or 80%)? Would another definition be more appropriate?

26. Should our rules require securitizers that are foreign private issuers[49] to provide information on Form ABS-15G for those Exchange Act-ABS that are to be offered and sold in the United States pursuant to an exemption in an unregistered offering, as proposed? Instead should our rules only require disclosure about Exchange Act-ABS as to which more than a certain percentage (e.g., 5%, 10% or 20%) of any class of such Exchange Act-ABS are sold to U.S. persons?

B. Proposed Disclosure Requirements in Regulation AB Transactions

The requirements in Section 943 of the Act are in many ways quite similar to the Commission's proposal for additional disclosure regarding fulfilled and unfulfilled repurchase requests. In our 2010 ABS Proposing Release,[50] we proposed expanded disclosure regarding originators[51] and sponsors,[52] such as information for certain identified originators and the sponsor relating to the amount of the originator's or sponsor's publicly securitized assets that, in the last three years, has been the subject of a demand to repurchase

49 17 CFR 240.3b-4.

50 See Section V.A. of the 2010 ABS Proposing Release.

51 See previously proposed Item 1110(c) of Regulation AB in the 2010 ABS Proposing Release.

52 See previously proposed Item 1104(f) of Regulation AB in the 2010 ABS Proposing Release.

or replace.[53] However, the Commission's proposals would only apply to registered offerings and would only require disclosure about other registered offerings, if material. In contrast, as we discuss in our proposals above, Section 943 of the Act requires similar but expanded disclosure by requiring that any securitizer of Exchange Act-ABS disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by securitizer, so that investors may identify asset originators with clear underwriting deficiencies.[54] In order to conform our 2010 ABS proposals to the rule proposed today to implement Section 943 of the Act, we are re-proposing our previous proposals for Regulation AB with respect to disclosures regarding sponsors in prospectuses and with respect to disclosures about the asset pool in periodic reports, so that issuers would be required to include the disclosures in the same format as required by proposed Rule 15Ga-1(a).[55] Under our revised proposals, issuers of Reg AB-ABS would need to provide disclosures in the same format as proposed Rule 15Ga-1(a) within a prospectus and within ongoing reports on Form 10-D as described below. As we

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53 The proposal would amend Regulation AB to require sponsors and originators (of greater than 20% of the assets underlying the pool) to disclose the amount, if material, of publicly securitized assets originated or sold by the sponsor that were the subject of a demand to repurchase or replace for breach of the representations and warranties concerning the pool assets that has been made in the prior three years pursuant to the transaction agreements on a pool by pool basis as well as the percentage of that amount that were not then repurchased or replaced by the sponsor. Of those assets that were not then repurchased or replaced, disclosure would be required regarding whether an opinion of a third party not affiliated with the sponsor/originator had been furnished to the trustee that confirms that the assets did not violate the representations and warranties. See proposed Items 1104(f), 1110(c) and 1121(c) of Regulation AB in the 2010 ABS Proposing Release.

54 See Section 943 of the Act. We note that several commentators on the 2010 ABS Proposing Release expressed concerns about the difficulty of producing data to comply with the proposed requirement to report three years of repurchase activity. See e.g., letters of ASF, Bank of America, Financial Services Roundtable and Mortgage Bankers Association. However, in light of the requirements of Section 943 of the Act, we continue to believe that the information is important to include in prospectuses.

55 As discussed above, in the 2010 ABS Proposing Release, we proposed to amend Item 1110(c) of Regulation AB to require originators (of greater than 20% of the assets underlying the pool) to disclose the amount, if material, of publicly securitized assets originated or sold by the sponsor that were the subject of a demand to repurchase or replace for breach of the representations and warranties concerning the pool assets that has been made in the prior three years pursuant to the transaction agreements on a pool by pool basis as well as the percentage of that amount that were not then repurchased or replaced by the sponsor. That proposal remains outstanding.

stated in the 2010 ABS Proposing Release, we believe that investors must be able to readily access and understand the information for a specific offering.[56] Consistent with that belief, we are proposing that certain repurchase history should be presented in the body of the prospectus and within ongoing reports in order to facilitate investor understanding and eliminate the need to locate all of the information that may be disclosed elsewhere and by a different party. Even though our proposals discussed above would require securitizers to provide repurchase history on Form ABS-15G, we believe that issuers should provide a subset of that information to investors in the body of a prospectus or a periodic report.[57] However, the obligation of an issuer to provide the disclosures in prospectuses and in ongoing reports under our proposed changes to Regulation AB would be independent from, and would not alleviate the disclosure obligations of a securitizer under, proposed Rule 15Ga-1.

We are revising and re-proposing our previous proposal to amend Item 1104 of Regulation AB. As noted above, the Commission's previous proposals applied to disclosure of a sponsor's repurchase demand and repurchase and replacement history concerning the last three years with respect to other registered transactions, if material. In order to conform our previous proposal to the format of the information that would be provided by the rule proposed today to implement Section 943 of the Act, we are proposing that if the underlying

[56] In the 2010 ABS Proposing Release, we proposed that issuers provide all disclosures in one prospectus, instead of the current practice of providing information in a base prospectus and prospectus supplement to address concerns that the base and supplement format resulted in unwieldy documents with excessive and inapplicable disclosure that is not useful to investors. See Section II.D.1 of the 2010 ABS Proposing Release.

[57] We are not proposing that issuers include all of the information that would be required of a securitizer under proposed Rule 15Ga-1 in prospectuses because information about other asset classes and information older than three years may make the size of the prospectus unwieldy and investors should have ready access to more current information. We are also not proposing that issuers include all of the proposed Rule 15Ga-1 in Form 10-Ds for the same reasons, and because the purpose of Form 10-D is to provide periodic performance of a specific asset pool.

transaction agreements provide a covenant to repurchase or replace an underlying asset for breach of a representation or warranty, then issuers would be required to provide in the body of the prospectus disclosure of a sponsor's repurchase demand and repurchase and replacement history for the last three years, pursuant to the format proscribed in proposed Rule 15Ga-1(a). In addition, we are also proposing to limit the disclosure required in the prospectus to repurchase history for the same asset class as the securities being registered. We are also excluding the materiality threshold that was previously proposed as Section 943 includes no such standard. Also, because we believe the complete historical information about repurchase activity may be useful to investors, an issuer would be required to reference the Form ABS-15G filings made by the securitizer (i.e., sponsor) of the transaction and disclose the CIK number of the securitizer so that investors may easily locate Form ABS-15G filings on EDGAR.

Our previous proposal would amend Item 1121 of Regulation AB so that issuers would be required to disclose the repurchase demand and repurchase and replacement history with respect to assets that underlie a particular ABS on an ongoing basis in periodic reports on Form 10-D, if material.[58] We are revising and re-proposing our previous proposal to require that issuers provide in Form 10-D, repurchase demand and repurchase and replacement disclosure regarding the assets in the pool in the format prescribed by proposed Rule 15Ga-1(a). In order to conform our previous proposal to the rule proposed today to implement Section 943 of the Act, we are also excluding the materiality threshold that was previously proposed. Because we believe the complete historical information about repurchase activity may be useful to investors, the Form 10-D would also be required to

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[58] See previously proposed Item 1121(c) and Section V.A. of the 2010 ABS Proposing Release.

include a reference to the Form ABS-15G filings made by the securitizer of the transaction and disclose the CIK number of the securitizer so that investors may easily locate Form ABS-15G filings on EDGAR. As discussed above, providing repurchase history disclosure for a particular pool in Form 10-D, is independent from and would not alleviate a securitizer's obligation to disclose ongoing information for all of their transactions as required by proposed Rule 15Ga-1.

Request for Comment:

27. Is our re-proposal to require disclosure pursuant to the format prescribed in Rule 15Ga-1(a) for the same asset class in prospectuses and for pool assets in periodic reports appropriate? Is it appropriate to limit the disclosure in prospectuses to the last three years of activity, as proposed? Would a different period (e.g., one or five years) be more appropriate?
28. Is it appropriate to omit a materiality requirement for disclosures in prospectuses, as proposed? What issues would arise by creating two different disclosure standards between what would be required to be disclosed in prospectuses and what would be disclosed by securitizers on Form ABS-15G? Are there any ways to address those issues?
29. Should we permit issuers to incorporate the repurchase demand and repurchase and replacement disclosure by reference from Form ABS-15G, instead of requiring that it be provided in the body of the prospectus or Form 10-D? Would it be burdensome for investors to search elsewhere to locate disclosure that would otherwise be included in a prospectus?

30. In the 2010 ABS Proposing Release, the Commission also proposed that originators of over 20% of the pool assets provide disclosure regarding the fulfilled and unfulfilled repurchase requests on a pool by pool basis for publicly securitized assets.[59] If we were to adopt that proposal, should we make any changes to conform that proposal given the information that would be required by proposed Rule 15Ga-1(a)? For example, should that information be provided in the same format as proposed Rule 15Ga-1(a) and should we require disclosures with respect to all originators of the pool assets?[60] Or is disclosure unnecessary in light of the other disclosures required by proposed Rule 15Ga-1?

C. Proposed Disclosure Requirements for NRSROs

We are proposing to add new Exchange Act Rule 17g-7, which would implement Section 943(1) of the Act by requiring an NRSRO to make certain disclosures in any report accompanying a credit rating relating to an asset-backed security.[61] Specifically, in

59 See proposed Item 1110(c) of Regulation AB in the 2010 ABS Proposing Release.

60 Originators may sell their assets to multiple securitizers. Proposed Rule 15Ga-1 would not require securitizers to disclose the demand, repurchase and replacement activity across all trusts across multiple securitizers that may contain an originator's assets. For example, under proposed Rule 15Ga-1, if securitizers A, B and C securitize the loans of an originator, Securitizer A would only need to disclose the fulfilled and unfulfilled repurchase request activity with respect to loans with respect to Securitizer A securitizations. As we discuss above, proposed Rule 15Ga-1 would require disclosure that indicates the name of the originator in order to permit "investors [to] identify asset originators with clear underwriting deficiencies," as required by Section 943 of the Act.

61 In June 2008, the SEC proposed a new Rule 17g-7 that would have required an NRSRO to publish a report containing certain information each time the NRSRO published a credit rating for a structured finance product or, as an alternative, use ratings symbols for structured finance products that differentiated them from the credit ratings for other types of debt securities. See Exchange Act Release No. 57967 (June 16, 2008), [73 FR 36212]. In November 2009, the SEC announced that it was deferring consideration of action on that proposal and separately proposed a new Rule 17g-7 to require annual disclosure by NRSROs of certain information. See Proposed Rules for Nationally Recognized Statistical Rating Organizations, SEC Release 34–61051 (November 23, 2009), [74 FR 63866]. Although we are proposing a new rule with the same rule number, that proposal remains outstanding.

accordance with Section 943(1), Rule 17g-7 would require an NRSRO[62] to include a description of the representations, warranties and enforcement mechanisms available to investors and a description of how they differ from the representations, warranties and enforcement mechanisms in issuances of similar securities.[63] As discussed above, the Act also amended the Exchange Act to include the definition of an "asset-backed security" and Section 943 of the Act references that definition.[64] Therefore, Rule 17g-7 would provide that the NRSRO must provide the disclosures with respect to any Exchange Act-ABS, whether or not the security is offered in a transaction registered with the SEC.

Section 943, by its terms, applies to any report accompanying a credit rating for an ABS transaction, regardless of when or in what context such reports and credit ratings are issued. Proposed Rule 17g-7 is intended to reflect the broad scope of this congressional mandate. In addition, we are proposing a note to the proposed rule which would clarify that for the purposes of the proposed rule, a "credit rating" would include any expected or preliminary credit rating issued by an NRSRO.[65] In ABS transactions, pre-sale reports are typically issued by an NRSRO at the time the issuer commences the offering and typically include an expected or preliminary credit rating and a summary of the important features of a

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62 Current Item 1111(e) of Regulation AB [17 CFR 1111(e)] already requires issuers to disclose the representations and warranties related to the transaction in prospectuses. Additionally, in the 2010 ABS Proposing Release, the Commission proposed changes to this item to require a description of any representation and warranty relating to fraud in the origination of the assets, and a statement if there is no such representation or warranty.

63 As discussed further in Section V.B.6. below, we anticipate that one way an NRSRO could fulfill the requirement to describe how representations, warranties and enforcement mechanisms differ from those provided in similar securities would be to review previous issuances both on an initial and an ongoing basis in order to establish "benchmarks" for various types of securities and revise them as appropriate.

64 See Section 3(a)(77) of the Exchange Act, as amended by the Act.

65 We intend the term "preliminary credit rating" to include any rating, any range of ratings, or any other indications of a rating used prior to the assignment of an initial credit rating for a new issuance. See generally Credit Ratings Disclosure, SEC Release No. 33–9070 (October 7, 2009) [74 FR 53086].

transaction. Disclosure at the time pre-sale reports are issued is particularly important to investors, since such reports provide them with important information prior to the point at which they make an investment decision.[66]

Request for Comment:

31. The Act and our proposed new Rule 17g-7 require disclosure of how the representations, warranties and enforcement mechanisms in a particular deal differ from the representations, warranties and enforcement mechanisms in the issuance of similar securities. We are not specifying in this release a definition for the term "similar securities." Should we define "similar securities"? If so, how should it be defined? Should similar securities be defined by underlying asset classes (i.e., residential mortgages, commercial mortgages, auto loans, or auto leases, etc.)? Or should the distinction be narrower (i.e., prime residential mortgages, Alt-A residential mortgages, or subprime residential mortgages)? Or by sponsor (Originator A or Originator B, etc.)? Or by other ABS rated by the same NRSRO?
32. Section 932 of the Act further amends the Exchange Act by adding a new paragraph (s) to Section 15E requiring a form to accompany the publication of each credit rating that discloses certain information and requiring that we adopt rules requiring NRSROs to prescribe and use such a form. Would it be appropriate to require the

[66] We further note that Section 932 of the Act amends Section 15E of the Exchange Act to require a form to accompany the publication of each credit rating that discloses certain information. For the purposes of Section 943 and proposed Rule 17g-7, such a form would clearly be a "report" and its publication would therefore require the necessary disclosures regarding representations, warranties and enforcement mechanisms available to investors. The Commission has one year to adopt rules requiring NRSROs to prescribe and use a form to make certain required disclosures, whereas the Rule 17g-7 disclosures that we are proposing in this release must be prescribed within 180 days from the date of enactment of the Act. See Section 937 of the Act. Given that Sections 932 and 943 both mandate rules requiring NRSROs to disclose information, we solicit comment below on whether the proposed Rule 17g-7 disclosure should eventually be scoped into proposals we will issue under Section 932 regarding the disclosure that would need to be made by an NRSRO in the form accompanying the publication of each credit rating.

inclusion of the disclosures about representations, warranties and enforcement mechanisms required under proposed Rule 17g-7 in the form used to make the disclosures that will be required under rules adopted pursuant to Exchange Act Section 15E(s)? Are there any timing issues that we should take into account in determining whether to do so?

33. Should we require the proposed disclosure to include comparisons to industry standards in addition to similar securities? For instance, one organization has published model standards for representation, warranties and enforcement mechanisms with respect to residential mortgage backed securities.[67] What would be an industry standard for other asset classes?

34. Is there any reason not to consider an expected or preliminary credit rating to be a "credit rating" for the purposes of the proposed rule? If so, why?

35. In the case of a registered ABS transaction, should we allow NRSROs to satisfy the requirement to disclose representations, warranties and enforcement mechanisms by referring to disclosure about those matters that is included in a prospectus prepared by an issuer?

36. Rule 17g-5, among other things, is designed to facilitate the performance of unsolicited credit ratings for structured finance products by providing a mechanism for NRSROs not hired by arrangers of structured finance products to obtain the same

[67] For example, the ASF has proposed model representations and warranties designed to enhance the alignment of incentives of mortgage originators with those of investors in mortgage loans. See American Securitization Forum Press Release, "ASF Proposes Risk Retention and Issues Final RMBS Disclosure and Reporting Packages," July 15, 2009, available at http://www.americansecuritization.com/ story.aspx?id=3460.

information provided to NRSROs hired by such arrangers to rate those products.[68] As such, non-hired NRSROs performing unsolicited credit ratings pursuant to the Rule 17g-5 mechanism would have access to the same information on a transaction's representations, warranties, and enforcement mechanisms at the same time as hired NRSROs. However, in the event that a non-hired NRSRO elected to perform an unsolicited credit rating not pursuant to Rule 17g-5, it would likely not have access to such information until it was made public. It is the Commission's understanding that prior to the introduction of the Rule 17g-5 mechanism described above, NRSROs rarely, if ever, performed unsolicited credit ratings for structured finance products. Given the availability of the Rule 17g-5 mechanism, is it likely that any NRSROs would perform unsolicited credit ratings for structured finance products in the future without relying on that mechanism to obtain information from securitizers? If so, would such NRSROs be able to comply with proposed Rule 17g-7? Would it be appropriate for such NRSROs to include an explanatory note accompanying the disclosures required by proposed Rule 17g-7 indicating that such disclosures were based only on publicly available information?

III. Transition Period

We are considering the appropriate timing for compliance and effectiveness of the proposals, if adopted, and request that commentators provide input about feasible dates for implementation of the proposed amendments. We currently anticipate that, if adopted, the new and amended rules would apply to all securitizers and NRSROs related to new

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68 See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, SEC Release 34-61050 (November 23, 2009), [74 FR 63832].

issuances, including takedowns off of existing shelf registration statements, of Exchange Act-ABS. However, we note that Rule 15Ga-1, as proposed, would require disclosures about the repurchase demands and repurchases and replacements that occurred prior to the effective date of the new requirements.

Request for Comment

37. Should implementation of any proposals be phased-in? If so, explain why and describe the timeframe needed for a phase-in (e.g., six months, one or two years) and basis for such period?
38. Should implementation be based on a tiered approach that relates to a characteristic such as the size of the securitizer? Is there any reason to structure implementation around asset class of the securities? Because a reporting structure is already available for registered transactions, should prospectuses and periodic reports be required to include the demand, repurchase and replacement disclosures, as provided by our proposals to amend Items 1104 and Item 1121 of Regulation AB, before Form ABS-15G is implemented?

IV. General Request for Comments

We request comment on the specific issues we discuss in this release, and on any other approaches or issues that we should consider in connection with the proposed amendments. We seek comment from any interested persons, including investors, securitizers, asset-backed issuers, sponsors, originators, servicers, trustees, disseminators of EDGAR data, industry analysts, EDGAR filing agents, and any other members of the public.

V. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rule amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).[69] The Commission is submitting these proposed amendments and proposed rules to the Office of Management and Budget (OMB) for review in accordance with the PRA.[70] An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:[71]

(1) "Form ABS-15G" (a proposed new collection of information);

(2) "Regulation S-K" (OMB Control No. 3235-0071); and

(3) "Rule 17g-7" (a proposed new collection of information).

The regulation listed in No. 2 was adopted under the Securities Act and the Exchange Act and sets forth the disclosure requirements for registration statements and periodic and current reports filed with respect to asset-backed securities and other types of securities to inform investors.

The regulations and forms listed in Nos. 1 and 3 are newly proposed collections of information under the Act. Rule 15Ga-1 would require securitizers to provide disclosure regarding all fulfilled and unfulfilled repurchase requests with respect to Exchange Act-ABS

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69 44 U.S.C. 3501 <u>et seq</u>.

70 44 U.S.C. 3507(d) and 5 CFR 1320.11.

71 The paperwork burden from Regulation S-K is imposed through the forms that are subject to the requirements in those regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to Regulation S-K.

pursuant to the Act. Form ABS-15G would contain Rule 15Ga-1 disclosures and be filed with the Commission. Rule 17g-7 would require NRSROs to provide disclosure regarding representations, warranties, and enforcement mechanisms available to investors in any report accompanying a credit rating issued by an NRSRO in connection with an Exchange Act-ABS transaction.

Compliance with the proposed amendments would be mandatory. Responses to the information collections would not be kept confidential and there would be no mandatory retention period for proposed collections of information.

B. PRA Reporting and Cost Burden Estimates

Our PRA burden estimates for the proposed amendments are based on information that we receive on entities assigned to Standard Industrial Classification Code 6189, the code used with respect to asset-backed securities, as well as information from outside data sources.[72] When possible, we base our estimates on an average of the data that we have available for years 2004, 2005, 2006, 2007, 2008, and 2009.

In adopting rules under the Credit Rating Agency Reform Act of 2006 ("the Rating Agency Act"),[73] as well as proposing additional rules in November 2009, we estimated that approximately 30 credit rating agencies would be registered as NRSROs.[74]

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72 We rely on two outside sources of ABS issuance data. We use the ABS issuance data from Asset-Backed Alert on the initial terms of offerings, and we supplement that data with information from Securities Data Corporation (SDC).

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

74 See e.g., Section VIII of Proposed Rules for Nationally Recognized Statistical Rating Organizations, SEC Release 34–61051 (December 4, 2009) [74 FR 63866].

1. Form ABS-15G

This new collection of information relates to proposed disclosure requirements for securitizers that offer Exchange Act-ABS. Under the proposed amendments, such securitizers would be required to disclose demand, repurchase and replacement history with respect to pool assets across all trusts aggregated by securitizer. The new information would be required at the time a securitizer offers Exchange Act-ABS after the implementation of the proposed rule, and then monthly, on an ongoing basis as long as the securitizer has Exchange Act-ABS outstanding held by non-affiliates. The disclosures would be filed on EDGAR on proposed Form ABS-15G. We believe that the costs of implementation would include costs of collecting the historical information, software costs, costs of maintaining the required information, and costs of preparing and filing the form. Although the proposed requirements apply to securitizers, which by definition would include sponsors and issuers, we base our estimates on the number of unique ABS sponsors because we are also proposing that issuers affiliated with a sponsor would not have to file a separate Form ABS-15G to provide the same proposed Rule 15Ga-1 disclosures. We base our estimates on the number of unique ABS securitizers (i.e., sponsors) over 2004-2009, which was 540, for an average of 90 unique securitizers per year.[75] We base our burden estimates for this collection of information on the assumption that most of the costs of implementation would be incurred before the securitizer files its first Form ABS-15G. Because ABS issuers currently have access to systems that track the performance of the assets in a pool we believe that securitizers should also have access to information regarding whether an asset had been repurchase or replaced. However, securitizers may not have historically collected the

75 We base the number of unique sponsors on data from SDC.

information and systems may not currently be in place to track when a demand has been made,[76] and in particular, systems may not be in place to track those demands made by investors upon trustees. Therefore, securitizers would incur a one-time cost to compile historical information in systems. Furthermore, the burden to collect and compile the historical information may vary significantly between securitizers, due to the number of asset classes and number of ABS issued by a securitizer.

We estimate that a securitizer would incur a one-time setup cost for the initial filing of 972 hours to collect and compile historical information and adjust its existing systems to collect and provide the required information going forward.[77] Therefore, we estimate that it would take a total of 87,480 hours for a securitizer to set up the mechanisms to file the initial Rule 15Ga-1 disclosures.[78] We allocate 75% of these hours (65,610 hours) to internal burden for all securitizers. For the remaining 25% of these hours (21,870 hours), we use an estimate of $400 per hour for external costs for retaining outside professionals totaling $8,748,000.

After a securitizer has made the necessary adjustments to its systems in connection with the proposed rule and, after an initial filing of Form ABS-15G disclosures has been made, we estimate that each subsequent filing of Form ABS-15G to disclose ongoing information by a securitizer will take approximately 30 hours to prepare, review and file. We

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76 See e.g., comment letters from ASF, Bank of America, Financial Services Roundtable and the Mortgage Bankers Association on the 2010 ABS Proposing Release.

77 The value of 972 hours for setup costs is based on staff experience. We estimate that 672 of those hours will be to set up systems to track the information and is calculated using an estimate of two computer programmers for two months, which equals 21 days per month times two employees times two months times eight hours per day.

78 972 hours to adjust existing systems per securitizer X 90 average number of unique securitizers.

estimate, for PRA purposes, that the number of Form ABS-15G filings per year will be 1,620.[79]

Therefore, after the initial filing is made, we estimate the total annual burden hours for preparing and filing the disclosure will be 48,600 hours.[80] We allocate 75% of those hours (36,450 hours) to internal burden hours for all securitizers and 25% of those hours (12,150 hours) for professional costs totaling $400 per hour of external costs of retaining outside professionals totaling $ 4,860,000. Therefore, the total internal burden hours are 102,060[81] and the total external costs are $13,608,000.[82]

2. Rule 15Ga-1

Rule 15Ga-1 contains the requirements for disclosure that a securitizer must provide in Form15G-ABS filings described above. The collection of information requirements, however, are reflected in the burden hours estimated for Form ABS-15G, therefore, Rule 15Ga-1 does not impose any separate burden. Therefore, we have not included additional burdens for proposed Rule 15Ga-1.

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[79] The Form ABS-15G is required to be filed on a monthly basis; however, we are estimating that, in the first year after implementation, the number of Form ABS-15G per year would be a multiple of six times the number of unique securitizers per year since the obligation to initially file Form ABS-15G is an offering of Exchange Act-ABS, which could happen at any time of the year. Therefore, in the first year of implementation, a securitizer would most likely not be obligated to file Form ABS-15G for the full 12 months. Thus, we estimate the total number of Form ABS-15G to be filed in the first year after implementation to be 540 (90 unique securitizers year one X 6).

In the second year after implementation, we estimate the number of Form ABS-15G to be filed will be 1080 for a total of 1,620 (90 unique securitizers year one X 12) + (90 unique securitizers year two X 6). In the third year after implementation, we estimate the number of Form ABS-15G to be filed will be 2,160 for a total of 2,700 (90 unique securitizers year one X 12) + (90 unique securitizers year two X 12) + (90 unique securitizers year three X 6). The total number of Forms 15G-ABS over three years, would therefore be 4,860. Therefore, for PRA purposes, we estimate an annual average of 1,620 Form ABS-15G filings.

[80] 30 hours X 1,620 forms.

[81] 65,610 hours + 36,450 hours.

[82] $8,748,000 + $4,860,000.

3. Forms S-1 and S-3

We are proposing that asset-backed securities offered on Forms S-1 and S-3 include the required Rule 15Ga-1 disclosures for the same asset class in registration statements. The burden for the collection of information is reflected in the burden hours for Form ABS-15G filed by a securitizer; however, Forms S-1 and S-3 are filed by asset-backed issuers, and issuers may include only a portion of the information in the prospectus. Therefore, we have not included additional burdens for Forms S-1 and S-3.

4. Form 10-D

In 2004, we adopted Form 10-D as a new form limited to asset-backed issuers. This form is filed within 15 days of each required distribution date on the asset-backed securities, as specified in the governing documents for such securities. The form contains periodic distribution and pool performance information.

We are proposing that issuers of registered ABS include the proposed Rule 15Ga-1 disclosures for only the pool assets on Form 10-D. However, because the burden for the collection of information is reflected in the burden hours for Form ABS-15G, we have not included additional burdens for Form 10-D.

5. Regulation S-K

Regulation S-K, which includes the item requirements in Regulation AB, contains the requirements for disclosure that an issuer must provide in filings under both the Securities Act and the Exchange Act. In 2004, we noted that the collection of information requirements associated with Regulation S-K as it applies to ABS issuers are included in Form S-1, Form S-3, Form 10-K and Form 8-K. We have retained an estimate of one burden hour to

Regulation S-K for administrative convenience to reflect that the changes to the regulation did not impose a direct burden on companies.[83]

The proposed changes would make revisions to Regulation S-K. The collection of information requirements, however, are reflected in the burden hours estimated for the various Securities Act and Exchange Act forms related to ABS issuers. The rules in Regulation S-K do not impose any separate burden. Consistent with historical practice, we have retained an estimate of one burden hour to Regulation S-K for administrative convenience.

6. Rule 17g-7

This new collection of information relates to proposed disclosure requirements for NRSROs. Under the proposed amendments, an NRSRO would be required to disclose in any report accompanying a credit rating the representations, warranties and enforcement mechanisms available to investors and describe how they differ from those in issuances of similar securities. We believe that the costs of implementation would include the cost of preparing the report and maintaining the information. In addition, it is our understanding that the disclosures and drafts of transaction agreements that contain the representations, warranties and enforcement mechanisms related to an ABS transaction are prepared by the issuer and made available to NRSROs during the rating process. We estimate it would take 1 hour per ABS transaction to review the relevant disclosures prepared by an issuer, which an NRSRO would presumably have reviewed as part of the rating process, and convert those disclosures into a format suitable for inclusion in any report to be issued by an NRSRO. The proposed rule would also require an NRSRO to include disclosures describing how the

83 See the 2004 ABS Adopting Release.

representations, warranties and enforcement mechanisms differ from those provided in similar securities. Although we are not prescribing how an NRSRO must fulfill this requirement, we anticipate that one way an NRSRO could do so would be to review previous issuances both on an initial and an ongoing basis in order to establish "benchmarks" for various types of securities and revise them as appropriate. We expect that an NRSRO would incur an initial setup cost to collect, maintain and analyze previous issuances to establish benchmarks as well as an ongoing cost to review the benchmarks to ensure that they remain appropriate. We estimate that the initial review and set up system cost will take 100 hours and that NRSROs will spend an additional 100 hours per year revising the various benchmarks. Therefore, we estimate it would take a total of 3,000 hours[84] for NRSROs to set up systems and an additional 3,000 hours per year revising various benchmarks.[85]

On a deal-by-deal basis, we estimate it would take an NRSRO 10 hours per ABS transaction to compare the terms of the current deal to those of similar securities. Because NRSROs would need to provide the disclosures in connection with the issuance of a credit rating on a particular offering of ABS, we base our estimates on an annual average of 2,067 ABS offerings.[86] Typically, the terms of the transaction agreements condition the issuance of an ABS on a credit rating, and generally, two credit ratings are required, resulting in the hiring of two NRSROs per transaction, although some may only require one credit rating and thus the hiring of one NRSRO. However, we anticipate that our recent amendments to Rule

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84 100 hours X 30 NRSROs.

85 100 hours X 30 NRSROs.

86 The annual average number of registered offerings was 958 and the annual average number of Rule 144A ABS offerings was 716 for an estimated annual average of 1,674 over the period 2004-2009. See Section X. of the 2010 ABS Proposing Release. We also add 393 to estimate for offerings under other exemptions that were not within the scope of the 2010 ABS Proposing Release. Thus, in total we use an estimated annual average number of 2,067 ABS offerings for the basis of our PRA burden estimates.

17g-5, which provide a mechanism for allowing non-hired NRSROs to obtain the same information provided to NRSROs hired to rate structured finance transactions, will promote the issuance of credit ratings by NRSROs that are not hired by the arranger.[87] As a result, we assign 4 to the number of credit ratings per issuance of ABS, based on an average of two NRSROs preparing two reports (pre-sale and final) for each transaction. Therefore, we estimate that it would take a total of 90,948 hours, annually, for NRSROs to provide the proposed Rule 17g-7 disclosures.[88]

7. Summary of Proposed Changes to Annual Burden Compliance in Collection of Information

Table 1 illustrates the annual compliance burden of the collection of information in hours and costs for the new proposed disclosure requirements for securitizers and NRSROs. Below, the proposed Rule 15Ga-1 requirement for securitizers is noted as "Form ABS-15G" and the proposed requirement for NRSROs is noted as "17g-7."

Form	Current Annual Responses	Proposed Annual Responses	Current Burden Hours	Decrease or Increase in Burden Hours	Proposed Burden Hours	Current Professional Costs	Decrease or Increase in Professional Costs	Proposed Professional Costs
Form ABS-15G	-	1,620	-	102,060	102,060	-	13,608,000	13,608,000
17g-7	-	8,268	-	96,948	96,948		-	-

8. Solicitation of Comments

We request comments in order to evaluate: (1) whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility; (2) the accuracy of our estimate of the

87 See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, SEC Release 34-61050 (November 23, 2009), [74 FR 63832].

88 4 reports X 2,067 ABS offerings X 11 hours (1 hour to review disclosures + 10 hours to compare and prepare).

burden of the proposed collection of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.[89] In addition, we specifically ask whether it is appropriate to assume, as we have, that for the purposes of preparing the required disclosures describing how the representations, warranties and enforcement mechanisms differ from those provided in similar securities NRSROs would review previous issuances both on an initial and an ongoing basis in order to establish "benchmarks" for various types of securities and revise them as appropriate? Would NRSROs use other means to prepare the required comparisons, for example, reviewing previous issuances on a de novo basis for every ABS transaction?

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-24-10. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-24-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549. OMB is required to make a decision concerning

89 We request comment pursuant to 44 U.S.C. 3506(c)(2)(B).

the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Benefit-Cost Analysis

The Act requires us to implement the requirements discussed in this release. These changes will affect all securitizers of Exchange Act-ABS, including unregistered Exchange Act-ABS, and NRSROs that provide credit ratings on Exchange Act-ABS. Further, the proposed rules would also require historical information with respect to Exchange Act-ABS issued by a securitizer. We also re-propose disclosure requirements with respect to repurchase requests in Regulation AB in order to conform disclosures that we previously proposed under our 2010 ABS Proposals to those required by Section 943 of the Act.

We are sensitive to benefits and costs of the proposed rules, if adopted. We discuss these benefits and costs below. We request that commentators provide their views along with supporting data as to the benefits and costs of the proposed amendments.

A. Benefits

The proposals seek to fulfill the Act's objective to provide greater transparency regarding the use of representations and warranties in ABS transactions in both the registered and unregistered ABS markets. The recent financial crisis has revealed various problems with existing representation, warranty and enforcement provisions. Poor underwriting standards coupled with unenforceable representations and warranties by securitizers exacerbated investors losses in ABS.[90] Increasing transparency regarding all demands for

[90] See, e.g., N. Timiaros and Aparajita Saha-Bubna "Banks Face Fight Over Mortgage Loan Buybacks," Wall Street Journal (Aug. 18, 2010); and Alistair Barr, "Loan repurchases are a $10 billion problem for big

repurchases and replacements, including investor demands upon a trustee, will help investors and market participants identify originators with clear underwriting deficiencies. By having better information to judge the origination and underwriting quality of the assets that were previously securitized, investors can make more informed investment decisions.

The proposals may strengthen the incentives for securitizers to improve origination and underwriting standards and to refrain from securitizing assets that do not meet stated representations. In addition, following a securitization, securitizers may have stronger incentives to fulfill repurchase and replacement demands properly. We also propose to limit the scope of the disclosures to outstanding Exchange Act-ABS, and in the initial filing to the last five years of demand, repurchase and replacement history in order to ameliorate costs to securitizers, and still provide information so that investors may identify originators with underwriting deficiencies.

We are proposing to require that the disclosures be filed on EDGAR on new Form ABS-15G. By requiring the proposed Form ABS-15G to be filed on EDGAR, the information proposed to be required would be housed in a central repository that would preserve continuous access to the information. After the initial filing, securitizers would be required to file Form ABS-15G, periodically, on a monthly basis with updated information, so that consistent with the purpose of Section 943 of the Act, an investor may monitor the demand, repurchase and replacement activity across all Exchange Act-ABS issued by a securitizer.

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banks," (Feb. 3, 2010) available at http://www.marketwatch.com/story/banks-10-billion-problem-loan-repurchases-2010-02-03.

If an ABS is rated, the proposals would require more disclosures by NRSROs about the representations, warranties and enforcement mechanisms available to investors, and how they differ from those of other similar securities. The proposed disclosures will enhance the comparability of information across issuers in a relatively efficient manner by centralizing this disclosure in NRSRO reports. As a result, these disclosures will possibly expand the information available to investors and improve transparency regarding the use of representations and warranties in ABS transactions.

As a result, proposed Rules 15Ga-1 and 17g-7 disclosures are likely to help investors more accurately evaluate and price initial offerings and existing issues of ABS securities and in turn, are likely to improve capital allocation in both the markets for ABS and the original loan markets that back those ABS. Further, the proposed rules would require disclosures regarding the registered and unregistered transactions, thus extending the benefits of disclosure to the unregistered market. While it is difficult to quantify the benefits listed above, they are likely to be substantial in light of the recent financial crisis.

B. Costs

The proposals would implement the Act's requirement on securitizers to disclose the repurchase and replacement demands resulting from breaches of representations and warranties in past ABS transactions initially, for the last five years and then updated disclosures going forward on a monthly basis. We understand that some of the data collection may be costly. In some cases, it may be very difficult to obtain repurchase or replacement records from the distant past.[91] However, we believe that the information about whether an asset had been repurchased or replaced from recent years should be accessible by

[91] See discussion in Section II.A. 3.

issuers of outstanding ABS, because the current servicing history of the underlying assets would still be accessible on servicers' systems. However, systems may not currently be in place to track when a demand has been made and therefore, securitizers may incur a significant one-time cost to collect and compile historical information and that cost may vary substantially between securitizers, due to the number of asset classes and number of ABS issued by a securitizer. In addition to the costs on a securitizer, trustees would also incur costs of tracking investor demands upon the trustee. We also expect that the cost of compiling and reporting this information would require a one-time set up cost to adjust existing systems to compile the initial historical information. Additionally, under the proposal, the securitizer would incur additional costs to satisfy the obligation to file ongoing monthly reports on EDGAR of repurchase demand and repurchase and replacement activity. Filing on EDGAR would require a securitizer to obtain authorization codes and to adhere to formatting instructions. The Act does not specify the periodicity with which information should be provided so that investors may identify originators with clear underwriting deficiencies. However, we believe that monthly reporting would provide a better picture of repurchase activity and a shorter interval might be too burdensome. Also, many ABS pay distributions to investors monthly and likewise, the related transaction agreements, including in unregistered transactions, typically provide for monthly reporting to investors. Therefore, because most securitizers would most likely be accustomed to preparing and providing monthly disclosures, we anticipate that it may be less costly than providing the disclosures at any other interval. However, any securitizers that do not make payments or provide reporting on a monthly basis may find it costlier to prepare the proposed disclosures.

Indirectly, as we discussed in the 2010 ABS Proposing Release, disclosures about an originator's or a sponsor's refusal to repurchase or replace assets put back to them for breach of representations and warranties might create incentives for originators to agree to repurchase or replace such assets even in cases where these assets were not clearly in breach. If investors regard such disclosures as indicative of a willingness to comply with representations and warranties in the future, then originators or sponsors might try to preserve their reputation by taking back assets even when they do not have an obligation to do so. This might create an incentive for sponsors and possibly trustees to ask for repurchase or replacement of poorly performing assets that represent no breach of representations and warranties.[92] However, securitizers may devise other disclosures and mechanisms to solve such problems in the long-run, if they occur.

In the aggregate, the proposed requirements are likely to affect unregistered ABS more significantly because traditionally these securities have provided less disclosure. Since, as discussed previously, the Act requires disclosures with respect to all ABS issued by a securitizer, registered and unregistered, the initial and ongoing disclosures may significantly increase the direct and particularly indirect costs of issuing unregistered ABS relative to their historical cost structure. The indirect costs include the possibility of revealing information about the quality of assets to competitors. A possible effect of these requirements is that such issuers may look towards alternative forms of financing. Given that those issuers have historically preferred ABS issues, they may consider more expensive and less efficient forms

92 See Section XI.C.2. of the 2010 ABS Proposing Release. However, in certain situations, it may have the opposite effect, where the threat of such a disclosure requirement relating to an originator could induce a sponsor to be more reticent in pursuing repurchase claims where the originator may be affiliated with the sponsor. A sponsor may also be worried that a large number of successful repurchase claims could indicate that its initial due diligence, or the originator's loan quality, was poor. See letter from Commonwealth of Massachusetts Attorney General in response to the 2010 ABS Proposing Release.

of financing. Some of these incremental financing costs are likely to be passed to consumers and other borrowers whose loans make up the underlying pools backing the ABS. While it is difficult to quantify such incremental costs, researchers have estimated that securitization has generally been beneficial in banking and mortgage industries. However, other factors may be more determinative in deciding what form of financing a business will pursue.[93]

The proposals would also require NRSROs to disclose in any report accompanying a credit rating for an ABS transaction the representations, warranties and enforcement mechanisms available to investors and how they differ from those of other similar securities. NRSROs often issue a pre-sale report for ABS transactions that includes a preliminary credit rating as well as a summary of important features of a transaction; however, they do not usually provide disclosure of how representations and warranties would differ from other similar securities. We anticipate that in order to fulfill this requirement, NRSROs will incur a direct cost to review previous issuances both on an initial and an ongoing basis. In connection with that review, they may establish "benchmarks" for various types of securities and revise them as appropriate. To the extent that they have not already established such systems, we expect that an NRSRO would incur initial and ongoing costs to set up systems to collect maintain and analyze previous issuances to establish such benchmarks as well as an ongoing cost to review the benchmarks to ensure that they remain appropriate. An NRSRO may pass those costs onto the issuers and underwriters by building them into the costs it charges to provide a credit rating, which in turn could be passed on as an indirect cost onto

[93] See generally, Kashyap, A. and J. Stein (2000) "What Do a Million Observations on Banks Say About the Transmission of Monetary Policy," The American Economic Review, Vol. 90, No. 3, at 407-428 and Loutskina, E. and P. Strahan (2009) "Securitization and the declining impact of bank financial condition on loan supply: Evidence from mortgage originations," The Journal of Finance, Vol. 64, No. 2, at 861-889.

investors. We are not prescribing how an NRSRO must fulfill its responsibility to compare the terms of a deal to those of similar securities.

We believe that the proposed requirements are necessary to implement the purposes of the Act. For purposes of the Paperwork Reduction Act, we have estimated that the proposed paperwork/disclosure requirements on securitizers would result in an approximate burden of 102,060 internal hours and external cost of $13,608,000 paperwork/disclosure and the proposed requirement on NRSROs would result in an approximate burden of 96,948 internal hours. Additionally, we believe that the re-proposed requirements in Regulation AB on issuers would not impose a significant additional burden on asset-backed issuers because the disclosures would have already been prepared for purposes of filing on Form ABS-15G.

C. Request for Comment

We seek comments and empirical data on all aspects of this Benefit-Cost Analysis including identification and quantification of any additional benefits and costs. Specifically, we ask the following:

39. Are there other more cost-effective ways securitizers can provide the disclosure of fulfilled and unfulfilled repurchase requests consistent with the requirements of Section 943 of the Act?

VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a) of the Exchange Act[94] 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

[94] 15 U.S.C. 78w(a).

impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The proposed amendments implement the Act and the re-proposals amend Regulation AB in order to conform the disclosures that would be required under our 2010 ABS Proposals to those required by Section 943 of the Act. The amendments are intended to increase transparency regarding the use of representations and warranties in asset-backed securities transactions. We anticipate that these proposals would enhance the proper functioning of the capital markets by providing investors with disclosures about the representations, warranties and enforcement mechanisms available to them and by giving investors greater insight into whether underlying pool assets met stated underwriting guidelines across registered and unregistered transactions of a securitizer. Because investors would be able to more easily understand the representations, warranties and enforcement mechanisms available to them and identify originators with better underwriting criteria, competition in the ABS markets should increase.

We request comment on whether the proposed amendments, if adopted would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Commentators are requested to provide empirical data and other factual support for their views if possible.

Section 2(b) of the Securities Act[95] and Section 3(f) of the Exchange Act[96] require the Commission, when engaging in rulemaking that requires it to consider whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of

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95 15 U.S.C. 77b(b).

96 15 U.S.C. 78c(f).

investors, whether the action would promote efficiency, competition, and capital formation. The proposed amendments would enhance our reporting requirements. The purpose of the amendments is to increase transparency regarding the use of representations and warranties in asset-backed securities transactions. This should improve investors' ability to make informed investment decisions. Informed investor decisions generally promote market efficiency and capital formation.

However, the proposals could have indirect adverse consequences by changing the willingness of issuers to access securitization markets. If the required disclosures results in revealing information that would benefit competitors, issuers may instead prefer to use other funding sources that do not require such public disclosures.

Finally, proposed Rule 17g-7 would require NRSROs to describe in any report accompanying a credit rating how the representations, warranties and enforcement mechanisms of the rated ABS differ from the representations, warranties and enforcement mechanisms in issuances of similar securities. We believe that the proposed additional disclosures and, especially, the required comparisons of the representations, warranties, and enforcement measures in a given ABS transaction to those available in similar transactions may provide an impetus to the development of more standardized representations, warranties, and enforcement mechanisms across the ABS markets, which is likely to benefit the efficiency of these markets.

We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Commentators are requested to provide empirical data and other factual support for their views if possible.

VIII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[97] a rule is "major" if it has resulted, or is likely to result in:

- an annual effect on the U.S. economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposed amendments would be a "major rule" for purposes of the Small Business Regulatory Enforcement Fairness Act. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment, or innovation.

IX. Regulatory Flexibility Act Certification

The Commission hereby certifies pursuant to 5 U.S.C. 605(b) that the proposals contained in this release, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposals relate to the registration, disclosure and reporting requirements for asset-backed securities under the Act, the Securities Act and the Exchange Act. Securities Act Rule 157[98] and Exchange Act Rule 0-10(a)[99] defines an issuer, other than an investment company, to be a "small business" or "small organization" if it had

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97 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

98 17 CFR 230.157.

99 17 CFR 240.0-10(a).

total assets of $5 million or less on the last day of its most recent fiscal year. As the depositor and issuing entity are most often limited purpose entities in an ABS transaction, we focused on the sponsor in analyzing the potential impact of the proposals under the Regulatory Flexibility Act. Based on our data, we only found one sponsor that could meet the definition of a small broker-dealer for purposes of the Regulatory Flexibility Act.[100] With respect to our proposals related to disclosures by an NRSRO, currently there are two NRSROs that are classified as "small" entities for purposes of the Regulatory Flexibility Act. As noted above, we are not prescribing how an NRSRO must fulfill its responsibility to compare the terms of a deal to those of similar securities. Accordingly, the Commission does not believe that those proposals, if adopted, would have a significant economic impact on a substantial number of small entities.

X. Statutory Authority and Text of Proposed Rule and Form Amendments

We are proposing the new rules, forms and amendments contained in this document under the authority set forth in Section 943 of the Act, Sections 5, 6, 7, 10, 19(a), and 28 of the Securities Act and Sections 3(b), 12, 13, 15, 15E, 17, 23(a), 35A and 36 of the Exchange Act.

List of Subjects

17 CFR Parts 229, 240 and 249

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

100 This is based on data from Asset-Backed Alert.

PART 229 -- STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 -- REGULATION S-K

1. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 777iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Amend § 229.1104 by adding paragraph (e) to read as follows:

§ 229.1104 (Item 1104) Sponsors.

* * * * *

(e) Repurchases and replacements.

(1) If the underlying transaction agreements provide a covenant to repurchase or replace an underlying asset for breach of a representation or warranty, provide the information required by Rule 15Ga-1(a) (17 CFR 240.15Ga-1(a)) concerning all assets originated or sold by the sponsor that were subject of a demand to repurchase or replace for breach of the representations and warranties concerning the pool assets for all outstanding asset-backed securities (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934) where the underlying transaction agreements included a covenant to repurchase or replace an underlying asset of the same asset class held by non-affiliates of the sponsor, within the prior three years in the body of the prospectus.

(2) Include a reference to the most recent Form ABS-15G filed by the securitizer (as that term is defined in Section 15G(a) of the Securities Exchange Act of 1934) and disclose the CIK number of the securitizer.

3. Amend § 229.1121 by adding paragraph (c) to read as follows:

§ 229.1121 (Item 1121) Distribution and pool performance information.

* * * * *

(c) Repurchases and replacements.

(1) Provide the information required by Rule 15Ga-1(a) (17 CFR 240.15Ga-1(a)) concerning all assets of the pool that were subject of a demand to repurchase or replace for breach of the representations and warranties pursuant to the transaction agreements.

(2) Include a reference to the most recent Form ABS-15G (17.CFR 249.1300) filed by the securitizer (as that term is defined in Section 15G(a) of the Securities Exchange Act of 1934) and disclose the CIK number of the securitizer.

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

4. The authority citation for part 240 is amended by adding authorities for § 240.15Ga-1 and § 240.17g-7 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, 78 l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78 ll, 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.

* * * * *

Section 240.15Ga-1 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

*   *   *   *   *

Section 240.17g-7 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

*   *   *   *   *

5. Add Sections 240.15Ga-1 to read as follows:

Securitizers of Asset-Backed Securities

*   *   *   *   *

240.15Ga-1 Repurchases and replacements relating to asset-backed securities.

§ 240.15Ga-1 Repurchases and replacements relating to asset-backed securities.

(a) General. With respect to any asset-backed security (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934) for which the underlying transaction agreements contain a covenant to repurchase or replace an underlying asset for breach of a representation or warranty, then the securitizer (as that term is defined in Section 15G(a) of the Securities Exchange Act of 1934) shall disclose fulfilled and unfulfilled repurchase requests across all trusts by providing the information required in paragraph (1) concerning all assets originated or sold by the securitizer that were subject of a demand to repurchase or replace for breach of the representations and warranties concerning the assets for all outstanding asset-backed security held by non-affiliates of the securitizer.

Name of Issuing Entity	Check if Regis-tered	Name of Originator	Assets That Were Subject of Demand			Assets That Were Repurchased or Replaced			Assets That Were Not Repurchased or Replaced			Assets Pending Repurchase or Replacement		
			(#)	($)	(% of pool)	(#)	($)	(% of pool)	(#)	($)	(% of pool)	(#)	($)	(% of pool)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)	(o)
Asset Class X														
Issuing Entity A CIK #	X	Originator 1												
		Originator 2												
Issuing Entity B		Originator 3												
Total			#	$		#	$		#	$		#	$	
Asset Class Y														
Issuing Entity C		Originator 2												
		Originator 3												
Issuing Entity D CIK #	X	Originator 1												
Total			#	$		#	$		#	$		#	$	

(1) The table shall:

(i) Disclose the asset class and group the issuing entities by asset class (column (a)).

(ii) Disclose the name of the issuing entity (as that term is defined in Item 1101(f) of Regulation AB (17 CFR 229.1101(f)) of the asset-backed securities. List the issuing entities in order of the date of formation (column (a)).

(iii) For each named issuing entity, indicate by check mark whether the transaction was registered under the Securities Act of 1933 (column (b))

(iv) Disclose the name of the originator of the underlying assets (column (c)).

(v) Disclose the number, outstanding principal balance and percentage by principal balance of assets that were subject of demand to repurchase or replace for breach of representations and warranties (columns (d) through (f)).

Instruction to (a)(1)(v): If a securitizer requested and was unable to obtain all information with respect to investor demands upon a trustee that occurred prior to [insert effective date], so state by footnote. In this case, also state that the disclosures do not contain investor demands upon a trustee made prior to [insert effective date].

(vi) Disclose the number, outstanding principal balance and percentage by principal balance of assets that were repurchased or replaced for breach of representations and warranties (columns (g) through (i)).

(vii) Disclose the number, outstanding principal balance and percentage by principal balance of assets that were not repurchased or replaced for breach of representations and warranties (columns (j) through (l)).

(viii) Disclose the number, outstanding principal balance and percentage by principal balance of assets that are pending repurchase or replacement for breach of representations and warranties (columns (m) through (o)).

Instruction to (a)(1)(viii): Indicate by footnote and provide narrative disclosure of the reasons why any repurchase or replacement is pending. For example, if pursuant to the terms of a transaction agreement, assets have not been repurchased or replaced pending the expiration of a cure period, indicate by footnote.

(ix) Provide totals by asset class for columns that require number of assets and principal amounts (columns (d), (e), (g), (h), (j), (k), (m) and (n)).

(b) If a securitizer has filed all the disclosures required in order to meet the obligations under paragraph (a), which would include disclosures of the activity of affiliated securitizers, those affiliated securitizers are not required to separately provide and file the same disclosures.

(c) The disclosures in paragraph (a) shall be provided by a securitizer:

(1) initially, with respect to the five year period immediately preceding the date of filing, as of the end of the preceding month, by any securitizer that issues an asset-backed

security, or organizes and initiates an asset-backed securities transaction by selling or transferring an asset, either directly or indirectly, including through an affiliate, to the issuer, at the time the securitizer, or an affiliate commences its first offering of the asset-backed securities after [insert effective date], if the underlying transaction agreements provide a covenant to repurchase or replace an underlying asset for breach of a representation or warranty.

(2) periodically, for a securitizer which was required to provide the information required pursuant to subparagraph (c)(1), as of the end of each calendar month, to be filed not later than 15 calendar days after the end of such calendar month. Information is not required for the time prior to that specified in subparagraph (c)(1).

(3) except that, if a securitizer has no asset-backed securities outstanding held by non-affiliates, the duty under paragraph (c)(2) to file periodically the disclosures required by paragraph (a) shall be terminated immediately upon filing a notice on Form ABS-15G (17 CFR 249.1300).

6. Add § 240.17g-7 to read as follows:

§ 240.17g-7 Report of representations and warranties.

Each nationally recognized statistical rating organization shall include in any report accompanying a credit rating with respect to an asset-backed security (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934) a description of –

(a) the representations, warranties and enforcement mechanisms available to investors; and

(b) how they differ from the representations, warranties and enforcement mechanisms in issuances of similar securities.

Note. For the purposes of this requirement, a "credit rating" includes any expected or preliminary credit rating issued by a nationally recognized statistical rating organization.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

7. The authority citation for part 249 is amended by adding an authority for § 249.1300 to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Section 249.1300 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

8. Add Subpart O and Form ABS-15G (referenced in § 249.1300) to Section 249 to read as follows:

Subpart O – Forms for Securitizers of Asset-Backed Securities

§ 249.1300 Form ABS-15G, Asset-backed securitizer report pursuant to Section 15G of the Securities Exchange Act of 1934

Note: The text of Form ABS-15G does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM ABS-15G

ASSET-BACKED SECURITIZER
REPORT PURSUANT TO SECTION 15G OF
THE SECURITIES EXCHANGE ACT OF 1934

Date of Report (Date of earliest event reported)____________________

Commission File Number of securitizer: ____________________
Central Index Key Number of securitizer: ____________________

____
Name and telephone number, including area code, of the person to contact in connection with this filing

GENERAL INSTRUCTIONS

A. Rule as to Use of Form ABS-15G.

This form shall be used to comply with the requirements of Rule 15Ga-1 under the Exchange Act (17 CFR 240.15Ga-1).

B. Events to be Reported and Time for Filing of Reports.

Forms filed under Rule 15Ga-1. In accordance with Rule 15Ga-1, file the information required by Part I in accordance with Item 1.01, Item 1.02, or Item 1.03, as applicable. If the filing deadline for the information occurs on a Saturday, Sunday or holiday on which the Commission is not open for business, then the filing deadline shall be the first business day thereafter.

C. Preparation of Report.

This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the report on paper meeting the requirements of Rule 12b-12 (17 CFR 240.12b-12). The report shall contain the number and caption of the applicable item, but the text of such item may be omitted, provided the answers thereto are prepared in the manner specified in Rule 12b-13 (17 CFR 240.12b-13). All items that are not required to be answered in a particular report may be omitted and no reference thereto need be made in the report. All instructions should also be omitted.

D. Signature and Filing of Report.

1. Forms filed under Rule 15Ga-1. Any form filed for the purpose of meeting the requirements in Rule 15Ga-1 must be signed by the senior officer in charge of securitization of the securitizer.
2. Copies of report. If paper filing is permitted, three complete copies of the report shall be filed with the Commission.

INFORMATION TO BE INCLUDED IN THE REPORT

REPRESENTATION AND WARRANTY INFORMATION

Item 1.01 Initial Filing of Rule 15Ga-1 Representations and Warranties Disclosure

If any securitizer (as that term is defined in Section 15G(a) of the Securities Exchange Act of 1934), issues an asset-backed security, (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934), or organizes and initiates an asset-backed securities transaction by selling or transferring an asset, either directly or indirectly, including through an affiliate, to the issuer, provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) at the time the securitizer, or an affiliate commences its first offering of the asset-backed securities after [insert effective date], if the underlying transaction agreements contain a covenant to repurchase or replace an underlying asset for breach of a representation or warranty.

Item 1.02 Periodic Filing of Rule 15Ga-1 Representations and Warranties Disclosure

Each securitizer that was required to provide the information required by Item 1.01 of this form, shall provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) as of the end of each calendar month, to be filed not later than 15 calendar days after the end of such calendar month.

Item 1.03 Notice of Termination of Duty to File Reports under Rule 15Ga-1

If any securitizer has no asset-backed securities outstanding (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934) held by non-affiliates, provide the date of the last payment on the last asset-backed security outstanding that was issued by or issued by an affiliate of the securitizer.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the reporting entity has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

______________________________________ (Securitizer)

Date ____

____ (Signature)*

*Print name and title of the signing officer under his signature.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: October 4, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63033 / October 4, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3195 / October 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-11374

In the Matter of Victor R. Wahba, CPA	ORDER GRANTING APPLICATION FOR REINSTATEMENT TO APPEAR AND PRACTICE BEFORE THE COMMISSION AS AN ACCOUNTANT

On January 15, 2004, Victor R. Wahba ("Wahba") was suspended from appearing or practicing as an accountant before the Commission as a result of settled public administrative proceedings instituted by the Commission against Wahba pursuant to Rule 102(e) of the Commission's Rules of Practice.[1] Wahba consented to the entry of the January 15, 2004 order without admitting or denying the findings therein. This order is issued in response to Wahba's application for reinstatement to practice before the Commission as an accountant.

During the years 1997 and 1998, Wahba was employed as a partner at Weiser LLP ("Weiser"). During these two years, Wahba participated as the partner in charge of Weiser's surprise inspections of the Sagam Capital Management Corporation ("Sagam Corp."). As the partner in charge of these surprise inspections, the Commission alleged that Wahba engaged in instances of highly unreasonable conduct by failing to conduct them in accordance with the Investment Advisers Act of 1940 ("Advisers Act") Rule 206(4)-2(a)(5). This conduct caused and aided and abetted Sagam Corp.'s violations of Section 206(4) of the Advisers Act and constituted improper professional conduct.

Wahba has met all of the conditions set forth in his suspension order and, in his capacity as an independent accountant, has stated that he will comply with all requirements of the Commission and the Public Company Accounting Oversight Board, including, but not limited to all requirements relating to registration, inspections, concurring partner reviews and quality

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[1] *See* Accounting and Auditing Enforcement Release No. 1943 dated January 15, 2004. Wahba was permitted, pursuant to the order, to apply for reinstatement after four years upon making certain showings.

control standards. In his 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, Wahba attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity.

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 the information supplied, representations made, and undertakings agreed to by Wahba, it appears that he has complied with the terms of the January 15, 2004 order denying him 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 his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Wahba, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, and that Wahba, by undertaking to comply with all requirements of the Commission and the Public Company Accounting Oversight Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards, in his practice before the Commission as an independent accountant has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Victor R. Wahba, CPA is hereby reinstated to appear and practice before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy

Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

[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).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3097 / October 5, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14085

In the Matter of **ROBERT P. PINKAS,** **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 Robert P. Pinkas ("Pinkas" 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.4 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. Pinkas, age 56, served as Chairman of the Board, Chief Executive Officer, and Treasurer of Brantley Capital Corp. ("Brantley Capital") from 1996 until September 28, 2005. He was also Chairman of the Board, Chief Executive Officer, and Treasurer of Brantley Capital Management, LLC ("BCM").

2. BCM was, at all relevant times, a limited liability company headquartered in Ohio, which served as Brantley Capital's investment adviser from Brantley Capital's 1996 inception until September 28, 2005. BCM was registered with the Commission as an investment adviser until 2006, but currently is not registered and is not serving as an investment adviser. Brantley Capital's prospectus and BCM's investment advisory agreement and Form ADV indicated that BCM was responsible for Brantley Capital's records and financial reporting requirements.

3. Brantley Capital was, at all relevant times, a closed-end, non-diversified investment company, incorporated in Maryland and headquartered in Ohio, which elected to be regulated as a business development company under the Investment Company Act of 1940. Brantley Capital's common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Prior to August 3, 2005, Brantley Capital's common stock traded on The Nasdaq National Market system.

4. On August 13, 2009, the Commission filed a complaint against Pinkas in SEC v. Brantley Capital Management, LLC et al. (Civil Action No. 1:09-cv-01906). On September 28, 2010, the court entered an order permanently enjoining Pinkas, by consent, from future violation of Exchange Act Sections 10(b) and 13(b)(5) and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 and Advisers Act Sections 206(1) and 206(2), and from aiding and abetting violation of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 13a-1 and 13a-13. Pinkas was also ordered to pay disgorgement in the amount of $482,561, plus prejudgment interest thereon in the amount of $150,168, and a civil money penalty of $325,000. In addition, Pinkas was barred from serving as an officer or director of a publicly-traded company for five years.

5. The Commission's complaint alleges, among other things, that in Brantley Capital's Forms 10-Q, 10-K, and 8-K for the period 2002 to 2005, Pinkas knowingly or recklessly overstated the value of two companies, Flight Options International ("FOI") and Disposable Products Company ("DPC"), that together represented over one-half of Brantley Capital's investment portfolio. The Complaint alleges that Pinkas also knowingly or recklessly made material misrepresentations and failed to make required disclosures regarding FOI and DPC to Brantley Capital's board of directors, independent auditors, and to investors in Brantley Capital's public filings.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, Respondent Pinkas be, and hereby is barred from association with any investment adviser, with the right to reapply for association after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission;

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63048 / October 6, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14086

In the Matter of **AOB Holdings, Inc.,** **Applied Data Communications, Inc.,** **Appoint Technologies, Inc.,** **Aqua Care Systems, Inc.,** **AquaSciences International, Inc., and** **Arix Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents AOB Holdings, Inc., Applied Data Communications, Inc., Appoint Technologies, Inc., Aqua Care Systems, Inc., AquaSciences International, Inc., and Arix Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. AOB Holdings, Inc. (CIK No. 1307715) is a void Delaware corporation located in Brea, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AOB Holdings 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 June 30, 2006, which reported a net loss of $413,567 for the prior nine months.

2. Applied Data Communications, Inc. (CIK No. 728398) is a void Delaware corporation located in Santa Ana, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Applied Data 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, 2001, which reported a net loss of $529,203 for the prior three months.

3. Appoint Technologies, Inc. (CIK No. 93379) is a suspended California corporation located in Anaheim, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Appoint Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended April 30, 1994. On September 26, 1994, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was terminated on May 24, 1995.

4. Aqua Care Systems, Inc. (CIK No. 910566) is a void Delaware corporation located in Vista, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aqua Care 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 June 30, 2002, which reported a net loss of $774,016 for the prior three months. As of October 5, 2010, the company's stock (symbol "AQCR") was traded on the over-the-counter markets.

5. AquaSciences International, Inc. (CIK No. 762831) is a dissolved New York corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AquaSciences 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 March 31, 1992, which reported a net operating loss of over $1.52 million for fiscal year 1992.

6. Arix Corp. (CIK No. 838445) is a void Delaware corporation located in Sunnyvale, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Arix 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 $921,000 for the prior nine months.

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 hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63062 / October 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14087

In the Matter of	
Andain, Inc., Aquest Minerals Corp. (n/k/a Anderson Energy Ltd.), Ariel Resources, Ltd., Asensia, Inc., ATG, Inc., Audre Recognition Systems, Inc. (a/k/a eXtr@act, Inc.), Axis.Com, Inc., and Aztek Technologies, Inc. (n/k/a Aztek Resource Development, 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 Andain, Inc., Aquest Minerals Corp. (n/k/a Anderson Energy Ltd.), Ariel Resources, Ltd., Asensia, Inc., ATG, Inc., Audre Recognition Systems, Inc. (a/k/a eXtr@ct, Inc.), Axis.Com, Inc., and Aztek Technologies, Inc. (n/k/a Aztek Resource Development, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

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1. Andain, Inc. (CIK No. 1321502) is a revoked Nevada corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Andain 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, 2006, which reported a net loss of $104,940 for the prior three months.

2. Aquest Minerals Corp. (n/k/a Anderson Energy Ltd.) (CIK No. 1043455) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aquest Minerals 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 March 31, 1998, which reported a loss from continuing operations of $633,535 (Canadian) for the prior twelve months.

3. Ariel Resources, Ltd. (CIK No. 817398) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ariel Resources 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 September 30, 2001, which reported a deficit of over $10.7 million for the prior twelve months.

4. Asensia, Inc. (CIK No. 1353488) is a delinquent Delaware corporation located in Big Sky, Montana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asensia 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, 2007, which reported a net loss of over $250 million for the prior twelve months.

5. ATG, Inc. (CIK No. 1054000) is a suspended California corporation located in Hayward, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ATG 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 $1 million for the prior six months. On December 31, 2001, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was terminated on April 3, 2009. As of October 5, 2010, the company's stock (symbol "ATGCQ") was traded on the over-the-counter markets.

6. Audre Recognition Systems, Inc. (a/k/a eXtr@ct, Inc.) (CIK No. 811206) is a Delaware corporation located in Escondido, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Audre 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 July 31, 1995, which reported a net loss of $422,802 for the prior three months. As of October 5, 2010, the company's stock (symbol "XTRC") was traded on the over-the-counter markets.

7. Axis.Com, Inc. (CIK No. 1122105) is a permanently revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Axis.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 June 30, 2001, which reported a net loss of $3,500 since the company's August 4, 2000 inception.

8. Aztek Technologies, Inc. (n/k/a Aztek Resource Development, Inc.) (CIK No. 1050483) is a British Columbia corporation located in Winfield, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aztek 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, 2001, which reported a net loss of $33,360 (Canadian) for the prior six 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, 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 hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 200

[Release No. 34-63049]

Delegation of Authority to the Director of the Division of Trading and Markets

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending its rules to delegate authority to the Director of the Division of Trading and Markets ("Division") to disapprove a proposed rule change pursuant to Section 19(b) of the Securities Exchange Act of 1934 ("Exchange Act"); to temporarily suspend a proposed rule change of a self-regulatory organization ("SRO"); to notify an SRO that a proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change; and to determine that a proposed rule change is unusually lengthy and complex or raises novel regulatory issues and to inform the SRO of such determination. In addition, the Commission is amending its rules to delegate authority to the Director of the Division ("Director") to determine the appropriateness of extending the time periods specified in Section 19(b) and publish the reasons for such determination as well as to effect any such extension; to update the references to proceedings to determine whether to disapprove a proposal and to provide to the SRO notice of the grounds for disapproval under consideration; to find good cause to approve a proposal on an accelerated basis and to publish the reasons for such determination; and to extend the period for consideration of a national market system plan or an amendment to such plan. This delegation is intended to conserve Commission resources and to increase the effectiveness and efficiency of the Commission's SRO rule filing process.

EFFECTIVE DATE: [Insert date of publication in Federal Register]

FOR FURTHER INFORMATION CONTACT: Richard Holley III, Assistant Director, at (202) 551-5614, Kristie Diemer, Special Counsel, at (202) 551-5613, and Arisa Tinaves, Special Counsel, at (202) 551-5676, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

The Dodd-Frank Wall Street Reform and Consumer Protection Act[1] amended Section 19 of the Exchange Act, 15 U.S.C. 78s(b)(2), so that there are new deadlines by which the Commission must publish and act upon proposed rule changes submitted by SROs. In recognition of the amendments to Section 19, the Commission is amending its rules governing delegations of authority to the Director of the Division. The amendments to Rule 30-3 (17 CFR 200.30-3) authorize the Director of the Division: (1) to disapprove an SRO proposed rule change pursuant to Section 19(b)(2) of the Exchange Act, 15 U.S.C. 78s(b)(2), provided that, with respect to a particular proposed rule change, if two (2) or more Commissioners object in writing to the Director within five (5) business days of being notified by the Director that the Division intends to exercise its authority to disapprove that particular proposed rule change, then the delegation of authority to approve or disapprove that proposal is withdrawn and the Director shall either present a recommendation to the Commission or institute pursuant to delegated authority proceedings to determine whether the proposed rule change should be disapproved;[2] (2)

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

2 Section 19(b)(2)(C), 15 U.S.C. 78s(b)(2)(C), provides the standards for Commission approval and disapproval of a proposed rule change. Under this paragraph, the Commission shall approve a proposed rule change if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization, and the Commission shall disapprove a proposal if it does not make such finding. Additionally, this paragraph provides that the Commission may not approve a proposed rule change earlier than 30 days after

pursuant to Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2), and Section 19(b)(3) of the Act, 15 U.S.C. 78s(b)(3), to institute proceedings to determine whether a proposed rule change of a SRO should be disapproved and to provide to the SRO notice of the grounds for disapproval under consideration, and, in addition, if the Commission has not taken action on a proposal for which delegated authority has been withdrawn under subparagraph (12) prior to the expiration of the applicable time period specified in Section 19(b)(2), 15 U.S.C. 78s(b)(2), to require the Director to institute proceedings to determine whether the proposed rule change should be disapproved; (3) pursuant to new Section 19(b)(10) of the Exchange Act, 15 U.S.C. 78s(b)(10), to (a) notify an SRO that a proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change, and (b) determine that a proposed rule change is unusually lengthy and complex or raises novel regulatory issues and to inform the SRO of such determination; (4) pursuant to Section 19(b)(2)(A) of the Exchange Act, 15 U.S.C. 78s(b)(2)(A), to extend for a period not exceeding 90 days from the date of publication of notice of the filing of a proposed rule change the period during which the Commission must by order disapprove the proposed rule change; (5) pursuant to Section 19(b)(2)(A) of the Exchange Act, 15 U.S.C. 78s(b)(2)(A), to determine the appropriateness of extending the period during which the Commission must by order approve or disapprove a proposed rule change or institute proceedings to determine whether to disapprove the proposal and publish the reasons for such determination; (6) pursuant to Section 19(b)(2)(B) of the Exchange Act, 15 U.S.C. 78s(b)(2)(B), to extend for a period not exceeding 240 days from the date of publication of notice of the filing of a proposed rule change the period during which the Commission must conclude proceedings to determine whether to disapprove the proposal and to determine whether such longer period is

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the date of publication unless the Commission finds good cause for so doing and publishes the reason for the finding.

appropriate and publish the reasons for such determination; (7) to temporarily suspend an SRO's proposed rule change pursuant to Section 19(b)(3)(C) of the Exchange Act, 15 U.S.C. 78s(b)(3)(C); (8) to update the references to proceedings to determine whether to disapprove a proposal and to provide to the SRO notice of the grounds for disapproval under consideration;[3] and (9) to find good cause to approve a proposal on an accelerated basis and to publish the reasons for such determination. In addition, the Commission is amending Rule 30-3(a)(42) to authorize the Director, pursuant to rule 608(b), 17 CFR 242.608(b), to extend for a period not exceeding 180 days from the date of publication of notice of the filing of a proposed national market system plan or an amendment to an effective national market system plan the time for Commission consideration of such plan or amendment.

Finally, the Commission is amending Rule 30-3(a)(12) to remove obsolete references to a former compliance deadline that is now inconsistent with the amendments to Section 19 of the Exchange Act since the former provision included a 15 business day deadline that is incompatible with the new 15 calendar day deadline to send the notice to the Federal Register for publication from the date on which the SRO publishes the notice of the filing contained in revised Section 19(b)(2)(E).

This delegation is intended to conserve Commission resources and increase the effectiveness and efficiency of the Commission's process for handling proposed rule changes submitted by SROs. The Commission anticipates that the delegation of authority will help facilitate timely compliance with the amendments to Section 19 of the Exchange Act and the

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3 Section 19(b)(3)(C) provides that if the Commission temporarily suspends the change in the rules of a SRO, it shall "institute proceedings under paragraph (2)(B) to determine whether the proposed rule should be approved or disapproved." The Commission is amending Rule 30-3(a)(57), which presently delegates authority to the Director of the Division to institute such proceedings, to clarify its applicability to all references to such proceedings contained in amended Sections 19(b)(2) and 19(b)(3) of the Exchange Act.

new statutory deadlines prescribed therein. Nevertheless, the Division may submit matters to the Commission for its consideration, as it deems appropriate.

The Commission finds, in accordance with the Administrative Procedure Act (5 U.S.C. 553(b)(3)(A)), that these amendments relate solely to agency organization, procedures, or practices, and do not relate to a substantive rule. Accordingly, notice, opportunity for public comment, and publication of the amendments prior to their effective date are unnecessary and these changes are effective on [insert date of publication in the Federal Register].

LIST OF SUBJECTS IN 17 CFR PART 200

Administrative practice and procedure, Authority delegations (Government agencies).

TEXT OF AMENDMENT

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The authority citation for Part 200, Subpart A, continues to read in part as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 77d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Section 200.30-3 is amended by:

a. Revising paragraphs (a)(12) and (a)(31);

b. In paragraph (a)(42), at the end remove "." and in its place add ", and pursuant to 17 CFR 242.608(b) to extend for a period not exceeding 180 days from the date of publication of notice of filing of a national market system plan or an amendment to an effective national market system plan the time for Commission consideration of the national market system plan or the amendment to an effective national market system plan and to determine whether such longer period is appropriate and publish the reasons for such determination."; and

c. Revising paragraphs (a)(57) and (a)(58).

The revisions read as follows:

§ 200.30-3 Delegation of authority to Director of Division of Trading and Markets.

* * * * *

(a) * * * * *

(12) Pursuant to Section 19(b) of the Act, 15 U.S.C. 78s(b), and Rule 19b-4 (§240.19b-4) of this chapter, to publish notices of proposed rule changes filed by self-regulatory organizations and to approve such proposed rule changes, and to find good cause to approve a proposed rule change earlier than 30 days after the date of publication of such proposed rule change and to publish the reasons for such finding. Pursuant to Section 19(b) of the Act, 15 U.S.C. 78s(b), and Rule 19b-4 (§240.19b-4) of this chapter, to disapprove a proposed rule change, provided that, with respect to a particular proposed rule change, if two (2) or more Commissioners object in writing to the Director within five (5) business days of being notified by the Director that the Division intends to exercise its authority to disapprove that particular proposed rule change, then the delegation of authority to approve or disapprove that proposal is withdrawn, and the Director shall either

present a recommendation to the Commission or institute pursuant to delegated authority proceedings to determine whether the proposed rule change should be disapproved. In addition, pursuant to Section 19(b)(10) of the Act, 15 U.S.C. 78s(b)(10), (a) to notify a self-regulatory organization that a proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change, and (b) to determine that a proposed rule change is unusually lengthy and complex or raises novel regulatory issues and to inform the self-regulatory organization of such determination.

* * * * *

(31) Pursuant to Section 19(b)(2)(A) of the Act, 15 U.S.C. 78s(b)(2)(A), to extend for a period not exceeding 90 days from the date of publication of notice of the filing of a proposed rule change pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), the period during which the Commission must by order approve or disapprove the proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved and to determine whether such longer period is appropriate and publish the reasons for such determination.

* * * * *

(57) Pursuant to Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2), and Section 19(b)(3) of the Act, 15 U.S.C. 78s(b)(3), to institute proceedings to determine whether a proposed rule change of a self-regulatory organization should be disapproved and to provide to the self-regulatory organization notice of the grounds for disapproval under consideration. If the Commission has not taken

action on a proposed rule change for which delegated authority has been withdrawn under subsection (12) of this paragraph prior to the expiration of the applicable time period specified in Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2), then the Director shall institute pursuant to delegated authority proceedings to determine whether the proposed rule change should be disapproved. In addition, pursuant to Section 19(b)(2)(B) of the Act, 15 U.S.C. 78s(b)(2)(B), to extend for a period not exceeding 240 days from the date of publication of notice of the filing of a proposed rule change pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), the period during which the Commission must issue an order approving or disapproving the proposed rule change and to determine whether such longer period is appropriate and publish the reasons for such determination.

(58) Pursuant to Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C), to temporarily suspend a change in the rules of a self-regulatory organization.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: October 6, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63061 / October 7, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3196 / October 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12502

In the Matter of Michael S. Joseph, 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 December 11, 2006, Michael S. Joseph, CPA ("Joseph") 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 Joseph pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1] This order is issued in response to Joseph'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 found that in 2001 Joseph violated certain of the antifraud, reporting, and recordkeeping provisions of the federal securities laws, as well as auditor independence standards, while he was a partner in the national office of Ernst & Young LLP (E&Y"). Specifically, Joseph helped develop and market an accounting product for one E&Y client, American International Group, Inc. and then worked with an E&Y audit team to advise an E&Y audit client, PNC Financial Services Group, Inc. ("PNC"), on the accounting treatment for a version of that product. As a result of his advice, PNC improperly excluded certain assets from its consolidated financial statements. The improper accounting was included in several Forms 10-Q and certain registration statements for PNC securities.

In his 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, Joseph

[1] *See* Accounting and Auditing Enforcement Release No. 2523 dated December 11, 2006. Joseph was permitted, pursuant to the order, to apply for reinstatement after three years upon making certain showings.

attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Joseph is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to resume appearing and practicing before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original suspension order in this regard. Therefore, Joseph's suspension from practice 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 suspension 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 Joseph, it appears that he has complied with the terms of the December 11, 2006 order denying him 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 his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Joseph, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his 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,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Michael S. Joseph, 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

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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).

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63059 / October 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-11645

In the Matter of

PA FUND MANAGEMENT, LLC,
PEA CAPITAL LLC, and
PA DISTRIBUTORS LLC,

Respondents.

NOTICE OF PROPOSED PLAN OF DISTRIBUTION AND OPPORTUNITY FOR COMMENT

Notice is hereby given, pursuant to Rule 1103 of the Securities and Exchange Commission's ("Commission") Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103, that the Division of Enforcement has submitted to the Commission a proposed plan for the distribution of the Fair Fund in this matter ("Distribution Plan").

On September 13, 2004, the Commission issued an Order instituting administrative and cease-and-desist proceedings against PA Fund Management LLC, PEA Capital LLC, and PA Distributors LLC ("Respondents") in this matter (the "Order"). Pursuant to the Order, a Fair Fund was established, comprised of disgorgement, prejudgment interest and penalties paid by the Respondents, for distribution to investors harmed by market timing in certain mutual funds formerly offered by the PIMCO Equity Funds: Multi-Manager Series (the "Equity Funds" or "Funds').

OPPORTUNITY FOR COMMENT

Pursuant to this Notice, all interested parties are advised that they may print a copy of the proposed Distribution Plan from the Commission's public website, http://www.sec.gov. Interested parties may also obtain a written copy of the proposed Distribution Plan by submitting a written request to Lorraine B. Echavarria, Assistant Regional Director, United States Securities and Exchange Commission, 5670 Wilshire Blvd., 11th Floor, Los Angeles, CA 90036. All persons who desire to comment on the Distribution Plan may submit their comments, in writing, no later than thirty (30) days from the date of this Notice:

1. by sending a letter to the Office of the Secretary, United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090;

2. by using the Commission's Internet comment form (http://www.sec.gov/litigation/admin.shtml); or

3. by sending an e-mail to rule-comments@sec.gov.

Comments submitted by e-mail or via the Commission's website should include "Administrative Proceeding File Number 3-11645" on the subject line. Comments received will be publicly available. Persons should submit only information that they wish to make publicly available.

DISTRIBUTION PLAN

The Fair Fund is comprised of $48,383,262 in disgorgement, prejudgment interest and penalties paid by the Respondents, plus accumulated interest, less any federal, state, or local taxes on the interest. The Distribution Plan, if approved, proposes the distribution of the monies based on shareholders' losses, defined as shareholder dilution and transactions costs, caused by market timing in the Equity Funds from February 2002 to April 2003. Harmed shareholders will receive their losses suffered and their proportionate share of advisory fees paid by the funds that suffered losses and their proportionate share of interest earned on the Fair Fund. Upon termination of the Fair Fund, any monies that remain in the Fair Fund will be transferred to the Commission for remittance to the U.S. Treasury.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

ADMINISTRATIVE PROCEEDING
FILE NO. 3-13847

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

October 8, 2010

In the Matter of MORGAN ASSET MANAGEMENT, INC.; MORGAN KEEGAN & COMPANY, INC., JAMES C. KELSO, JR. and JOSEPH THOMPSON WELLER, CPA, Respondents	ORDER EXTENDING INTERIM STAY OF PRODUCTION OF DOCUMENTS AND OF HEARING DATE

On August 27, 2010, the Commission ordered that the administrative law judge's order, dated July 20, 2010, requiring production of Office of Compliance Inspections and Examinations ("OCIE") documents pursuant to a subpoena duces tecum served on June 1, 2010, be stayed pending its consideration of OCIE's request for interlocutory review of the July 20, 2010 order. The August 27, 2010 order also stayed the hearing in this matter, scheduled for September 13, 2010, for thirty days. The Commission has determined to extend both of these stays for an additional sixty-day period.

Accordingly, it is ORDERED that the administrative law judge's order, dated July 20, 2010, requiring production of OCIE documents pursuant to the subpoena, and the hearing in this matter, originally scheduled for September 13, 2010, be, and hereby are, STAYED until December 13, 2010, pending Commission consideration of OCIE's request for interlocutory review.

By the Commission.

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA-3098; File No. S7-25-10]

RIN 3235-AK66

Family Offices

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (the "Commission") is proposing a rule to define "family offices" that would be excluded from the definition of an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") and thus would not be subject to regulation under the Advisers Act.

DATES: Comments must be received on or before November 18, 2010.

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-25-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-25-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website 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: Sarah ten Siethoff, Senior Special Counsel, or Vivien Liu, Senior Counsel, at (202) 551-6787 or <IArules@sec.gov>, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is requesting public comment on proposed rule 202(a)(11)(G)-1 [17 CFR 275.202(a)(11)(G)-1] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] (the "Advisers Act" or "Act").[1]

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1 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified.

VII. STATUTORY AUTHORITY
TEXT OF PROPOSED RULE

I. BACKGROUND

"Family offices" are entities established by wealthy families to manage their wealth, plan for their families' financial future, and provide other services to family members. Single family offices generally serve families with at least $100 million or more of investable assets.[2] Industry observers have estimated that there are 2,500 to 3,000 single family offices managing more than $1.2 trillion in assets.[3]

Family office services typically include managing securities portfolios, providing personalized financial, tax, and estate planning advice, providing accounting services, and directing charitable giving, in each case to members of a family. Some family offices even provide services such as travel planning or managing a family's art collection or household staff.[4] Family offices generally meet the definition of "investment adviser" under the Advisers Act, as we and our staff have interpreted the term, because, among the

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2 *See* John J. Bowen, Jr., *In the Family Way*, FINANCIAL PLANNING (Aug. 1, 2004); Robert Frank, *Minding the Money—'Family Office' Chiefs Get Plied with Perks; Club Membership, Jets*, THE WALL STREET JOURNAL (Sept. 7, 2007), at W2. A recent study found the average net worth of a single family office was $517 million. *See* Russ Alan Prince et al., THE FAMILY OFFICE: ADVISING THE FINANCIAL ELITE (2010) ("THE FAMILY OFFICE").

3 *See* Pamela J. Black, *The Rise of the Multi-Family Office*, FINANCIAL PLANNING (Apr. 27, 2010). A single family office generally provides services only to members of a single family.

4 *See* Raphael Amit, et al., *Single Family Offices: Private Wealth Management in the Family Context*, WHARTON GLOBAL FAMILY ALLIANCE (Apr. 1, 2008), *available at* http://knowledge.wharton.upenn.edu/papers/1354.pdf ("Wharton Study"); THE FAMILY OFFICE, *supra* note 2; Angelo J. Robles, *Creating a Single Family Office for Wealth Creation and Family Legacy Sustainability*, FAMILY OFFICE ASSOCIATION, *available at* http://familyofficeassociation.org /dwnld/FOA_White_Paper.pdf.

variety of services provided, family offices are in the business of providing advice about securities for compensation.[5]

We understand that many family offices have been structured to take advantage of the exemption from registration under section 203(b)(3) of the Advisers Act for any adviser that during the course of the preceding 12 months had fewer than 15 clients and neither held itself out to the public as an investment adviser nor advised any registered investment company or business development company.[6] Other family offices have sought and obtained from us orders under the Advisers Act declaring those offices not to be investment advisers within the intent of section 202(a)(11) of the Advisers Act.[7] We have issued more than a dozen of these orders since the 1940s.

The Commission issued those exemptive orders pursuant to a provision of the Advisers Act that authorizes us to exclude any person that falls within the Advisers Act's definition of investment adviser, but that we conclude is "not within the intent" of that definition.[8] We viewed the typical single family office as not the sort of arrangement that

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5 15 U.S.C. 80b-2(a)(11). *See Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)]. There are certain exceptions to this definition, but the typical single family office does not meet any of these exceptions.

6 15 U.S.C. 80b-2(b)(3).

7 *See, e.g.*, *In the Matter of Donner Estates, Inc.*, Investment Advisers Act Release No. 21 (Nov. 3, 1941); *In the Matter of the Pitcairn Company*, Investment Advisers Act Release No. 52 (Mar. 2, 1949) ("Pitcairn"); *In the Matter of Roosevelt & Son*, Investment Advisers Act Release No. 54 (Aug. 31, 1949); *Bear Creek Inc.*, Investment Advisers Act Release Nos. 1931 (Mar. 9, 2001) (notice) [66 FR 15150 (Mar. 15, 2001)] and 1935 (Apr. 4, 2001) (order); *Riverton Management, Inc.*, Investment Advisers Act Release Nos. 2459 (Dec. 9, 2005) [70 FR 74381 (Dec. 15, 2005)] and 2471 (Jan. 6, 2006) (order).

8 15 U.S.C. 80b-2(a)(11)(G), which will be re-designated as 15 U.S.C. 80b-2(a)(11)(H) on July 21, 2010. If a person is excluded from the definition of an investment adviser, no

Congress designed the Advisers Act to regulate. We also were concerned that application of the Advisers Act would intrude on the privacy of family members. Thus, each of our orders exempted the particular family office from *all* of the provisions of the Advisers Act (and not merely the registration provisions). As a consequence, disputes among family members concerning the operation of the family office could be resolved within the family unit or, if necessary, through state courts under laws specifically designed to govern family disputes, but without the involvement of the Commission.

Our exemptive orders have included conditions designed to distinguish between a "family office," as described above, and a "family-run office" that, although owned and controlled by a single family, provides advice to a broader group of clients and much more resembles the business model common among many smaller investment adviser firms that are registered with the Commission or state regulatory authorities.[9] Accordingly, and as described in more detail below, our exemptive orders have limited relief to those family offices that provide advisory services only to members of a single family and their lineal descendants, with very limited exceptions.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[10] The Dodd-Frank Act, among other matters, will repeal the 15-client exemption contained in section 203(b)(3)

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state can require that person to register as an investment adviser. *See* 15 U.S.C. 80b-3A(b)(1).

9 There also are commercial family offices, which are for-profit organizations that serve a much larger number of families and typically are registered as an investment adviser with the Commission or one or more states. *See* THE FAMILY OFFICE, *supra* note 2. For example, GenSpring Family Offices, LLC reports on Part 1 of its Form ADV that it provides investment advisory services to 5000 clients.

10 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

of the Advisers Act, effective July 21, 2011.[11] The primary purpose of repealing this exemption was to require advisers to private funds, such as hedge funds, to register under the Advisers Act.[12] But another potential consequence, which Congress recognized, was that many family offices that have relied on that exemption would be required to register under the Advisers Act or seek an exemptive order before that section of the Dodd-Frank Act becomes effective.

To prevent that consequence, section 409 of the Dodd-Frank Act creates a new exclusion from the Advisers Act in section 202(a)(11)(G), under which family offices, as defined by the Commission, are not investment advisers subject to the Advisers Act.[13] Section 409 instructs that any definition the Commission adopts should be "consistent with the previous exemptive policy" of the Commission and recognize "the range of organizational, management, and employment structures and arrangements employed by family offices."[14] We have taken this legislative instruction into account in formulating our proposed rule, as further detailed below.

II. DISCUSSION

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11 *See* section 403 of the Dodd-Frank Act.

12 *See* S. CONF. REP. NO. 111-176, at 38-39 (2010) ("Senate Committee Report").

13 The Senate Report states that "family offices are not investment advisers intended to be subject to registration under the Advisers Act" and that "the Advisers Act is not designed to regulate the interactions of family members, and registration would unnecessarily intrude on the privacy of the family involved." Senate Committee Report, *supra* note 12, at 75.

14 Section 409(b) of the Dodd-Frank Act. Section 409 also includes a "grandfathering clause" that precludes us from excluding certain family offices from the definition solely because they provide investment advice to certain clients and had provided investment advice to those clients before January 1, 2010. *See* section 409(b)(3) of the Dodd-Frank Act.

We propose to adopt new rule 202(a)(11)(G)-1 under the Advisers Act to define family offices that would be excluded from the definition of "investment adviser" under the Advisers Act. As a consequence, these family offices would not be subject to any of the provisions of the Advisers Act.

Proposed rule 202(a)(11)(G)-1 largely would codify the exemptive orders that we have issued to family offices. Each of these exemptive orders reflected the specific factual situation presented by the family office applicant. Drafting a rule defining family offices, however, requires us to turn these fact-specific exemptive orders into a rule of general applicability. Thus, the proposed rule would not (and could not) match the exact representations, conditions or terms contained in every exemptive order as they varied to accommodate the particular circumstances of each family office. For example, some of these orders have permitted specific individuals to be treated as a member of a family for purposes of the exemption.[15] Moreover, the Commission's views have changed over time as we have gained experience with family offices, and as we have been presented with new issues. Finally, some questions raised by this rulemaking have never been presented to us in the context of an exemptive request, but seem appropriate to address in a rule of general applicability.

The proposal, which we discuss in more detail below, reflects the Commission's current exemptive policy regarding family offices, and thus the policy judgments that we have made in granting the more recent orders, which Congress understood. Where terms and conditions in exemptive applications have varied over the years, we have sought to

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15 *See, e.g., Adler Management, L.L.C.*, Investment Advisers Act Release Nos. 2500 (Mar. 21, 2006) [71 FR 15498 (Mar. 28, 2006)] (notice) and 2508 (Apr. 14, 2006) (order) ("Adler") (permitting one particular "long-standing loyal family employee" to hold a beneficial interest in a family entity advised by the family office).

distill the policy rationale for the term or condition, and designed our proposed rule to align with the general policy.

The core policy judgment that formed the basis of our exemptive orders (and which prompted Congressional action) is the lack of need for application of the Advisers Act to the typical single family office.[16] The Act was not designed to regulate the interactions of family members in the management of their own wealth. Accordingly, most of the conditions of the proposed rule (like our exemptive orders) operate to restrict the structure and operation of a family office relying on the rule to activities unlikely to involve commercial advisory activities, while permitting traditional family office activities involving charities, tax planning, and pooled investing.

Finally, we note that the failure of a family office to be able to meet the conditions of this rule would not preclude the office from providing advisory services to family members either collectively or individually. In such a situation, a family office could seek an exemptive order from the Commission or, in the absence of such an order, the family office would be subject to the Advisers Act and would have to register unless another exemption is available. A number of family offices currently are registered under the Advisers Act.

We request comment generally on our approach to the proposed rule and its implementation of section 409 of the Dodd-Frank Act. Are other approaches available that we should consider?

A. Family Office Structure and Scope of Activities

16 We note that the proposed rule would exclude directors, partners, trustees, and employees of family offices from regulation under the Advisers Act only when they are acting within the scope of their position or employment.

As discussed below, the proposed rule contains three general conditions. First, it would limit the availability of the rule to family offices that provide advice about securities only to certain family members and key employees. Second, it would require that family members wholly own and control the family office. Third, it would preclude a family office from holding itself out to the public as an investment adviser. In addition to these conditions, we have incorporated into the rule the "grandfathering" provision required by section 409 of the Dodd-Frank Act.[17]

1. Family Clients

We propose that excluded family offices not be permitted to have any investment advisory clients other than "family clients."[18] As discussed in more detail below, family clients would include family members, certain employees of the family office, charities established and funded exclusively by family members or former family members, trusts or estates existing for the sole benefit of family clients, and entities wholly owned and controlled exclusively by, and operated for the sole benefit of, family clients (with certain exceptions), and, under certain circumstances, former family members and former employees.

a. *Family Member*

We propose to define the term "family member" to include the individual and his or her spouse or spousal equivalent for whose benefit the family office was established and any of their subsequent spouses or spousal equivalents, their parents, their lineal descendants (including by adoption and stepchildren), and such lineal descendants'

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[17] *See supra* note 14 and section II.A.4 of this release.

[18] Proposed rule 202(a)(11)(G)-1(b)(1).

spouses or spousal equivalents.[19] Except as discussed below, this definition generally corresponds to the types of clients that family offices have advised under our exemptive orders.

Our exemptive orders issued to family offices typically have included adopted children as family members because adopted children generally are not treated differently as a legal matter than children by birth.[20] However, our exemptive orders have not always included stepchildren as "family members."[21] Proposed rule 202(a)(11)(G)-1 would include stepchildren as family members. We recognize that stepchildren are not treated as consistently as adopted children under relevant tax, family, and estate law.[22]

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19 Proposed rule 202(a)(11)(G)-1(d)(3).

20 *See, e.g.*, *WLD Enterprises, Inc.*, Investment Advisers Act Release Nos. 2804 (Oct. 17, 2008) [73 FR 63218 (Oct. 23, 2008)] (notice) and 2807 (Nov. 14, 2008) (order) ("WLD"); *Woodcock Financial Management Company*, LLC, Investment Advisers Act Release Nos. 2772 (Aug. 26, 2008) [73 FR 51322 (Sept. 2, 2008)] (notice) and 2787 (Sept. 24, 2008) (order); Adler, *supra* note 15. For an example of the legal treatment of adopted children, *see, e.g.*, National Conference of Commissioner on Uniform State Laws, *Uniform Adoption Act*, (1994), at § 1-104 (each adoptive parent and the adoptee have the legal relationship of parent and child and have all the rights and duties of that relationship). This treatment is also reflected in federal laws. For example, section 2(a)(51)(ii) of the Investment Company Act of 1940 recognizes adopted children as "lineal descendants" for purposes of determining whether a person is a "qualified purchaser."

21 Our exemptive orders issued to family offices in two instances have included family offices advising stepchildren. *See* WLD, *supra* note 20 (included two stepchildren of the patriarch's son and their spouses and children, but required that those individuals be provided with written disclosure describing the material terms and effects of the exemptive order and that the office obtain written consent from these individuals); *Woodcock Financial Management Company, LLC*, Investment Advisers Act Release Nos. 2772 (Aug. 26, 2008) [73 FR 51322 (Sept. 2, 2008)] (notice) and 2787 (Sept. 24, 2008) (order) ("Woodcock") (including matriarch's children from a former marriage and their lineal descendants, and the spouses of such children and descendents).

22 For example, under state inheritance law, stepchildren typically are not granted the inheritance rights of genetic children unless they are adopted. *See, e.g.*, MASS. GEN. LAWS ANN. Ch. 190B, § 1-201(5) (West 2010); ALASKA STAT. § 13.06.050(5) (2010); FLA. STAT. ANN. § 731.201(3) (West 2010); HAW. REV. STAT. § 560:1-201(5) (2009), (32). *See also* Susan N. Gary, *We Are Family: The Definition of Parent and Child for*

However, we are proposing including stepchildren in our definition of a family client based on our understanding of their close ties to the family members who would be included in the definition, and on the fact that permitting stepchildren to be included as clients of the family office leaves to the family members whether they wish to include stepchildren as part of the family office clientele. Indeed, nothing in our proposed rule would mandate that the family office provide advice to any particular family member; it simply permits such advice.[23] We request comment on our proposed inclusion of stepchildren within the meaning of the term "family members" for purposes of the "family office" definition. Should we include stepchildren? Are there any additional conditions that we should impose if stepchildren are included?

Succession Purposes, 34 ACTEC J. 171, 172 (Winter 2008). Other states provide limited inheritance rights to stepchildren. *See, e.g.*, CAL. PROB. CODE § 6454 (West 2010) (stating that a stepchild may inherit through intestate succession if (1) the relationship began during the child's minority and continued throughout the joint lifetimes of the child and the child's stepparent and (2) it is established by clear and convincing evidence that the stepparent would have adopted the stepchild but for a legal barrier); CONN. GEN. STAT. ANN.§ 45a-439(a)(1) (West 2010) (stating that if a person dies intestate without any surviving children, spouse, parents, siblings, or other next of kin, then the estate is distributed to stepchildren rather than escheat to the state); MD. CODE ANN., EST. & TRUSTS § 3-104(e) (2010) (same). Other legal contexts have been more generous in ascribing legal rights to stepchildren. For example, some states have inheritance tax statutes that treat stepchildren the same as natural or adopted children. *See* Wendy C. Gerzog, *Families for Tax Purposes: What About the Steps?*, 42 U. MICH. J.L. REFORM 805, at n.37 and accompanying text (Summer 2009). The laws of inheritance are beginning to ascribe more rights to stepchildren. In 2008, the Uniform Probate Code was amended to recognize as a "child" for purposes of intestate succession any child for whom a parent-child relationship exists, regardless of whether the child's genetic parents are married and regardless of whether the child is a genetic child of each parent. *See* UNIFORM PROBATE CODE §§ 2-115 to 2-122. Some states have begun to amend their intestacy laws to reflect these amendments. *See, e.g.*, H.B. 09-1287, 67th Gen. Assem., 1st Reg. Sess. (Colo. 2009); H.B. 1072, 61st Leg. Assem., Reg. Sess. (N.D. 2009).

23 Thus, for example, this context differs from the intestacy context where family is often defined narrowly because the decedent is not alive to state whether or not he or she wishes his or her stepchildren to inherit his or her estate.

We also propose including "spousal equivalents," using the definition of that term currently used under our auditor independence rules.[24] We are not aware of any applicant that requested that spousal equivalents be included as a permitted client of any family office covered by our exemptive orders, and thus have never provided such relief. However, we believe that permitting spousal equivalents to be a family office client seems appropriate in a rule of general applicability. We request comment on our proposed definition of spousal equivalent.

The proposed rule also would permit a family office relying on the exclusion to provide investment advice to parents of the family office's founders.[25] While the family offices that have obtained an exemptive order from the Commission typically were managing wealth built by an older generation—and thus the "parents" are typically the "founders," we understand that this may not always be the case. For example, some entrepreneurs (such as in the technology and private fund management sectors) have built sizeable fortunes at an early age and may form a family office.[26] These younger founders may wish to include one or more of their parents as a client of the family office. We request comment on including parents of the founders as a "family member" under the proposed rule.

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[24] *See* 17 CFR 210.2-01(f)(9) and (13); *Revision of the Commission's Auditor Independence Requirements*, Securities Act Release No. 7919 (Nov. 21, 2000) [65 FR 76008 (Dec. 5, 2000)], at section IV.H.8. Spousal equivalent is defined as a cohabitant occupying a relationship generally equivalent to that of a spouse. *See* proposed rule 202(a)(11)(G)-1(d)(7).

[25] Proposed rule 202(a)(11)(G)-1(d)(3).

[26] *See, e.g.*, *Google Executives Eye Family Office*, PRIVATE ASSET MANAGEMENT (Dec. 5, 2005), at 1; Jim Grote, *Old Money vs. New Money*, FINANCIAL ADVISOR MAGAZINE (May 2003).

Our proposed definition of "family member" also would include siblings of the founders of the family office, their spouses or spousal equivalents, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents.[27] We have issued an exemptive order to a family office that advised siblings of one of the founders and certain of those siblings' descendants.[28] These individuals have close family ties to the founders and allowing family members to choose to include these individuals as family office clients does not appear to us to expand the family office's clientele to such an extent that it starts to resemble a typical commercial investment adviser. We request comment on including siblings and their spouses and descendants in the definition of family client.

More generally, we request comment on our definition of family member. Are we drawing the line too broadly or too narrowly regarding when the clientele of a family office starts to resemble that of a typical commercial investment adviser and not a single family? For example, certain legally created relationships such as certain types of guardianships may resemble the type of relationship that is included in the definition of family member depending on the facts and circumstances. Are there other types of family members that should be included? Why or why not? We note that family offices would still be able to seek a Commission exemptive order if they wanted to continue to advise family that did not meet our proposed definition of family member.

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27 Proposed rule 202(a)(11)(G)-1(d)(3).

28 The order was to a family office that advised siblings of one of the founders, those siblings' spouses, their children and their spouses, and their grandchildren and spouses (the applicant was required to give these individuals a disclosure statement describing the material legal effects associated with a Commission order exempting the family office from regulation under the Advisers Act). *See* WLD, *supra* note 20.

We are aware that some families have added other families to their family office's clientele to achieve economies of scale and thus save on costs.[29] The rule would not extend to family offices serving multiple families. We have never granted an exemptive order to a multifamily office declaring them not to be an investment adviser and thus including them would seem to be inconsistent with our prior exemptive policy. Many multifamily offices more resemble a typical commercial investment adviser appropriately subject to the Advisers Act. Should we permit multifamily offices to operate under this exclusion from the Advisers Act? If so, how would we distinguish between a multi-family commercial office and an office more closely resembling those operating under our exemptive orders (except providing advice to multiple families)?

b. *Involuntary Transfers*

We recognize that family offices may encounter situations in which assets under management are transferred involuntarily. We note that one implication of the proposed rule would be that a family office could continue to provide advice without becoming an investment adviser under the Advisers Act to a person that receives assets in an involuntary transfer only if the involuntary transaction is to a person that is a family client. For example, if a family member in his will left assets in a family office-advised private fund to a charity that did not qualify as a family client, generally after that family member died the family office could not continue to provide investment advice with respect to those assets and still rely on rule 202(a)(11)(G)-1 to be excluded from the definition of an investment adviser. The proposed rule would permit the family office to

29 *See* Hannah Shaw Grove & Russ Alan Prince, *E Pluribus Unum*, REGISTERED REP (May 1, 2004). These multi-family offices generally serve families with a lesser average net worth. *See* THE FAMILY OFFICE, *supra* note 2 (finding that the average net worth for a multi-family office client to be $116 million).

continue to advise such a client without violating the terms of the exclusion for four months following the transfer of assets resulting from the involuntary event, which should allow that family office to orderly transition that client's assets to another investment adviser, seek exemptive relief, or otherwise restructure its activities to comply with the Advisers Act.[30]

We believe that this treatment of involuntary transfers is appropriate because after such a bequest, the office would no longer be providing advice solely to members of a single family, and after several such bequests the office would cease to operate as a family office. Indeed, we have never issued an exemptive order to a family office permitting involuntary transfers to non-family members. However, we recognize that the Commission in some contexts has treated involuntary transfers in this manner and in other contexts permitted involuntary transfers outside the family.[31] We request comment

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30 Proposed rule 202(a)(11)(G)-1(b)(1).

31 For example, under our rules addressing the exclusion of private funds from the definition of an investment company, the Commission has treated an involuntary transfer of securities as if the transfer had not occurred, consistent with the direction from Congress in the Investment Company Act. *See* 15 U.S.C. 80a-3(c)(1)(B) 15 U.S.C. 80a-3(c)(7)(A); 17 CFR 270.3c-6. However, under our rules relating to the registration of securities pursuant to certain compensatory benefit plans, we have only permitted involuntary transfers to family members without jeopardizing the ability of the person to continue to rely on the exemptive provision. *See* 17 CFR 230.701 (exempting offers and sales of securities under a written compensatory benefit plan or written compensation contract for the participation of employees, directors, general partners, trustees, officers, or consultants and advisors, and their family members who acquire such securities from such persons through gifts or domestic relations orders). *See also* General Instruction A.1(a)(5) to Form S-8 (The form also is available for the exercise of employee benefit plan options and the subsequent resale of the underlying securities by an employee's family member who has acquired the options from the employee through a gift or a domestic relations order.); *Registration of Securities on Form S-8*, Securities Act Release No. 7646 (Feb. 26, 1999) [64 FR 11103 (Mar. 8, 1999)], at section III.A.2 (explicitly rejecting expanding the availability of the abbreviated disclosure in Form S-8 for the exercise of employee benefit plan options transferred by gift to charities or to other "unrelated persons who are the object of the employee's generosity" and stating that "[w]hile we seek to facilitate employees' estate planning through the amendments we adopt today, we must keep in mind that investor protection is our primary objective" and

on our proposed approach regarding involuntary transfers. Should we permit family clients to transfer assets advised by the family office to non-family clients if there is a death or other involuntary event without jeopardizing the ability of the family office to rely on the exclusion under proposed rule 202(a)(11)(G)-1? If so, under what conditions and to what types of transferees? How would we distinguish between a typical commercial adviser serving both related and unrelated clients from a family office resembling those operating under our prior exemptive orders? Should we allow a different period of time or transition mechanism to transfer assets that a non-family client receives in an involuntary transfer to another investment adviser?

c. *Former Family Members*

None of our exemptive orders have permitted former family members to receive investment advice from an exempt family office.[32] However, we recognize that divorces and other events may occur in some families covered by the rule and that addressing in our proposed rule the effect of these circumstances on the family office would provide clarity to family offices affected by such a legal separation from the family.

We propose permitting former family members, *i.e.*, former spouses, spousal equivalents and stepchildren, to retain any investments held through the family office at

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to "permit entities that are not controlled by, or for the primary benefit of, an employee's family members to exercise options on Form S-8 would suggest that the abbreviated Form S-8 disclosure is adequate for the offer and sale of securities to non-employees generally. As discussed above, we remain firmly persuaded of the contrary view.").

32 By including in the definition of "founders" any subsequent spouse of a founder,our proposed rule would address the situation in which the founders divorce and one or both of the founders subsequently remarries. *See* proposed rule 202(a)(11)(G)-1(d)(5). Again, we are not aware of any applicant for an exemptive order having requested that the order cover this situation, but in formulating a rule of general applicability, we thought it important to address the impact of this situation on the family office's exclusion under the Advisers Act.

the time they became a former family member.[33] However, we propose to limit former family members from making any new investments through the family office.[34] Our approach is designed to prevent such a separation from resulting in harmful investment or tax consequences, while also recognizing that such persons are no longer members of the family controlling the office, and thus would not be subject to the protections we assume accompany membership in a family. We request comment on this approach. Should we exclude former family members? Are there other approaches to treating such persons that we should consider?

d. *Family Trusts, Charitable Organizations, and Other Family Entities*

We also propose to treat as a "family client" any charitable foundation, charitable organization, or charitable trust established and funded exclusively by one or more family members[35] and any trust or estate existing for the sole benefit of one or more family clients.[36] Similarly, we would also treat as a family client any company,[37] including a pooled investment vehicle, that is wholly owned and controlled, directly or indirectly, by

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33 Proposed rule 202(a)(11)(G)-1(d)(2)(vi), and (d)(4).

34 The proposed rule would permit the family office to provide investment advice with respect to additional investments that the former spouse or spousal equivalent was contractually obligated to make, and that relate to a family-office advised investment existing, prior to the time the person became a former spouse or spousal equivalent (*e.g.*, if the individual has a previously existing capital commitment to a private fund advised by the family office). *See* proposed rule 202(a)(11)(G)-1(d)(2)(vi).

35 Proposed rule 202(a)(11)(G)-1(d)(2)(iii).

36 Proposed rule 202(a)(11)(G)-1(d)(2)(iv).

37 "Company" is defined in section 202(a)(5) of the Advisers Act to mean "a corporation, a partnership, an association, a joint-stock company, a trust, or any organized group of persons, whether incorporated or not; or any receiver, trustee in a case under title 11, or similar official, or any liquidating agent for any of the foregoing, in his capacity as such."

one or more family clients and operated for the sole benefit of family clients.[38] We generally have included these types of companies and organizations when owned and controlled by family members to be treated as permitted clients of the family office under our exemptive orders.[39] Including them should allow the family office to structure its activities through typical investment structures. We request comment on this aspect of our proposal.

e. *Key Employees*

We also are proposing to treat as family members certain key employees of the family office so that they may receive investment advice from and participate in investment opportunities provided by the family office. Such persons have been treated like family members in some of our exemptive orders.[40] Permitting participation by key employees allows such family offices to incentivize key employees to take a job with the

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38 Proposed rule 202(a)(11)(G)-1(d)(2)(v). Under proposed rule 202(a)(11)(G)-1(d)(1), control would be defined as the power to exercise a controlling influence over the management or policies of an entity, unless such power is solely the result of being an officer of such entity. If any of these companies are pooled investment vehicles, they must be exempt from registration as an investment company under the Investment Company Act of 1940 because the Advisers Act requires that an adviser to a registered investment company must register. *See* 15 U.S.C. 80b-3a(a)(1)(B).

39 *See, e.g.*, Woodcock, *supra* note 21; *Kamilche Company*, Investment Advisers Act Release Nos. 1958 (Jul. 31, 2001) [66 FR 41063 (Aug. 6 , 2001)] (notice) and 1970 (Aug. 27, 2001)(order).

40 *See, e.g.*, WLD, *supra* note 20 (family office provided investment advice to several executives of the family business and their trusts); Gates Capital Partners, LLC/Bear Creek, Inc., Investment Advisers Act Release Nos. 2590 (Feb. 16, 2007) [72 FR 8405 (Feb. 26, 2007)] (notice) and 2599 (Mar. 20, 2007) (order) (two pooled investment vehicles advised by the family office had non-voting interests owned by certain senior employees of the family office); Adler, *supra* note 15 (one long-standing employee held interest in one family office advised entity). These key employees typically either had their investments frozen or were permitted to continue their side-by-side investments through the family office but upon termination of employment were limited to investments at the time of termination along with reinvestment of accretions or distributions on the investment.

family office and to create positive investment results at the family office under terms that could be available to them as employees of other types of money management firms. It is our understanding that in some cases family offices may need to provide such incentives to attract highly skilled investment professionals who may not otherwise be attracted to work at a family office.[41]

The Dodd-Frank Act acknowledges the Commission's exemptive policy in this area by requiring that in defining a "family office" we "recognize the range of organizational, management, and employment structures and arrangements employed by family offices" in defining excluded family offices.[42] The Senate committee report explained that some family offices have non-family member directors, officers, and employees that may co-invest with family members, enabling them to share in the profits of investments that they oversee and better aligning the interests of such persons with those of the family members served by the family office.[43] The report states that it expected that "such arrangements would not automatically exclude a family office from the definition."[44]

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41 *See, e.g.*, Robert Frank, *Minding the Money—'Family Office' Chiefs Get Plied with Perks; Club Membership, Jets*, THE WALL STREET JOURNAL, at W2 (Sept. 7, 2007) ("a growing number of wealthy families are dangling the biggest perk of all: allowing their family office manager to become a "participant," investing his or her own funds along with the family money in big deals"). *But see* Thomas Coyle, *Family Offices Mostly Unscathed by Overhaul*, DOW JONES NEWS SERVICE (Jul. 16, 2010) ("family office recruiters don't think co-investment plays a big role in attracting family office managers").

42 Section 409(b)(2) of the Dodd-Frank Act.

43 Senate Committee Report, *supra* note 12, at 76.

44 *Id.*

The proposed rule would permit the family office to provide investment advice to any natural person (including persons who hold joint and community property with their spouse) who is (i) an executive officer, director, trustee, general partner, or person serving a similar capacity of the family office, or (ii) any other employee of the family office (other than an employee performing solely clerical, secretarial, or administrative functions) who, in connection with his or her regular duties, has participated in the investment activities of the family office, or similar functions or duties for or on behalf of another company, for at least twelve months.[45]

We believe that this standard would limit employees who participate without the protections of the Advisers Act (or family membership) to those employees that are likely to be in a position or have a level of knowledge and experience in financial matters sufficient to be able to evaluate the risks and take steps to protect themselves. This definition of key employee is based on the "knowledgeable employee standard" currently contained in Advisers Act rule 205-3(d)(iii), which specifies the types of clients to whom the adviser may charge performance fees.[46] We adopted the knowledgeable employee exception in the performance fee rule based on a similar policy conclusion that these

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45 Proposed rule 202(a)(11)(G)-1(d)(6). The proposed rule also would permit the family office to provide investment advice to trusts created for the sole benefit of family clients (which could include these key employees), and to other entities wholly owned and controlled by and operated for the sole benefit of family clients. Proposed rule 202(a)(11)(G)-1(d)(2)(iv)-(v).

46 The knowledgeable employee standard in Advisers Act rule 205-3 was itself based on the similar standard under the Investment Company Act of 1940 for knowledgeable employees of private funds that are exempt from registration under the Investment Company Act through section 3(c)(1) or 3(c)(7) of the Investment Company Act. *See* rule 3c-5 under the Investment Company Act [17 CFR 270.3c-5]; *Exemption To Allow Investment Advisers To Charge Fees Based upon a Share of Capital Gains upon or Capital Appreciation of a Client's Account*, Investment Advisers Act Release No. IA-1731 (Jul. 15, 1998) [63 FR 39022 (Jul. 21, 1998)], at nn.24-28 and accompanying text.

types of employees are likely to be sophisticated financially and not need the protections of the Advisers Act's restrictions on performance fees.[47]

Similar to our treatment of family members under the proposed rule, key employees would be able to structure their investments through trusts and other entities, subject to the conditions relating to control and ownership described earlier in this Release.[48] Upon the end of key employees' employment by the family office, key employees (including their trusts and controlled entities) would not be permitted to make additional investments through the family office.[49] Similar to our treatment of former spouses, spousal equivalents, and stepchildren, our proposed rule would not require former key employees to liquidate or transfer investments held through the family office at the time of the end of their employment, however, to avoid imposing possible adverse tax or investment consequences that might otherwise result.

We request comment on our proposed treatment of investments by employees of the family office. Should we permit key employees to receive investment advice through the family office? Do family offices rely on allowing co-investment to attract talented investment professionals to work at the family office? Should the definition of key employee be based on the knowledgeable employee standard in rule 205-3 under the Advisers Act? Are there restrictions that we should consider imposing as a condition to

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47 *See Exemption To Allow Investment Advisers To Charge Fees Based upon a Share of Capital Gains upon or Capital Appreciation of a Client's Account*, Investment Advisers Act Release No. IA-1731 (Jul. 15, 1998) [63 FR 39022 (Jul. 21, 1998)], at nn.24-28 and accompanying text.

48 *See* section II.A.1.d of this Release. *See also* WLD, *supra* note 20 (permitting the family office to advise key employee trusts).

49 Proposed rule 202(a)(11)(G)-1(d)(2)(vii).

such investment to help protect non-family members investing through the family office? Should we allow former key employees to retain their investments through the family office at the time of termination? Are any of our conditions too restrictive? For example, should we modify or eliminate the 12-month experience requirement for key employees? If so, how and why? Are there other types of individuals or entities that should be permitted to invest through the family office without jeopardizing that family office's exclusion under the Advisers Act?

More broadly, we request comment on our definition of who is considered a "family client." We have not included every type of individual or entity that has been included in a prior exemptive order based on specific facts and circumstances. We do not believe we could have taken such an approach in a rule of general applicability and we note that family offices would remain free to seek a Commission exemptive order to advise an individual or entity that does not meet our proposed family client definition. However, we request comment on our approach. Are there other individuals or entities that should be included? Under our proposed rule, the family office could not provide investment advice to a person that may have a long employment relationship with the family but does not qualify as a "key employee." Are there other types of individuals that commonly have close ties to a family that should be included as a family client? We note that as a family office extends its provision of investment advice beyond family members, it increasingly resembles a more typical commercial investment advisory business, and not a family managing its own wealth.

2. Ownership and Control

We propose that to operate under the proposed exclusion from the Advisers Act the family office be wholly owned and controlled, either directly or indirectly, by family members.[50] This condition generally is consistent with our exemptive orders[51] and assures that the family is in a position to protect its own interests and thus is less likely to need the protection of the federal securities laws.

This condition also helps distinguish family offices from family-run offices that may provide advice to other people, as well as other families, and operates as a more typical commercial investment adviser. Most family offices that have obtained an exemptive order from the Commission under the Advisers Act have represented that they did not operate for the purpose of generating a profit and charged fees designed to just cover their costs.[52] This feature helped distinguish these family offices from the family-run investment advisory businesses that the Advisers Act appropriately regulates. Requiring that the family office be wholly owned by family members alleviates any concern that we may otherwise have about the profit structure of the family office, because any profits generated by the family office from managing family clients' assets

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50 Proposed rule 202(a)(11)(G)-1(b)(2).

51 *See, e.g.*, WLD, *supra* note 20 (requiring that a majority of the board of directors of the family office be comprised of family members and that the family office be wholly owned by family members); *Slick Enterprises, Inc.*, Investment Advisers Act Release Nos. 2736 (May 22, 2008) [73 FR 30984 (May 29, 2008)] (notice) and 2745 (June 20, 2008) (order) (same) ("Slick").

52 *See, e.g.*, WLD, *supra* note 20; Adler, *supra* note 15; *Parkland Management Company, L.L.C.*, Investment Advisers Act Release Nos. 2362 (Feb. 24, 2005) [70 FR 10155 (Mar. 2, 2005)] (notice) and 2369 (Mar. 22, 2005) (order); *Longview Management Group LLC*, Investment Advisers Act Release Nos. 2008 (Jan. 3, 2002) [67 FR 1251 (Jan. 9, 2002)] (notice) and 2013 (Feb. 7, 2002) (order).

only accrue to family members. Accordingly, we are not proposing a specific condition regarding whether the family office generates a profit.

We request comment on the condition that the family office be wholly owned and controlled by family members. Are there reasons that we should not require that the family office be wholly owned and controlled by family members? Should some minor ownership stake of non-family members be permitted?[53] If we permitted non-family members to own a minor ownership stake in the family office, what other protections should we impose to ensure that the family office did not operate as a more typical commercial investment adviser? Are there other restrictions on ownership and control of the family office that we should impose consistent with our policy goals? Should we also require that the family office be operated without the intent of generating a profit or only charge fees designed to cover its costs and the compensation of its employees?

3. Holding Out

Consistent with our exemptive orders,[54] we propose to prohibit a family office relying on the rule from holding itself out to the public as an investment adviser.[55] Holding itself out to the public as an investment adviser suggests that the family office is seeking to enter into typical advisory relationships with non-family clients, and thus is inconsistent with the basis on which we have provided exemptive orders and this

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53 In one case we granted an exemptive order to a family office in which four churches owned a small interest in the family office. *See* Pitcairn, *supra* note 7. In one other case we granted an exemptive order to a family office owned by a trust in which half of the trustees were independent and half of the trustees were family members. *See Moreland Management Company*, Investment Advisers Act Release Nos. 1700 (Feb. 12, 1998) [63 FR 8710 (Feb. 20, 1998)] (notice) and 1706 (Mar. 10, 1998) (order).

54 *See, e.g.*, WLD, *supra* note 20; Woodcock, *supra* note 21; Slick, *supra* note 51.

55 Proposed rule 202(a)(11)(G)-1(b)(3).

proposed rule.[56] We request comment on this proposed condition. Are there circumstances where a family office holding itself out to the general public as an investment adviser should nevertheless be excluded from the protections afforded to the investing public under the Advisers Act?

4. Grandfathering Provisions

The Dodd-Frank Act prohibits us from excluding from our definition of family office persons not registered or required to be registered on January 1, 2010 that would meet all of the required conditions under rule 202(a)(11)(G)-1 but for their provision of investment advice to certain clients specified in section 409(b)(3) of the Dodd-Frank Act.[57] We have incorporated this required grandfathering into paragraph (c) of our proposed rule.[58]

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56 We note that the exemption from registration under section 202(b)(3) of the Advisers Act is not available to a person that holds himself out as an investment adviser. In addition, our staff has stated that a person that holds himself out as an investment adviser or as one who provides investment advice satisfies the "in the business" element of being an investment adviser under the Advisers Act. *See Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)].

57 *See* section 409(b)(3) and (c) of the Dodd-Frank Act. The family office must have been providing investment advice to such clients before January 1, 2010. The grandfathered clients are natural persons who, at the time of their investment, are officers, directors, or employees of the family office, and had invested with the family office before January 1, 2010. These clients must be accredited investors under Regulation D of the Securities Act of 1933. The other grandfathered clients are investment advisers registered under the Advisers Act that in turn provide investment advice and identify investment opportunities to the family office and invest in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office and whose assets as to which the family office directly or indirectly provides investment advice represent, in the aggregate, not more than 5% of the value of the total assets as to which the family office provides investment advice. *See* proposed rule 202(a)(11)(G)-1(c).

58 A family office that will only qualify for the exclusion under section 202(a)(11)(G) of the Advisers Act, as amended by the Dodd-Frank Act, because of section 409(b)(3) of the

B. Effect of Rule on Previously Issued Exemptive Orders

As discussed above, the Commission has issued orders under section 202(a)(11)(G) of the Advisers Act to certain family offices declaring them and their employees acting within the scope of their employment to not be investment advisers within the intent of the Act. In some areas these exemptive orders may be slightly broader than the rule we are proposing today, and in other areas they may be narrower.

We are not proposing to rescind the orders we have issued to family offices because we do not believe that the policy behind the previously issued orders differs substantially from that of our proposal. Further, single family offices do not compete with one another and thus there is no need to rescind exemptive orders to create a "level playing field." Family offices currently operating under these orders could continue to rely on those orders or, if they meet the conditions of proposed rule 202(a)(11)(G)-1, they could rely on the rule. We request comment on whether we should rescind previous orders granted to family offices under section 202(a)(11)(G) of the Advisers Act. Should we rescind the very early orders that did not impose all of the same conditions as more recent orders?

III. GENERAL REQUEST FOR COMMENT

The Commission requests comment on the rule proposed in this Release, suggestions for additional changes to the existing rules and comment on other matters that might have an effect on the proposals contained in this Release. Commenters should provide empirical data to support their views.

Dodd-Frank Act will still be subject to paragraphs (1), (2) and (4) of section 206 of the Advisers Act. *See* section 409(c) of the Dodd-Frank Act.

IV. PAPERWORK REDUCTION ACT

Proposed rule 202(a)(11)(G)-1 does not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[59] Accordingly, the Paperwork Reduction Act is not applicable.

V. COST-BENEFIT ANALYSIS

We have identified certain costs and benefits of the proposed new rule, and we request comment on all aspects of this cost benefit analysis, including identification and assessment of any costs and benefits not discussed in this analysis. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in this analysis, and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular family offices as well as any other costs or benefits that may result from the adoption of the proposed new rule.

In proposing this rule, we are responding to the Dodd-Frank Act's repeal of section 203(b)(3) of the Advisers Act and proposing a new exclusion for a "family office," which Congress anticipated we would define.[60] Proposed rule 202(a)(11)(G)-1 would exclude from regulation under the Advisers Act family offices that meet the qualifications and conditions contained in the proposed rule. Among other matters, to qualify as an excluded family office, the family office generally must have no non-family clients, must be wholly owned and controlled by family members, and must not hold itself out to the public as an investment adviser.

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59 44 U.S.C. 3501 *et seq.*

60 *See* section 409 of the Dodd-Frank Act.

A. Benefits

As discussed earlier in this Release, we expect that proposed rule 202(a)(11)(G)-1 would yield several important benefits. First, the proposed rule would result in several benefits for excluded family offices that do not already have an exemptive order. They would not be subject to the costs of registering with the Commission as an investment adviser and its associated compliance costs (or if they were previously registered, they would benefit from the reduced regulatory costs after de-registering in reliance on the exclusion). These reduced regulatory costs should result in direct cost savings to these family offices, and thus to their family clients. Excluded family offices would be able to maintain greater privacy because they would not have to make the public filings with the Commission that they would otherwise have to make as a registered investment adviser.

The proposed rule also would benefit the Commission and family offices that meet the conditions of the proposed rule and their clients by eliminating the costs and inefficiencies of seeking (and considering) individual exemptive orders. As discussed above, family offices that did not qualify for the exemption from registration contained in section 203(b)(3) of the Advisers Act often applied to the Commission for exemptive relief from the Advisers Act. Following the repeal of the exemption contained in section 203(b)(3), we would expect a much greater number of family offices to otherwise apply for exemptive relief absent our rule proposal.[61] We estimate that a typical family office (and thus indirectly their family clients) would incur legal fees of $200,000 on average to engage in the exemptive order application process, including preparation and revision of

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61 *See supra* note 3 and accompanying text for industry estimates of the number of single family offices.

an application and consultations with Commission staff.[62] The proposed rule would benefit qualifying family offices and their family clients by eliminating the costs of applying to the Commission for an exemptive order to avoid registration and the associated compliance burdens. It also would benefit excluded family offices and their family clients by eliminating the uncertainty that they might not obtain such an order.

The proposed rule also would benefit the Commission by freeing staff resources from reviewing and processing family office exemptive applications that would result from the repeal of section 203(b)(3) of the Advisers Act in many cases where the staff would likely recommend to the Commission that exclusion from regulation under the Advisers Act was appropriate and in the public interest, allowing the staff to target its work more efficiently, and thus would indirectly benefit investors.

We seek comment on whether the elimination of these costs would result in additional benefits to family offices or their clients.

B. Costs

We recognize that there are costs that could result if we adopted our proposed rule. We do not expect that the proposed rule would impose any significant costs on family offices currently operating under a Commission exemptive order. We are permitting these family offices to continue to rely on their exemptive orders and thus would expect them to do so if the costs to do so were lower than complying with the proposed rule. We expect that most of these family offices could satisfy all the conditions of the rule without changing their structure or operations. However, these family offices may incur one-time "learning costs" in determining the differences between their orders and the

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62 This estimate is based on our understanding of typical outside legal fees for past applications.

rule. We expect that such costs would be no more than $5,000 on average for a family office if it hires an external consulting firm or law firm to assist in determining the differences.[63] There are 13 family offices that have obtained exemptive orders. Accordingly, we estimate that these family offices collectively would incur outside consulting or legal expenses of $65,000 to discern the differences between their orders and the rule.

As discussed above, there are a number of family offices that currently are not registered as an investment adviser in reliance on the exemption from registration in section 203(b)(3) of the Advisers Act. The proposed rule would not impose any costs on those advisers because they currently are exempt from registration and thus would have no reason to consider whether they would rather rely on the proposed rule to relieve them of the burdens associated with being a registered investment adviser. After July 21, 2010, section 203(b)(3) of the Advisers Act will be repealed and as a result, some of these family offices would be subject to the costs and burdens of registration under the Advisers Act. However, these costs are a consequence of section 403 of the Dodd-Frank Act repealing the section 203(b)(3) exemption, and not this rulemaking. Accordingly, we do not attribute these costs to this rulemaking and thus are not considering them.

We recognize that some family offices may decide to restructure their business to meet the conditions imposed by proposed rule 202(a)(11)(G)-1 so that they would avoid the costs and burdens of registration in reliance on our proposed rule. Some family offices may need to reorganize the ownership or control structure of the family office in order to meet the family office definition under the proposed rule. We estimate that this

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63 We expect that a family office would need no more than 10 hours of consulting or legal advice to learn the differences between its order and the rule. We estimate that this advice would cost the family office $500 per hour based on our understanding of the rates typically charged by outside consulting or law firms.

type of reorganization could be accomplished without significant costs being imposed on the family office because we estimate that most family offices are wholly owned and those that are not only have a small number of non-family members with ownership interests. Other family offices may have to terminate providing investment advice to certain persons because they would not meet the definition of a "family client," which may require these individuals to divest interests in pooled investment vehicles and other entities advised by the family office. The costs of any such restructuring would be highly dependent on the nature and extent of investment of these non-qualifying clients through the family office, which we understand may vary significantly from family office to family office.

Finally, if there were any family offices that previously registered with the Commission, but now may de-register in reliance on the new family office exclusion in the Advisers Act, the proposed rule may have competitive effects on investment advisers that may compete with the family office for the provision of investment management services to family clients since these third party investment advisers would bear the regulatory costs associated with compliance with the Advisers Act or state investment adviser regulatory requirements. We do not expect that the proposed rule would impact capital formation.

We request comment on this analysis. Would family offices that currently rely on an order bear lower costs if they rely on the proposed rule? What amount and types of costs will these family offices bear as a result of the proposed rule? How many family offices are likely to restructure and in what ways? At what cost? What competitive impacts may result if registered family offices de-register if the proposed rule is adopted?

C. Request for Comment

The Commission requests comments on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this Release, as well as any other costs or benefits that may result from the proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[64] the Commission also requests information regarding the potential annual effect of the proposals on the U.S. economy. Commenters are requested to provide empirical data to support their views.

VI. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") regarding proposed rule 202(a)(11)(G)-1 in accordance with section 3(a) of the Regulatory Flexibility Act.[65]

A. Reasons for Proposed Action

We are proposing rule 202(a)(11)(G)-1 defining family offices excluded from regulation under the Advisers Act because we are required to do so under Section 409 of the Dodd-Frank Act.

B. Objectives and Legal Basis

As described more fully in Sections I and II of this Release, the general objective of proposed rule 202(a)(11)(G)-1 is to define a family office consistent with prior Commission exemptive policy consistent with the Dodd-Frank Act. The Commission is

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64 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

65 5 U.S.C. 603(a).

proposing rule 202(a)(11)(G)-1 pursuant to our authority set forth in section 202(a)(11)(G) of the Advisers Act [15 U.S.C. 80b-2(a)(11)(G)].

C. Small Entities Subject to the Rule

Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year.[66]

We do not have data and are not aware of any databases that compile information regarding how many family offices would be a small entity under this definition, but since family offices only are established for the very wealthy and given the statistics noted earlier showing that they generally serve families with at least $100 million or more of investable assets and have an average net worth of $517 million, we believe it is unlikely that any family offices would be small entities.[67]

D. Reporting, Recordkeeping, and other Compliance Requirements

Proposed rule 202(a)(11)(G)-1 would impose no reporting, recordkeeping or other compliance requirements.

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66 17 CFR 275.0-7(a).

67 *See supra* note 2 and accompanying text. *See also* THE FAMILY OFFICE, *supra* note 2 (finding investable assets of single family offices surveyed ranged from $197 million to $843 million); Family Wealth Alliance, Single-Family Office Study Executive Summary, *available at* http://www.fwalliance.com/store/2ndannualsinglefamilystudy.html (finding assets under management of surveyed single family offices ranged from $51 million to $2.1 billion); Wharton Study, *supra* note 4, at 4 (stating that surveyed single family offices had at least $100 million in investable assets).

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission has not identified any federal rules that duplicate, overlap, or conflict with the proposed rule.

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant impact on small entities. In connection with the proposed rules and amendments, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rule, or any part thereof, for small entities.

Proposed rule 202(a)(11)(G)-1 is exemptive and compliance with the rule would be voluntary. We therefore do not believe that different or simplified compliance, timetable, or reporting requirements, or an exemption from coverage of the proposed rule for small entities would be appropriate. The conditions in the proposed rule are designed to ensure that family offices operating under the rule would only impact the family itself and not the general public and, accordingly, the protections of the Advisers Act are not warranted. Reducing these conditions for smaller family offices would be inconsistent with the policy underlying the exclusion and would harm investor protection.

Our prior exemptive orders have not made any differentiation based on the size of the family office. In addition, as discussed above, we expect that very few, if any, family offices are small entities. The Commission also believes that proposed rule 202(a)(11)(G)-1 would decrease burdens on small entities by making it unnecessary for them to seek an exemptive order from the Commission to operate without registration under the Advisers Act. As a result, we do not anticipate that the potential impact of the proposed rule on small entities would be significant.

The proposed rule specifies broad conditions with which a family office must comply to rely on the exclusion; the proposed rule leaves to each family office how to structure its specific operations to meet these conditions. The proposed rule thus already incorporates performance rather than design standards. For these reasons, alternatives to the proposed rule appear unnecessary and in any event are unlikely to minimize any impact that the proposed rule might have on small entities.

G. Solicitation of Comments

We encourage written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on:

- the number of small entities that would be affected by the proposed rule; and
- whether the effect of the proposed rule on small entities would be economically significant.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect.

VII. STATUTORY AUTHORITY

We are proposing rule 202(a)(11)(G)-1 [17 CFR 275.202(a)(11)(G)-1] pursuant to our authority set forth in section 202(a)(11)(G) of the Advisers Act [15 U.S.C. 80b-2(a)(11)(G)].

LIST OF SUBJECTS IN 17 CFR PART 275

Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows.

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

2. Section 275.202(a)(11)(G)-1 is added to read as follows:

§ 275.202(a)(11)(G)-1 Family offices.

(a) *Exclusion.* A family office, as defined in this section, shall not be considered to be an investment adviser for purpose of the Act.

(b) *Family office.* A family office is a company (including its directors, partners, trustees, and employees acting within the scope of their position or employment) that:

(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this section 275.202(a)(11)(G)-1 for four months following the transfer of assets resulting from the involuntary event;

(2) Is wholly owned and controlled (directly or indirectly) by family members; and

(3) Does not hold itself out to the public as an investment adviser.

(c) *Grandfathering.* A family office as defined in paragraph (a) above shall not exclude any person, who was not registered or required to be registered under the Act on January 1, 2010, solely because such person provides investment advice to, and was engaged before January 1, 2010 in providing investment advice to:

(1) Natural persons who, at the time of their applicable investment, are officers, directors, or employees of the family office who have invested with the family office before January 1, 2010 and are accredited investors, as defined in Regulation D under the Securities Act of 1933;

(2) Any company owned exclusively and controlled by one or more family members; or

(3) Any investment adviser registered under the Act that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and whose assets as to which the family office directly or indirectly provides investment advice represents, in the aggregate, not more than 5 percent of the value of the total assets as to which the family office provides investment advice; provided that a family office that would not be a family office but for this subsection (c) shall be deemed to be an investment adviser for purposes of paragraphs (1), (2) and (4) of section 206 of the Act.

(d) *Definitions.* For purposes of this section:

(1) *Control* means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of being an officer of such company.

(2) *Family client* means:

(i) Any family member;

(ii) Any key employee;

(iii) Any charitable foundation, charitable organization, or charitable trust, in each case established and funded exclusively by one or more family members or former family members;

(iv) Any trust or estate existing for the sole benefit of one or more family clients;

(v) Any limited liability company, partnership, corporation, or other entity wholly owned and controlled (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more family clients; provided that if any such entity is a pooled investment vehicle, it is excepted from the definition of "investment company" under the Investment Company Act of 1940;

(vi) Any former family member, provided that from and after becoming a former family member the individual shall not receive investment advice from the family office (or invest additional assets with a family office-advised trust, foundation or entity) other than with respect to assets advised (directly or indirectly) by the family office immediately prior to the time that the individual became a former family member, except that a former family member shall be permitted to receive investment advice from the family office with respect to additional investments that the former family member was contractually obligated to make, and that relate to a family-office advised investment existing, in each case prior to the time the person became a former family member; or

(vii) Any former key employee, provided that upon the end of such individual's employment by the family office, the former key employee shall not receive investment advice from the family office (or invest additional assets with a family office-advised trust, foundation or entity) other than with respect to assets advised (directly or indirectly) by the family office immediately prior to the end of such individual's employment, except that a former key employee shall be permitted to receive investment advice from the family office with respect to additional investments that the former key employee was contractually obligated to make, and that relate to a family-office advised investment existing, in each case prior to the time the person became a former key employee.

(3) *Family member* means:

(i) the founders, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents;

(ii) the parents of the founders; and

(iii) the siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents.

(4) *Former family member* means a spouse, spousal equivalent, or stepchild that was a family member but is no longer a family member due to a divorce or other similar event.

(5) *Founders* means the natural person and his or her spouse or spousal equivalent for whose benefit the family office was established and any subsequent spouse of such individuals.

(6) *Key employee* means any natural person (including any person who holds a joint, community property, or other similar shared ownership interest with that person's spouse or spousal equivalent) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or any employee of the family office (other than an employee performing solely clerical, secretarial, or administrative functions with regard to the family office) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office, provided that such employee has been performing such functions and duties for or on behalf of the family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months.

(7) *Spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

October 12, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63081 / October 13, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14088

In the Matter of **Camera Platforms International, Inc.,** **Castleguard Energy, Inc.,** **CD Warehouse, Inc.,** **Ceatech USA, Inc.,** **Cedyco Corp.,** **Cell Robotics International, Inc.,** **Cell Wireless Corp.,** **Cellcom Corporation (n/k/a Cellcom I Corp.), and** **Central Utilities Production Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Camera Platforms International, Inc., Castleguard Energy, Inc., CD Warehouse, Inc., Ceatech USA, Inc., Cedyco Corp., Cell Robotics International, Inc., Cell Wireless Corp., Cellcom Corporation (n/k/a Cellcom I Corp.), and Central Utilities Production Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Camera Platforms International, Inc. (CIK No. 775714) is a void Delaware corporation located in Santa Ynez, California with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Camera Platforms 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, 2007, which reported a net loss of $59,000 for the prior three months. On September 17, 1999, an involuntary Chapter 7 petition was filed against Camera Platforms in the U.S. Bankruptcy Court for the Central District of California, converted to Chapter 11, and the case was terminated on December 11, 2001. As of October 7, 2010, the company's common stock (symbol "CPFR") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Castleguard Energy, Inc. (CIK No. 1077924) is a dissolved Florida corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Castleguard 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, 2006, which reported a net loss of $44,177 for the prior nine months. As of October 7, 2010, the company's stock (symbol "MOAT") 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).

3. CD Warehouse, Inc. (CIK No. 1025822) is a void Delaware corporation located in Oklahoma City, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CD Warehouse is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2002, which reported a net loss of $112,528 for the prior three months. On July 26, 2002, CD Warehouse filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Oklahoma, which was converted to Chapter 7, and the case was terminated on March 16, 2006. As of October 7, 2010, the company's common stock (symbol "CDWR") was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Ceatech USA, Inc. (CIK No. 943941) is a delinquent Colorado corporation located in Honolulu, Hawaii with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ceatech 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 July 31, 2003, which reported a net loss of $737,419 for the prior three months. On March 22, 2005, Ceatech filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Hawaii, and the case was terminated on May 2, 2007. As of October 7, 2010, the company's common stock (symbol "CEAH") was quoted on the Pink Sheets, had five market makers and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Cedyco Corp. (CIK No. 318894) is a void Delaware corporation located in Houston, Texas, with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cedyco 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, 1994. As of October 7, 2010, the company's common stock

(symbol "CYDC") was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Cell Robotics International, Inc. (CIK No. 845291) is a delinquent Colorado corporation located in Albuquerque, New Mexico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cell Robotics is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $600,293 for the prior three months. As of October 7, 2010, the company's common stock (symbol "CRII") 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).

7. Cell Wireless Corp. (CIK No. 1141880) is a Nevada corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cell Wireless 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, 2005, which reported a net loss of $377,792 for the prior three months. As of October 7, 2010, the company's common stock (symbol "CLWL") 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).

8. Cellcom Corporation (n/k/a Cellcom I Corp.) (CIK No. 737275) is a void Delaware corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cellcom 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 December 31, 2005, which reported a net loss of $14,614 for the prior three months. As of October 7, 2010, the company's common stock (symbol "CJCL") 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).

9. Central Utilities Production Corp. (CIK No. 1072229) is a revoked Nevada corporation located in Carrollton, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Central Utilities 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 June 30, 2002, which reported a net loss of $151,570 for the prior three months. On August 29, 2003, Central Utilities filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Texas, and the case was terminated on October 15, 2008. As of October 7, 2010, the company's common stock (symbol "CUPR") was quoted on the Pink Sheets, had six market makers and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

10. 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.

11. 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.

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

III.

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 13, 2010

IN THE MATTER OF Camera Platforms International, Inc., Castleguard Energy, Inc., CD Warehouse, Inc., Ceatech USA, Inc., Cedyco Corp., Cell Robotics International, Inc., Cell Wireless Corp., Cellcom Corporation (n/k/a Cellcom I Corp.), and Central Utilities Production Corp., 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 Camera Platforms International, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Castleguard Energy, Inc. because it has not filed any periodic reports since the period ended September 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of CD Warehouse, Inc. because it has not filed any periodic reports since the period ended March 31, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ceatech USA, Inc. because it has not filed any periodic reports since the period ended July 31, 2003.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cedyco Corp. because it has not filed any periodic reports since the period ended September 30, 1994.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cell Robotics International, Inc. because it has not filed any periodic reports since the period ended March 31, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cell Wireless Corp. because it has not filed any periodic reports since the period ended September 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cellcom Corporation (n/k/a Cellcom I Corp.) because it has not filed any periodic reports since the period ended December 31, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Central Utilities Production Corp. because it has not filed any periodic reports since the period ended June 30, 2002.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on October 13, 2010, through 11:59 p.m. EDT on October 26, 2010.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

Release No. 34-63094; File No. S7-28-10

RIN 3235-AK73

Reporting of Security-Based Swap Transaction Data

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rule; request for comments.

SUMMARY: Section 766 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires the Securities and Exchange Commission ("Commission") to adopt an interim final rule for the reporting of security-based swaps entered into before July 21, 2010, the terms of which had not expired as of that date ("pre-enactment security-based swap transactions"), within 90 days of the enactment of the Dodd-Frank Act. Pursuant to this requirement, the Commission today is adopting an interim final temporary rule that requires specified counterparties to pre-enactment security-based swap transactions to report certain information relating to pre-enactment security-based swaps to a registered security-based swap data repository or to the Commission by the compliance date established in the security-based swap reporting rules required under Sections 3C(e) and 13A(a) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first and report information relating to pre-enactment security-based swaps to the Commission upon request. The Commission also is issuing an Interpretive Note to

1 All references to the Exchange Act contained in this release refer to the Securities Exchange Act of 1934, as amended by the Dodd-Frank Act.

the rule that states that counterparties that may be required to report to the Commission will need to preserve information pertaining to the terms of these pre-enactment security-based swaps.

DATES: Effective Date: § 240.13Aa-2T is effective [insert date of publication in the Federal Register] and will remain in effect until the operative date of the permanent recordkeeping and reporting rules for security-based swap transactions to be adopted by the Commission or January 12, 2012, whichever occurs first.

Comment Date: Comments on the interim final temporary rule should be received on or before [insert date 60 days after publication in 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/final.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-28-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File Number S7-28-10. 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/interim-final-temp.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. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: David Michehl, Senior Special Counsel, at (202) 551-5627, Sarah Albertson, Special Counsel, at (202) 551-5647, Natasha Cowen, Special Counsel, at (202) 551-5652, Yvonne Fraticelli, Special Counsel, at (202) 551-5654, Geoffrey Pemble, Special Counsel, at (202) 551-5628, Brian Trackman, Special Counsel, at (202) 551-5616, Mia Zur, Special Counsel, at (202) 551-5638, Kathleen Gray, Attorney, at (202) 551-5305, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is adopting Rule 13Aa-2T under the Exchange Act as an interim final temporary rule. We are soliciting comments on all aspects of this interim final temporary rule. We will carefully consider the comments that we receive and will address them, if applicable, in connection with the permanent reporting rules the Commission is required to adopt under the Dodd-Frank Act.

I. Introduction

On July 21, 2010, the President signed into law the Dodd-Frank Act.[2] An important element of the Dodd-Frank Act is Title VII, the Wall Street Transparency and Accountability Act of 2010, which directly addresses regulation of over-the-counter derivatives ("OTC derivatives"). Title VII of the Dodd-Frank Act establishes a regulatory framework for OTC derivatives, and makes a number of statutory revisions to the Commodity Exchange Act and the

2 The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 11-203, H.R. 4173).

Exchange Act ("Title VII Amendments"). The Title VII Amendments broadly categorize covered products as either swaps, regulated primarily by the Commodity Futures Trading Commission ("CFTC"), security-based swaps, regulated primarily by the Commission, or mixed swaps, jointly regulated by the Commission and the CFTC.

Pursuant to Section 761 of the Dodd-Frank Act, new Section 3(a)(68) of the Exchange Act defines a security-based swap to include a swap, as defined in Section 1a of the Commodity Exchange Act,[3] that is based on a narrow-based security index, or a single security or loan, or

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[3] 7 U.S.C. 1a. Section 721(b) of the Dodd-Frank Act amends Section 1(a) of the Commodity Exchange Act to add paragraph (47) defining swap, subject to enumerated exceptions, as any agreement, contract, or transaction: (i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind; (ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence; (iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any agreement, contract, or transaction commonly known as (I) an interest rate swap; (II) a rate floor; (III) a rate cap; (IV) a rate collar; (V) a cross-currency rate swap; (VI) a basis swap; (VII) a currency swap; (VIII) a foreign exchange swap; (IX) a total return swap; (X) an equity index swap; (XI) an equity swap; (XII) a debt index swap; (XIII) a debt swap; (XIV) a credit spread; (XV) a credit default swap; (XVI) a credit swap; (XVII) a weather swap; (XVIII) an energy swap; (XIX) a metal swap; (XX) an agricultural swap; (XXI) an emissions swap; and (XXII) a commodity swap; (iv) that is an agreement, contract, or transaction that is, or in the future becomes commonly known to the trade as a swap; (v) including any security-based swap agreement which meets the definition of 'swap agreement' as defined in section 206A of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or

any interest therein or on the value thereof, or the occurrence or non-occurrence of an event relating to an issuer of a security or the issuers of securities in a narrow-based index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.[4] Section 761 of the Dodd-Frank Act also adds new definitions in Section 3(a) of the Exchange Act[5] for entities involved in the security-based swaps markets, including, among others, security-based swap dealer,[6] major security-based swap participant,[7]

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any interest therein; or (vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of clauses (i) through (v).

4 See 15 U.S.C. 78c(a)(68).

5 15 U.S.C. 78c(a).

6 Security-based swap dealer is defined in Section 3(a)(71)(A) of the Exchange Act, 15 U.S.C. 78c(a)(71)(A), to mean any person who: (i) holds themself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. The term security-based swap dealer does not include a person that enters into security-based swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business. 15 U.S.C. 78c(a)(71)(C). In addition, the Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers. 15 U.S.C. 78c(a)(71)(D).

7 Major security-based swap participant is defined in Section 3(a)(67)(A) of the Exchange Act, 15 U.S.C. 78c(a)(67)(A), as any person: (i) who is not a security-based swap dealer; and (ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; (II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (III) that is a financial entity that (aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking regulator; and (bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission. For purposes of subparagraph

security-based swap data repository,[8] and security-based swap execution facility.[9] The Commission has issued an advance notice of proposed rulemaking seeking comment on the definitions of key terms relating to the regulation of swaps and security-based swaps.[10]

The Dodd-Frank Act requires, among other things, that security-based swaps be reported to a registered security-based swap data repository or the Commission.[11] In particular, the Dodd-Frank Act added Section 13A(a)(2)(A) of the Exchange Act, which requires that pre-enactment security-based swaps be reported to a registered security-based swap data repository or the Commission by a date that is not later than: (i) 30 days after issuance of the interim final rule; or (ii) such other period as the Commission determines to be appropriate.[12] Section 13A(a)(2)(B) of the Exchange Act[13] requires the Commission to promulgate an interim final rule providing for

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(A), the Commission shall define, by rule or regulation, the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. 15 U.S.C. 78c(a)(67)(B).

8 Security-based swap data repository is defined in Section 3(a)(75) of the Exchange Act, 15 U.S.C. 78c(a)(75), as any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps.

9 Security-based swap execution facility is defined in Section 3(a)(77) of the Exchange Act, 15 U.S.C. 78c(a)(77), as a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of security-based swaps between persons; and (B) is not a national securities exchange.

The new definitions in Section 3(a) parallel amendments to Section 1(a) of the Commodity Exchange Act pursuant to Section 721 of the Title VII Amendments.

10 See Securities Exchange Act Release No. 62717 (August 13, 2010), 75 FR 51429 (August 20, 2010).

11 15 U.S.C. 78m-1(a)(2)(A).

12 See id.

13 15 U.S.C. 78m-1(a)(2)(B).

the reporting of these pre-enactment security-based swaps within 90 days of the enactment of the Dodd-Frank Act.[14] Consistent with its responsibilities under Section 13A(a)(2) of the Exchange Act, the Commission is today adopting Rule 13Aa-2T, an interim final temporary rule governing reporting of pre-enactment security-based swaps.

II. Interim Final Temporary Exchange Act Rule 13Aa-2T

The Commission is adopting Rule 13Aa-2T under the Exchange Act to specify the reporting requirements applicable to pre-enactment security-based swaps. Rule 13Aa-2T requires specified counterparties to a pre-enactment security-based swap transaction to: (1) report certain information relating to pre-enactment security-based swaps to a registered security-based swap data repository or to the Commission by the compliance date established in the security-based swap reporting rules required by Section 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first; and (2) report information relating to pre-enactment security-based swaps to the Commission upon request during an interim period. In addition, the Commission is issuing an Interpretive Note to Rule 13Aa2-T that reflects what information the Commission believes reporting parties should retain in order to meet the reporting obligation contained in the rule. Specifically, the Commission believes that counterparties will need to preserve information

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14 The Commission notes that Section 3C of the Exchange Act, added by Section 763(a) of the Dodd-Frank Act, also requires the Commission to adopt rules that provide for the reporting of data for security-based swaps entered into before the date of enactment of the Dodd-Frank Act to a registered security-based data repository or to the Commission no later than 180 days after the effective date of the Dodd-Frank Act (thus, by January 12, 2012). See 15 U.S.C. 78c-3(e). Section 3C is not effective until 360 days after enactment of Dodd-Frank Act. The Commission believes that its action today is consistent with both Sections 13A and Section 3C of the Exchange Act.

pertaining to the terms of such pre-enactment security-based swaps, to the extent and in such form as it currently exists.

We have included several requests for comment in this release. We will carefully consider the comments that we receive and will address them, if applicable, in connection with the permanent reporting rules, which will be published for notice and comment.

As explained above, the Dodd-Frank Act revises Section 3(a) of the Exchange Act to define key terms related to the new regulatory framework for security-based swaps.[15] Rule 13Aa-2T(a) incorporates the definitions of "major security-based swap participant," "security-based swap," "security-based swap dealer," and "security-based swap data repository" from the Dodd-Frank Act. The statutory language reserves to the Commission authority to further define these terms,[16] which the Commission expects to do as rules are developed relating to the regulation of security-based swaps and in response to input from market participants. In addition, the Commission notes that rules governing the registration of security-based swap data repositories will be the subject of another Commission rulemaking. As a result, there currently are no registered security-based swap data repositories able to accept security-based swap data as required under the Dodd-Frank Act.

A. Reporting Obligations

Rule 13Aa-2T(b)(1) requires that a counterparty to a pre-enactment security-based swap transaction shall report, with respect to a pre-enactment security-based swap transaction, to a registered security-based swap data repository or to the Commission: (1) a copy of the transaction confirmation, in electronic form, if available, or in written form, if there is no

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15 See supra Section I.

16 The Title VII Amendments enable the Commission to further define certain terms jointly with the CFTC, in consultation with the Board of Governors of the Federal Reserve System. See Section 712(d) of the Dodd-Frank Act.

electronic copy; and (2) the time, if available, the transaction was executed.[17] Rule 13Aa-2T(b)(1) also establishes the compliance deadline for reporting pre-enactment security-based swap transactions. Pursuant to Rule 13Aa-2T(b)(1), a reporting party shall report the pre-enactment security-based swap transaction by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act[18] or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first.[19] The Commission believes it is appropriate to delay the reporting of such transaction information until the time detailed above because, until the registration rule is adopted and implemented, there will not be a registered security-based swap data repository able to accept security-based swap data as required under the Dodd-Frank Act. Rule 13Aa-2T(a)(4) defines a pre-enactment security-based swap transaction as a security-based swap that was entered into prior to, and that had not expired as of, July 21, 2010.[20]

In addition, pursuant to Rule 13Aa-2T(b)(2), a counterparty to a pre-enactment security-based swap transaction is required to report to the Commission upon request any information relating to these pre-enactment security-based swap transactions during the time that the interim final temporary rule is in effect.[21] The information that the Commission would request to be

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17 See Rule 13Aa-2T(b)(1). See infra Section II.B for a discussion of which counterparty has the reporting obligation.

18 The Commission notes that Section 3C(e) of the Exchange Act requires that security-based swaps entered into before the date of enactment shall be reported no later than 180 days after the effective date of the section, i.e., January 12, 2012.

19 See Rule 13Aa-2T(b)(1). The Commission notes that rulemaking regarding registered security-based swap repositories must be completed within 360 days after the date of enactment of the Dodd-Frank Act.

20 See Rule 13Aa-2T(a)(4).

21 See infra Section II.B for a discussion of which counterparty has the reporting obligation.

reported may vary depending upon the needs of the Commission, and may include actual trade data as well as summary trade data. Such summary data may include a description of the types of a security-based swap dealer's counterparties or types of reference entities, or the total number of pre-enactment security-based swap transactions entered into by the dealer and some measure of the frequency and duration of those contracts.[22]

The Commission anticipates that Rule 13Aa-2T(b) will facilitate the Commission's ability to understand and evaluate the current market for security-based swaps, and may inform the Commission's analysis of the other required rulemakings under the Dodd-Frank Act. In addition, information requested by the Commission may be used to facilitate other activities of the Commission, such as examinations.

B. Reporting Party

Section 13A(a)(3) to the Exchange Act[23] specifies the party obligated to report a security-based swap – either a security-based swap dealer, a major security-based swap participant, or a counterparty to the swap. These provisions apply for purposes of reporting pursuant to the interim final temporary rule.[24] Specifically, Section 13A(a)(3) of the Exchange Act provides that with respect to a security-based swap in which only one counterparty is a security-based swap dealer or major security-based swap participant, the security-based swap dealer or major security-based swap participant shall report the security-based swap; with respect to a security-based swap in which one counterparty is a security-based swap dealer and the other counterparty is a major security-based swap participant, the security-based swap dealer shall report the

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22 See infra Section II.D for a discussion of the treatment of post-enactment security-based swaps.

23 15 U.S.C. 78m-1(a)(3).

24 See id.

security-based swap; and with respect to any other security-based swap, the counterparties to the security-based swap shall select a counterparty to report the security-based swap.[25]

Rule 13Aa-2T(c) incorporates these provisions. Specifically, Rule 13Aa-2T(c) provides that where only one counterparty to a security-based swap transaction is a security-based swap dealer or a major security-based swap participant, the security-based swap dealer or major security-based swap participant shall report the transaction; where one counterparty to a security-based swap transaction is a security-based swap dealer and the other counterparty is a major security-based swap participant, the security-based swap dealer shall report the transaction; and where neither counterparty to a security-based swap transaction is security-based swap dealer or a major security-based swap participant, the counterparties to the transaction shall select the counterparty who will report the transaction.[26]

C. Interpretive Note on Record Retention

Pre-enactment security-based swaps that must be reported pursuant to Section 13A(a)(2) of the Exchange Act[27] and new interim final temporary Rule 13Aa-2T thereunder have already occurred prior to enactment of the Dodd-Frank Act.[28] Thus, to support the reporting requirements in Rule 13Aa-2T(b), a Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T requires each counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction to retain information and documents relating to the terms of the

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25 See id.

26 See Rule 13Aa-2T(c).

27 15 U.S.C. 78m-1(a)(2).

28 Pre-enactment security-based swaps are those security-based swaps that were entered into before July 21, 2010, the terms of which had not expired as of that date. See Section 13A(a)(2)(A).

transaction.[29] Specifically, the Note requires a counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction to retain in its existing format all information and documents, if available, to the extent and in such form as they currently exist, relating to the terms of the security-based swap transaction, including but not limited to: any information necessary to identify and value the transaction; the date and time of execution of the transaction; all information from which the price of the transaction was derived; whether the transaction was accepted for clearing by any clearing agency or derivatives clearing organization, and, if so, the identity of such clearing agency or derivatives clearing organization; any modification(s) to the terms of the transaction; and the final confirmation of the transaction. The Commission believes that it is necessary for a counterparty that may be required to report such transaction to retain all information relating to the terms of pre-enactment security-based swaps in order for that counterparty to be able to comply with the reporting requirements of Rule 13Aa-2T. The specific information identified in the Note, as outlined above, is designed to encompass material information about pre-enactment security-based swap transactions that may be the subject of a request by the Commission to report pursuant to Rule 13Aa-2T(b)(2), as well as the information required to be reported pursuant to Rule 13Aa-2T(b)(1). The Commission believes that the information identified above will provide the Commission with access to relevant information to help the Commission perform its oversight functions under the federal securities laws.

The time of execution of a security-based swap transaction is the point at which the parties become irrevocably bound under applicable law.[30] For example, in the context of

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29 See Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T.

30 The Commission understands that time of execution is not a data element that is consistently captured with respect to security-based swap transactions.

security-based swaps, an oral agreement over the phone will create an enforceable contract, and the time of execution will be when the parties to the telephone call agree to the material terms.[31] The Commission also understands that the "price" of a security-based swap may be expressed differently for different asset classes.

The Commission envisions that documentation retained pursuant to the need to preserve all information from which the price of the transaction was derived should reflect all information necessary to determine the price including, among other things, the quoting convention (for example, the economic spread, which is variously referred to as the traded spread, quote spread or composite spread, expressed as a number of basis points per annum, for CDS transactions,[32] or the LIBOR-based Floating Rate Payment, expressed as a floating rate plus a fixed number of basis points multiplied by the notional amount, for equity or loan total return swaps).

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31 On the effective date of the Dodd-Frank Act, security-based swaps will be securities and the execution of the transaction will be the sale for federal securities law purposes. For an explanation of when a sale occurs under the Securities Act of 1933 see Securities Act Release No. 8591 and Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722 (August 3, 2005), notes 391 and 394.

32 Dealers quote prices for entering into credit default swaps as a fixed number of basis points per annum they require to be paid (if they are quoting to sell protection) or that they are willing to pay (if they are quoting to buy protection). This number is variously referred to as the "running spread," "quoted spread" or "traded spread." It will be higher to sell protection than to buy protection, allowing the dealer to earn a profit on offsetting transactions for the same reference entity – e.g., 510 basis points bid, 530 basis points asked.

On execution, the running spread is converted, using a standard, publicly available, industry-accepted formula, into an upfront payment plus a standardized coupon – generally 100 basis points for investment grade reference entities, and 500 basis points for high yield reference entities. This conversion does not affect the market value or economics of the transaction, and is done simply to make CDS more fungible, which makes them easier to clear, among other benefits. Because of this conversion, the running spread itself does not appear in the terms of the contract, but is replaced by its economic equivalent.

The interpretation to retain information does not require any counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction to create new records with respect to transactions that occurred in the past. By allowing such records to be retained in their existing format, the interpretation is designed to assure that important information relating to the terms of pre-enactment security-based swap transactions is preserved without unnecessary burden on the counterparties. Likewise, to the extent that any information required to be retained pursuant to the Note and reported pursuant to Rule 13Aa-2T(b)(1) or (b)(2) is not information that the counterparty already has prior to the effective date of this proposal, such as the time of execution, the Commission understands that such information could not be retained pursuant to the Note or reported pursuant to Rule 13Aa-2T(b)(1) or (b)(2).

D. Post-Enactment Security-Based Swaps

As noted above, Rule 13Aa-2T applies solely to security-based swap transactions entered into before July 21, 2010, the terms of which had not expired as of that date, and thus does not cover security-based swap transactions entered into on or after July 21, 2010. The Dodd-Frank Act, however, also requires the Commission to adopt reporting rules covering such post-enactment security-based swaps. Specifically, Section 3C(e)(2) of the Exchange Act requires the reporting of security-based swaps entered into on or after such date of enactment to a registered security-based swap data repository or the Commission no later than the later of: (A) 90 days after such effective date; or (B) such other time after entering into the security-based swap as the Commission may prescribe by rule or regulation.[33] In addition, Section 13A(a)(1) of the

33 See 15 U.S.C. 78c-3(e)(2). Section 3(C)(e)(1) also states that security-based swaps entered into before the date of the enactment of this section shall be reported to a

Exchange Act requires that each security-based swap that is not accepted for clearing by any clearing agency or derivatives clearing organization shall be reported to: (A) a security-based swap data repository described in Section 13(n) of the Exchange Act; or (B) in the case in which there is no security-based swap data repository that would accept the security-based swap, to the Commission within such time period as the Commission may by rule or regulation prescribe.[34] The Commission is directed to adopt rules under Sections 3C(e) and 13A(a) within 360 days of the enactment of the Dodd-Frank Act.[35] Parties to security-based swaps could be required under those rules, if adopted, to report information relating to such transactions. In that regard, counterparties could be expected to have access to similar information in order to report post-enactment security-based swaps.

E. Effective Date

Rule 13Aa-2T will be effective as of [insert date of publication in the Federal Register] and will remain in effect until the operative date of the permanent recordkeeping and reporting rules for security-based swap transactions to be adopted by the Commission or January 12, 2012, whichever occurs first.[36] The Commission believes it is appropriate to make the rule effective upon publication in the Federal Register since the rule applies to information parties to pre-enactment security-based swaps would already have in their possession. In addition, this would provide the Commission the ability to request information on such pre-enactment security-based swaps immediately. Further, the Commission believes the proposed sunset date is appropriate because it will allow the rule to remain in effect until a permanent rule relating to the reporting of

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registered security-based swap data repository or the Commission no later than 180 days after the effective date of that section.

34 See 15 U.S.C. 78m-1(a)(1).

35 See Sections 763(a) and 766(a) of the Dodd-Frank Act.

36 See Rule 13Aa-2T(d).

pre-enactment security-based swaps has become effective and operative, or until the date by which Section 3C of the Exchange Act requires security-based swaps entered into before the date of enactment of the Dodd-Frank Act to be reported to a registered security-based data repository or the Commission.[37]

III. Request for Comment

We are requesting comments from all members of the public. We will carefully consider the comments that we receive. We seek comment generally on all aspects of the interim final temporary rule. In addition, we seek comment on the following:

1. Should the Commission clarify or modify any of the definitions included in Rule 13Aa-2T? If so, which definitions and what specific modifications are appropriate or necessary?
2. The Commission seeks public comment on what specific information is necessary to derive the "price" of a security-based swap transaction. In other words, what specific information is needed for a third party to value the transaction? How do these data elements vary depending on the type or class of security-based swap? Do current quoting conventions across classes and types of securities-based swaps provide sufficient information from which to derive transaction prices?
3. Is there an industry standard format for information and records regarding security-based swaps? Are there different standard formats depending on the type or class of security-based swap? Please answer with specificity.
4. Rule 13Aa-2T(c) details which counterparty to a security-based swap transaction has the reporting obligation. In cases where counterparties must select which counterparty will

[37] See 15 U.S.C. 78c-3(e).

report the transaction, is additional Commission guidance necessary or desirable? Is there a mechanism to allocate the reporting obligation that the Commission should implement in such cases?

5. The Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T provides that counterparties shall retain, in their existing format, all information and documents relating to the terms of a pre-enactment security-based swap transaction, including but not limited to certain specified data elements. What documents and data typically are kept by security-based swap market participants to memorialize their transactions? What documents and data typically are kept to memorialize post-trade events such as novations, assignments, terminations and other events? In what format? How long are such records currently maintained by market participants? How often do market participants record the time of execution of a security-based swap?
6. The Commission requests comment on its interpretation of the types of documents and data needed to be retained in order to satisfy reporting required by the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T. What additional information, if any, should be retained and what burdens or costs would the retention of such information entail? What information and documents, if any, are not needed to be retained while still providing for an understanding of the material terms of a security-based swap?
7. What are the technological or administrative burdens of maintaining the information specified in the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T?
8. The Commission requests comment on the information that is required to be reported pursuant to Rule 13Aa-2T(b)(1). What additional information, if any, should be reported?

9. Rule 13Aa-2T is a temporary rule and is set to expire no later than January 12, 2012. Should we remove the expiration provision of the rule and make the rule permanent? Should we extend the expiration date of the rule? If so, for how long? Should we allow the rule to expire?

Title VII of the Dodd-Frank Act requires that the Commission consult and coordinate to the extent possible with the CFTC for the purposes of assuring regulatory consistency and comparability, to the extent possible,[38] and states that in adopting rules, the CFTC and Commission shall treat functionally or economically similar products or entities in a similar manner.[39]

The CFTC has adopted rules related to the reporting of swaps entered into before July 21, 2010, the terms of which had not expired as of that date ("pre-enactment swaps") as required under Section 729 of the Dodd-Frank Act. Understanding that the Commission and the CFTC regulate different products and markets, and as such, appropriately may be proposing alternative regulatory requirements, we request comments on the impact of any differences between the Commission and CFTC approaches to the regulation of pre-enactment security-based swaps and pre-enactment swaps. Specifically, do the regulatory approaches under the Commission's proposed rulemaking pursuant to Section 766 of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Section 729 of the Dodd-Frank Act result in duplicative or inconsistent efforts on the part of market participants subject to both regulatory regimes or result in gaps between those regimes? If so, in what ways do commenters believe that such duplication, inconsistencies, or gaps should be minimized? Do commenters believe the approaches proposed by the Commission and the CFTC to regulate pre-enactment security-based swaps and pre-

[38] Section 712(a)(2) of the Dodd-Frank Act.

[39] Section 712(a)(7) of the Dodd-Frank Act.

enactment swaps are comparable? If not, why? Do commenters believe there are approaches that would make the regulation of pre-enactment security-based swaps and pre-enactment swaps more comparable? If so,what? Do commenters believe that it would be appropriate for us to adopt an approach proposed by the CFTC that differs from our proposal? Is so, which one? We request commenters to provide data, to the extent possible, supporting any such suggested approaches.

IV. Other Matters

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.[40] This requirement does not apply, however, if the agency "for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest."[41] Further, the Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[42] This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.[43] The Commission, for good cause, finds that notice and solicitation of comment before the effective date of Rule 13Aa-2T is impracticable, unnecessary, or contrary to the public interest.[44] Section 766 of the Dodd-Frank Act amended the Exchange Act to add a new Section 13A. Section 13A(a)(2)(B) requires the Commission to adopt, within 90 days of enactment of the Dodd-Frank Act, an interim final rule providing for the reporting of

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40 See 5 U.S.C. 553(b).

41 Id.

42 See 5 U.S.C. 553(d).

43 Id.

44 This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are "impractical, unnecessary or contrary to the public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines.").

each security-based swap entered into before the date of enactment of the Dodd-Frank Act the terms of which were not expired as of that date.[45] The Commission is adopting Rule 13Aa-2T to fulfill this requirement.

V. Paperwork Reduction Act

Certain provisions of Rule 13Aa-2T contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[46] The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The title of this collection is "Rule 13Aa-2T – Reporting of Pre-Enactment Security-Based Swap Transactions." We are applying for a new OMB Control Number for this collection in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13.

1. Summary of Collection of Information

As required under Section 13A of the Exchange Act, as provided by Section 766 of the Dodd-Frank Act, the Commission is adopting new Rule 13Aa-2T governing the reporting requirements applicable to security-based swap transactions entered into before July 21, 2010, the terms of which have not expired as of that date, i.e., pre-enactment security-based swap transactions. Rule 13Aa-2T, by its terms, mandates three separate data collections for entities covered by the rule. The Commission believes that new Rule 13Aa-2T will impact more than 10 entities and thus meets the definition of a collection of information under the PRA.

First, pursuant to Rule 13Aa-2T(b)(1), pre-enactment security-based swap transactions must be reported to a registered security-based swap data repository or the Commission by the

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45 15 U.S.C. 78m-1(a)(2)(B).

46 44 U.S.C. 3501 et seq.

compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first.[47] The rule specifies that the transaction report shall include a copy of the transaction confirmation, in electronic form, if available, or in written form, if there is no electronic copy, and the time, if available, the transaction was executed.[48]

Second, Rule 13Aa-2T(b)(2) requires reporting to the Commission upon request of any information relating to pre-enactment security-based swap-transactions.[49] Finally, the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T requires each counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction to retain, in its existing format, all information and documents, if available, to the extent and in such form as they currently exist, relating to the terms of pre-enactment security-based swap transactions.[50] The rule specifies that such information shall include, without limitation: any information needed to identify and value the transaction; the time, if available, of execution of the transaction; all information from which the price of the transaction was derived; whether the transaction was accepted for clearing by any clearing agency or derivatives clearing organization, and, if so, the identity of such clearing agency or derivatives clearing organization; any modification(s) to the terms of the transaction; and the final confirmation of the transaction.[51]

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47 See Rule 13Aa-2T(b)(1).

48 Id.

49 See Rule 13Aa-2T(b)(2).

50 See Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T.

51 Id.

2. Proposed Use of Information

The rule makes information available to the Commission that can provide insight into the size and operation of the OTC derivatives market.[52] The information will provide a starting benchmark against which to assess the development of the security-based swap market over time. The information collected pursuant to Rule 13Aa-2T also will provide the Commission information to assist with its analysis of the permanent reporting and other rules required by the Dodd-Frank Act. Information related to pre-enactment security-based swap transactions may also be used by the Commission to assess activities and risks in the security-based swap markets or securities markets more generally. Requiring such information be reported also should facilitate general market oversight.

3. Respondents

Rule 13Aa-2T requires reporting of all security-based swaps entered into prior to July 21, 2010, the terms of which have not expired as of that date. The rule thus will cover security-based swap dealers, major security-based swap participants, each defined in Section 3(a) of the Exchange Act, and other counterparties when there is no security-based swap dealer or major security-based swap participant involved in the pre-enactment security-based swap transaction.[53]

The Commission does not know the exact number of security-based swap market participants. Based on the information currently available to the Commission, there are roughly 1,000 entities regularly engaged in the CDS marketplace, consisting primarily of banks, hedge funds, and asset managers. The Commission believes that most of these same entities would likely also participate in other security-based swap markets and that few, if any, other entities

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[52] For example, the information collected could provide the Commission with insight as to the size (in notional value), number of transactions, and number and type of participants, of the security-based swap market.

[53] See 15 U.S.C. 78c(a)(68) and (71).

engage in security-based swaps that are not CDSs. Accordingly, the Commission preliminarily believes that it is reasonable to use the figure of 1,000 potential respondents covered by Rule 13Aa-2T for purposes of estimating collection of information burdens under the PRA.

The Commission seeks comment on what entities may be subject to Rule 13Aa-2T, whether specific classes of entities may be impacted, how many entities may be impacted, and whether any such entity or class of entities may be impacted differently than others under the rule. The Commission seeks comment on the accuracy of its estimates as to the number of participants in the security-based swap market that will be required to report information pursuant to Rule 13Aa-2T.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

As described above, pursuant to Rule 13Aa-2T(b)(1), pre-enactment security-based swap transactions must be reported to a registered security-based swap data repository or the Commission by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first. Additionally, Rule 13Aa-2T(b)(2) requires reporting to the Commission upon request of any information relating to pre-enactment security-based swap-transactions. Finally, the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T requires each counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction to retain, in its existing format, all information and documents, if available, to the extent and in such form as they currently exist, relating to the terms of pre-enactment security-based swap transactions.

Although a new obligation, the Commission does not believe that Rule 13Aa-2T will require covered entities to materially change their current practices or operations with respect to recordkeeping for pre-enactment security-based swap transactions. The Commission believes that any counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction, as part of its regular business operations, would already maintain records of any such transactions, and that such records likely include the minimum information set out in the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T. Nonetheless, our interpretation that counterparties must retain information relating to the terms of pre-enactment security-based swaps in order to be able to satisfy their reporting obligation is a new burden. Entities subject to the rule may have to implement new document retention and reporting policies.[54]

Based on publicly available information and consultation with industry sources, the Commission estimates there were approximately 2 million CDS contracts outstanding on the date of enactment.[55] The Commission believes that CDS transactions represent the majority of security-based swap transactions. The Commission preliminarily estimates that CDS transactions represent approximately 85 percent of all security-based swap transactions open on the date of enactment of the Dodd-Frank Act.[56] Accordingly, the total number of security-based swap transactions subject to Rule 13Aa-2T would be approximately 2,400,000.

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[54] The Commission expects to issue permanent rules regarding the retention and reporting of information about the terms of security-based swaps within the next year in compliance with the Dodd-Frank Act. Any PRA burden contained in those rules will be taken into account in those rulemakings.

[55] See, e.g., http://www.dtcc.com/products/derivserv/data_table_i.php (data as of July 23, 2010).

[56] The Commission's estimate is based on internal analysis of available security-based swap market data. The Commission is seeking comment about the overall size of the security-based swap market, and as discussed in this release, believes that Rule 13Aa-2T will, among other things, provide insight about the number of pre-enactment security-based swaps and the overall size of the security-based swap market.

The Commission preliminarily estimates that the requirement to retain information and documents pursuant to the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T would impose a burden on each respondent of approximately 38 burden hours for an aggregate burden of approximately 38,000 hours, which includes an estimate of the number of potential burden hours required to amend internal procedures, reprogram systems, and implement compliance processes to ensure that pre-enactment security-based swap transaction data is preserved.[57]

Rule 13Aa-2T(b)(1) requires reporting entities to report pre-enactment security-based swap transactions to a registered security-based swap data repository or the Commission by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first. Reporting entities may have initial costs to establish connectivity with and report the pre-enactment security-based swaps to a registered security-based swap data repository or the Commission. The Commission preliminarily estimates that the cost to establish connectivity to a security-based swap data repository to facilitate the reporting required by Rule 13Aa-2T(b)(1) would impose a burden on each respondent of approximately $25,000, for an

57 This figure is based on discussions with various market participants. It is based on the following: [((Sr. Programmer at 2 hours) + (Sr. Systems Analyst at 4 hours) + (Compliance Manager at 5 hours) + (Compliance Clerk at 20 hours) + (Director of Compliance at 2 hours) + (Compliance Attorney at 5 hours)) x (1000 reporting entities)] = 38,000 burden hours, which is 38 hours per reporting entity. As noted, the Commission preliminarily believes that, given the current nature of the records to be retained, information on security-based swap transactions is currently being retained by market participants in the ordinary course of business, and as a practical matter should not result in any significant new burdens. Because the Commission expects to adopt permanent reporting rules within one year, the Commission does not believe that Rule 13Aa-2T will generate any ongoing burdens beyond the first 12 months. Accordingly, our estimates do not distinguish initial and ongoing burdens.

aggregate burden of approximately $25,000,000.[58] In addition, the Commission preliminarily estimates that complying with Rule 13Aa-2T(b)(1) would impose a burden on each respondent of approximately 480 hours, for an aggregate burden of approximately 480,000 burden hours.[59]

Rule 13Aa-2T(b)(2) requires reporting entities to report to the Commission upon request any information relating to pre-enactment security-based swap transactions. Because the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T(d) requires reporting entities to retain their documents and information relating to the terms of pre-enactment security-based swap transactions, the Commission preliminarily believes that responding to a Commission request for such information should not impose a significant additional burden on reporting entities. A reporting entity would need to review the request and gather responsive transaction data and

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58 This estimate is based on discussions of Commission staff with various market participants, as well as the Commission's experience regarding connectivity between securities market participants, including alternative trading systems and self-regulatory organizations for data reporting purposes. The Commission derived the total estimated expense from the following: ($25,000 relating to hardware- and software-related expenses) x (1,000 reporting entities) = $25,000,000. It is the Commission's understanding that many reporting entities already have established linkages to entities that may register as security-based swap data repositories, which may impact the out-of-pocket costs associated with Rule 13Aa-2T(b)(1).

59 This figure is based on discussions of Commission staff with various market participants, as well as the Commissions experience regarding connectivity between securities market participants, including alternative trading systems and self-regulatory organizations for data reporting purposes. The Commission derived the total estimated one-time burden from the following: [(2,400,000 estimated total pre-enactment securities-based swap transactions) x (75 percent automated, electronic reporting) x (0.1 hours/transaction)] + [2,400,000 estimated total pre-enactment securities-based swap transactions) x (25 percent manual, electronic reporting) x (Compliance Clerk 0.5 hours/transaction)] = 480,000 burden hours, which is 480 burden hours per respondent. Because the Commission expects to adopt permanent reporting rules within one year, the Commission does not believe that Rule 13Aa-2T will generate any ongoing burdens beyond the first 12 months. Accordingly, our estimates do not distinguish initial and ongoing burdens.

documents. Assuming the Commission requested one report from each reporting entity,[60] the Commission preliminarily estimates that responding to Commission requests for information and documents pursuant to Rule 13Aa-2T(b)(2) would impose a burden on each respondent of approximately 34 hours, for an aggregate burden of approximately 34,000 burden hours.[61]

The Commission seeks comment on the recordkeeping and reporting collection of information burdens associated with Rule 13Aa-2T. In particular, what burdens, if any, will respondents incur with respect to system design, programming, expanding systems capacity, and establishing compliance programs to comply with Rule 13Aa-2T? Will there be different or additional burdens associated with the collection of information under Rule 13Aa-2T that a covered entity does not currently undertake in the ordinary course of business that we have not identified?

5. Retention Period of Recordkeeping Requirements

A covered entity will be required by Rule 13Aa-2T to retain records and information only until such information has been reported to a registered security-based swap data repository or the Commission.[62] Rule 13Aa-2T(b)(1) provides that the reporting shall occur by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository

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60 The Commission preliminarily believes it would not request reports from every reporting entity. However, for purposes of estimating the burden, the Commission is assuming it would request one report from each reporting entity.

61 This figure is based on discussions with various market participants. It is based on the following: [(Compliance Manager at 5 hours) + (Compliance Attorney at 5 hours) + (Programmer Analyst at 1 hour) + (Compliance Clerk at 15 hours) + (Director of Compliance at 3 hours) + (Sr. Database Administrator at 5 hours)] x (1000 reporting entities) = 34,000 burden hours, which is 34 hours per reporting entity.

62 The Commission notes that a respondent may well be subject to additional record retention burdens for pre-enactment security-based swaps pursuant to rules to be adopted by the Commission pursuant to Section 3C(e) of the Exchange Act.

commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first.

6. Collection of Information is Mandatory

Any collection of information pursuant to Rule 13Aa-2T will be a mandatory collection of information to permit the Commission to collect accurate information about security-based swap transactions entered into prior to, and not expired as of, the date of enactment of the Dodd-Frank Act.

7. Responses to Collection of Information May Not Be Confidential

Other than information for which a reporting entity requests confidential treatment and that may be withheld from the public in accordance with the provisions of 5 U.S.C. 522 (The Freedom of Information Act ("FOIA")), the collection of information pursuant to Rule 13Aa-2T will not be kept confidential and will be publicly available. Among other things, FOIA recognizes the confidentiality of commercial information under two exemptions. First, FOIA Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential."[63] Second, FOIA Exemption 8 provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."[64] The Commission will carefully consider any requests for confidential treatment under either of these exemptions or under other exemptions contained in 5 U.S.C. 522.

8. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

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63 See 5 U.S.C. 552(b)(4).

64 See 5 U.S.C. 552(b)(8).

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;

2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

3. Enhance the quality, utility, and clarity of the information to be collected; and

4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

VI. Cost-Benefit Analysis

Earlier this year, Congress passed the Dodd-Frank Act. The far-reaching legislation was a response to the recent financial crisis. Among other things, it is designed to strengthen oversight, improve consumer protections, and reduce systemic risks throughout the financial system.[65] Title VII of the Dodd-Frank Act specifically addresses the OTC derivatives markets, including the market for security-based swaps. The swap markets have been described as being opaque.[66] Transaction-level data is not publicly available. A major source of information is the semi-annual survey conducted by the Bank of International Settlements ("BIS") on the volume

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65 See H.R. Rep. No. 111-517, at 865 (2010). See, e.g., 156 Cong. Rec. S5878 (July 15, 2010) and 156 Cong. Rec. S5882 (July 15, 2010).

66 With respect to CDS, for example, the Government Accountability Office found that "comprehensive and consistent data on the overall market have not been readily available," that "authoritative information about the actual size of the CDS market is generally not available," and that regulators currently are unable "to monitor activities across the market." Government Accountability Office, "Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps," GAO-09-397T (March 2009), at 2, 5, 27. See Robert E. Litan, "The Derivatives Dealers' Club and Derivatives Market Reform," Brookings Institution (April 7, 2010) at 15-20. See also Michael Mackenzie, June 25, 2010, Era of an opaque swaps market ends, FIN. TIMES, June 25, 2010.

of swaps transaction by major categories of swaps.[67] One of the purposes of the Dodd-Frank Act is to improve the transparency of the OTC derivatives market.[68]

Title VII requires the Commission to undertake a large number of rulemakings to implement the regulatory framework for security-based swaps that is set forth in the Dodd-Frank Act, including the reporting of security-based swap transactions. The interim final temporary rule being issued today is the first step in that process and is designed to provide for reporting of pre-enactment security-based swaps in the framework set up by the Dodd-Frank Act. The rule will provide the Commission the ability to obtain data on pre-enactment security-based swaps. Rule 13Aa-2T also will provide for the preservation of data on pre-enactment security-based swaps until the Commission issues permanent recordkeeping and reporting rules for all security-based swaps. By making records available to the Commission, Rule 13Aa-2T will enable the Commission to begin its review of the size and scope of the security-based swap marketplace. Today's action is designed to ultimately lead to a more robust, transparent environment for the market for security-based swaps.

The Commission is sensitive to the costs and benefits associated with Rule 13Aa-2T. The Commission requests comment on the costs and benefits associated with the rule, and its cost-benefit analysis, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comments on the accuracy of any of the

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67 The BIS semi-annual report on the swap markets summarizes developments in the OTC derivatives markets during the relevant period. The report breaks down trading volumes and other statistics for various classes of derivatives, including credit default swaps, interest rate and foreign exchange derivatives, and equity and commodity derivatives. The report covers derivatives trading within the G10 countries. The most recent report, available at http://www.bis.org/statistics/derstats.htm, covers the period through the last quarter of 2009.

68 See, e.g., 156 Cong. Rec. S5879 (July 15, 2010) and 156 Cong. Rec. H5252 (June 30, 2010).

benefits identified and also welcomes comments on the accuracy of any of the cost estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

A. Benefits

Rule 13Aa-2T, which is being adopted as required by the Dodd-Frank Act, will provide a means for the Commission to gain a better understanding of the security-based swap markets, including the size and scope of that market, by making available transaction data on pre-enactment security-based swaps. In addition, having such data available should help Commission staff to analyze the security-based swap market as a whole and identify risks. In this way, Rule 13Aa-2T will support the Commission's supervisory function over the security-based swap markets as required by Congress in the Dodd-Frank Act. Further, the rule should make available information to the Commission that could inform its decision-making with respect to the rules that it is required to implement under the Dodd-Frank Act. Rule 13Aa-2T also could facilitate the reports the Commission is required to provide to Congress on security-based swaps and the security-based swaps marketplace.[69]

Further, Rule 13Aa-2T will require market participants to inventory their positions in swaps to determine what information needs to be retained and reported. Potentially, this may encourage management review of internal procedures and controls by those market participants.

The Commission's rules on reporting pre-enactment security-based swap transaction data also may have benefits to the OTC derivatives market. For example, the introduction of the Trade Reporting and Compliance Engine (TRACE) system helped substantially increase the

69 See Section 719 of the Dodd-Frank Act.

transparency of, and decrease transaction costs in, the bond market.[70] This interim final temporary rule represents a first step toward a more transparent market for security-based swaps. Market participants also will be able to begin planning how security-based swap data can be maintained, consolidated, and reported in anticipation of permanent rules to be issued by the Commission pursuant to the requirements set forth in the Dodd-Frank Act. The initial experience in the context of Rule 13Aa-2T may help market participants and the Commission assess alternatives for permanent security-based swap transaction reporting requirements.

B. Costs

The Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T requires the retention of records relating to security-based swap transactions entered into before July 21, 2010, the terms of which had not expired as of that date. Although there are recordkeeping costs associated with the retention of existing pre-enactment security-based swap transaction information, the Commission preliminarily does not believe that they will be significant. The information that is required to be reported pursuant to Rule 13Aa-2T(b)(1)(A) – a copy of the transaction confirmation – should be information that respondents already keep in their normal course of business. In addition, that information can be reported in the form in which it is kept, either electronic or written form. Further, respondents must report the time of execution pursuant to Rule 13Aa-2T(b)(1)(B) only to the extent that the information is available.

The Commission preliminarily estimates that the interim final temporary rule could affect more than 1,000 market participants and cover approximately 2.4 million security-based swap transactions, although identification of the exact number of respondents and covered transactions

70 Michael, Goldstein, Edith Hotchkiss and Erik Sirri, Transparency and Liquidity: A Controlled Experiment on Corporate Bonds, Review of Financial Standards (2007); Amy Edwards, Lawrence Harris and Michael Piwowar, Corporate Bond Market Transaction Costs and Transparency, J. of Fin. (2007).

is impossible to determine at this time.[71] As stated above, however, the Commission preliminarily believes that information about open security-based swap transactions should already be maintained by covered entities as part of their day-to-day operations. Further, the rule does not require market participants to modify the data that they have for retention purposes. Rule 13Aa-2T requires only that parties retain records of the terms of the transactions in the form and to the extent that they already exist; parties are not required retroactively to supplement or otherwise alter transaction information.

The Commission recognizes that the permanent reporting rules that it is required to adopt under Section 3C(e) of the Exchange Act also will apply to pre-enactment security-based swaps. Therefore, in adopting Rule 13Aa-2T, the Commission sought to limit the burden on potential respondents by not imposing substantial and potentially conflicting affirmative reporting requirements that would require respondents to make system and other changes that may be different from the changes they will need to make pursuant to the permanent reporting rules.[72]

The Commission preliminarily estimates that amending internal procedures, reprogramming systems, and implementing compliance processes to ensure that pre-enactment security-based swap transaction data is preserved pursuant to the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T could result in a cost to each respondent of approximately $6,236 and an

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71 See supra Section V.

72 The Commission believes that it is practical to require this reporting after rules for registration of security-based data repositories are in place, to allow the choice of reporting to an entity that has experience receiving this type of information. The Commission will have access to the data it determines is most useful for understanding and analyzing the market for security-based swaps as it develops final reporting and other rules required under the Dodd-Frank Act by being able to require information to be reported upon request to the Commission under Rule 13Aa-2T(b)(2).

aggregate cost of approximately $6,236,000.[73] The Commission preliminarily does not believe that there will be additional costs attributable to the record retention requirements of Rule 13Aa-2T beyond the initial cost of ensuring that such records are maintained.

The Commission preliminarily estimates that the requirement to report the transaction confirmation and time, if available, of execution pursuant to Rule 13Aa-2T(b)(1) could result in a cost to each reporting entity of approximately $43,900 and an aggregate cost of approximately $43,900,000.[74] This cost figure includes two main components. These are, first, an estimate of the cost to establish connectivity to a security-based swap data repository; and second, an estimate of the cost to complete the reporting process.

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73 This figure is based on discussions with various market participants. The Commission derived the total estimated initial annualized expense from the following: ((Sr. Programmer (2 hours) at $292 per hour + (Sr. Systems Analyst (4 hours) at $244 per hour) + (Compliance Manager (5 hours) at $258 per hour) + (Compliance Clerk (20 hours) at $63 per hour) + (Director of Compliance (2 hours) at $388 per hour) + (Compliance Attorney (5 hours) at $270 per hour)) x (1000 reporting entities) = $6,236,000, which is $6,236 per reporting entity. Hourly figures cited in this release are from SIFMA's <u>Management & Professional Earnings in the Securities Industry 2008</u> and SIFMA's <u>Office Salaries in the Securities Industry 2008</u>, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 or 2.93, as appropriate, to account for bonuses, firm size, employee benefits, and overhead. Because the Commission expects to adopt permanent reporting rules within one year, the Commission does not believe that Rule 13Aa-2T will generate any ongoing costs beyond the first 12 months. Accordingly, our estimates do not distinguish initial and ongoing costs.

74 This figure is based on discussions of Commission staff with various market participants, as well as the Commission's experience regarding connectivity between securities market participants, including alternative trading systems and self-regulatory organizations for data reporting purposes. The Commission derived the total estimated one-time burdens from the following: [($25,000 / reporting entity to establish connectivity) x (1000 reporting entities)] + [2,400,000 estimated total pre-enactment securities-based swap transactions) x (25 percent manual, electronic reporting) x (Compliance Clerk (0.5 hours/transaction) at $63 per hour)] = $43,900,000, which is $43,900 per reporting entity. This estimate is intended to include the costs of system development that will facilitate reporting the majority (estimated 75 percent) of security-based swap transactions. Because the Commission expects to adopt permanent reporting rules within one year, the Commission does not believe that Rule 13Aa-2T will generate any ongoing costs beyond the first 12 months. Accordingly, our estimates do not distinguish initial and ongoing costs.

As stated above, the Commission estimates that it may make one request from each reporting entity pursuant to Rule 13Aa-2T(b)(2). The Commission preliminarily estimates that responding to Commission requests for information and documents could result in a cost to each reporting entity of approximately $6,352 and an aggregate cost of approximately $6,352,000.[75]

C. Request for Comment

The Commission requests comment on the costs and benefits of Rule 13Aa-2T discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits.

- How can the Commission accurately estimate the costs and benefits?
- What are the costs currently borne by entities covered by this rule with respect to the retention of records on security-based swap transactions?
- How many entities will be affected by the rule? How many transactions will be subject to the rule?
- Are there additional costs involved in complying with the rule that have not been identified? What are the types, and amounts, of the costs?
- Are there additional benefits from the rule that have not been identified?

[75] This figure is based on the following: [((Compliance Manager (5 hours) at $258 per hour) + (Compliance Attorney (5 hours) at $271 per hour) + (Programmer Analyst (1 hour) at $193) + (Compliance Clerk (15 hours) at $63 per hour) + (Director of Compliance (3 hours) at $388 per hour) + (Sr. Database Administrator (5 hours) at $281 per hour)) x (1 Commission request per reporting entity) x (1000 reporting entities)] = $6,352,000, which is $6,352 per reporting entity. Hourly figures are from SIFMA's Management & Professional Earnings in the Securities Industry 2008 and SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 or 2.93, as appropriate, to account for bonuses, firm size, employee benefits, and overhead.

VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 3(f) of the Exchange Act[76] requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act[77] requires the Commission, when making rules under the Exchange Act, to consider the impact of such rules on competition. Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

As discussed above, Rule 13Aa-2T will require counterparties to a pre-enactment security-based swap transaction to report: (1) to a registered security-based swap data repository or the Commission by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swaps, whichever occurs first, a copy of the transaction confirmation, in electronic form, if available, or in written form, if there is no electronic copy, and the time, if available, the transaction was executed; and (2) to the Commission upon request any information relating to the security-based swap transactions.[78] In addition, pursuant to the Note to paragraphs (b)(1) and (2) of Rule 13Aa-2T, any counterparty to a pre-enactment security-based swap transaction shall retain, in its existing format, all information and documents, if available, to the

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[76] 15 U.S.C. 78c(f).

[77] 15 U.S.C. 78w(a)(2).

[78] See supra Section II.B for a discussion of which counterparty has the reporting obligation.

extent and in such form as they currently exist, relating to the terms of a pre-enactment security-based swap transaction.[79]

Although the Commission is required to promulgate rules governing the reporting of pre-enactment security-based swap transactions, the Commission believes that by requiring the reporting of information about pre-enactment security-based swap transactions, this rule is an important first step in providing increased transparency to the market for security-based swaps, both to the participants or potential participants in the market and to regulators charged with overseeing a segment of the market that was previously not regulated. This increased transparency ultimately should provide the opportunity for increased competition among market participants and thus contribute to a more efficient market. This added visibility also should aid the Commission in carrying out its regulatory responsibilities by providing information that can be used to better understand and analyze the market. Further, a well-regulated security-based swap market may increase the confidence of market participants in the soundness of the market, potentially drawing additional participants into the market, increasing efficiency. The Commission also notes that all similarly situated respondents will be subject to the same requirements under the rule, and thus no participant should be at an unfair competitive advantage compared to others.

The Commission requests comment on all aspects of this analysis and, in particular, on whether Rule 13Aa-2T will place a burden on competition, as well as the effect of the proposal

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79 This information will include, but is not limited to: any information needed to identify and value the transaction; the date and time of execution of the transaction; all information from which the price of the transaction was derived; whether the transaction was accepted for clearing by any clearing agency or derivatives clearing organization and, if so, the identity of such clearing agency or derivatives clearing organization; any modification(s) to the terms of the transaction; and the final confirmation of the transaction.

on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

VIII. Regulatory Flexibility Certification

The Commission hereby certifies that pursuant to 5 U.S.C. 605(b) that the interim final temporary rules contained in this release will not have a significant economic impact on a substantial number of small entities. The interim final temporary rules apply only to counterparties that may engage in security-based swap transactions. Prior to the effective date of the Dodd-Frank Act, only an eligible contract participant (as defined in Section 1(a)(12) of the Commodity Exchange Act) may enter into security-based swap transactions. For this reason, the interim final temporary rule should not have a significant economic impact on a substantial number of small entities.

IX. Statutory Basis and Text of Amendments

The Commission is adopting Rule 13Aa-2T pursuant to Section13A of the Exchange Act, as amended.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission is amending Title 17, chapter II of the Code of Federal Regulations as follows:

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

1. The authority citation for Part 240 is amended by adding authorities for §240.13Aa-2T 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, unless otherwise noted.

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Section 240.13Aa-2T is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

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2. Section 240.13Aa-2T is added to read as follows:

§ 240.13Aa-2T Interim rule for reporting pre-enactment security-based swap transactions.

(a) *Definitions*. For purposes of this rule, the following definitions shall apply:

(1) Clearing agency shall have the same meaning as set forth in Section 3(a)(23) of the Exchange Act;

(2) Exchange Act shall mean the Securities Exchange Act of 1934, as amended;

(3) Major security-based swap participant shall have the meaning provided in Section 3(a)(67) of the Exchange Act and any rules or regulations thereunder;

(4) Pre-enactment security-based swap transaction shall mean a security-based swap that was entered into prior to, and that had not expired as of, July 21, 2010;

(5) Security-based swap shall have the meaning provided in Section 3(a)(68) of the Exchange Act and any rules or regulations thereunder;

(6) Security-based swap dealer shall have the meaning provided in Section 3(a)(71) of the Exchange Act and any rules or regulations thereunder; and

(7) Security-based swap data repository shall have the meaning provided in Section 3(a)(75) of the Exchange Act and any rules or regulations thereunder.

(b) *Reporting of pre-enactment security-based swap transactions*. A counterparty to a pre-enactment security-based swap transaction as provided in paragraph (c) below shall:

(1) Report to a registered security-based swap data repository or the Commission by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a registered security-based swap data repository commences operations to receive and maintain data concerning such security-based swap, whichever occurs first, the following information with respect to the pre-enactment security-based swap transaction:

(A) A copy of the transaction confirmation, in electronic form, if available, or in written form, if there is no electronic copy; and

(B) The time, if available, the transaction was executed; and

(2) Report to the Commission, in a form and manner as prescribed by the Commission, upon request any information relating to the security-based swap transaction.

Note to paragraphs (b)(1) and (2): In order to comply with the above reporting requirements, each counterparty to a pre-enactment security-based swap transaction that may be required to report such transaction shall retain, in its existing format, all information and documents, if available, to the extent and in such form as they currently exist, relating to the terms of a pre-enactment security-based swap transaction, including but not limited to: any information necessary to identify and value the transaction; the date and time of execution of the transaction; all information from which the price of the transaction was derived; whether the transaction was accepted for clearing by any clearing agency or derivatives clearing organization and, if so, the identity of such clearing agency or derivatives clearing organization; any modification(s) to the terms of the transaction; and the final confirmation of the transaction.

(c) *Reporting party:* The counterparties to a pre-enactment security-based swap transaction shall report the information required under paragraph (b) of this section as follows:

(1) Where only one counterparty to a pre-enactment security-based swap transaction is a security-based swap dealer or a major security-based swap participant, the security-based swap dealer or major security-based swap participant shall report the transaction;

(2) Where one counterparty to a pre-enactment security-based swap transaction is a security-based swap dealer and the other counterparty is a major security-based swap participant, the security-based swap dealer shall report the transaction; and

(3) Where neither counterparty to a pre-enactment security-based swap transaction is security-based swap dealer or a major security-based swap participant, the counterparties to the transaction shall select the counterparty who will report the transaction.

(d) *Effective Date.* This interim final temporary rule shall be effective beginning [insert date of publication in the Federal Register] until the operative date of the permanent recordkeeping and reporting rules for security-based swap transactions to be adopted by the Commission or January 12, 2012, whichever occurs first.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: October 13, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 249 and 274

[Release Nos. 34-63087; IC-29461]

TECHNICAL AMENDMENTS TO FORMS N-CSR AND N-SAR IN CONNECTION WITH THE COMPREHENSIVE IRAN SANCTIONS, ACCOUNTABILITY, AND DIVESTMENT ACT OF 2010

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; technical amendments.

SUMMARY: The Securities and Exchange Commission is adopting technical amendments to Forms N-CSR and N-SAR under the Securities Exchange Act of 1934 and the Investment Company Act of 1940 in connection with amendments to Section 13(c) of the Investment Company Act that were included in the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010.

EFFECTIVE DATE: [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Kieran G. Brown, Senior Counsel, Office of Disclosure Regulation, Division of Investment Management, at (202) 551-6784, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting technical amendments to Form N-CSR[1] and Form N-SAR[2] under the Securities Exchange Act of 1934 ("Exchange Act")[3] and the Investment Company Act of 1940 ("Investment Company Act").[4]

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1 17 CFR 249.331 and 274.128.

2 17 CFR 249.330 and 274.101.

3 15 U.S.C. 78a et seq.

4 15 U.S.C. 80a-1 et seq.

Under our current regulations, each registered investment company that divests itself of securities in accordance with Section 13(c) of the Investment Company Act is required to disclose the divestment on the next Form N-CSR or Form N-SAR that it files following the divestment. Management investment companies are required to provide the disclosure on Form N-CSR, pursuant to Item 6(b) of the form, and unit investment trusts are required to provide the disclosure on Form N-SAR, pursuant to Item 133 of the form.[10] These form items were originally adopted to implement the Sudan Accountability and Divestment Act of 2007 ("Sudan Divestment Act"), which limits civil, criminal, and administrative actions that may be brought against a registered investment company that divests from securities of issuers that conduct or have direct investments in certain business operations in Sudan, provided that the investment company makes disclosures in accordance with regulations prescribed by the Commission.[11] As a result, each item contains a termination provision that is based on the termination of the relevant provisions of the Sudan Divestment Act. Moreover, the

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10 Item 6(b) of Form N-CSR; Item 133 of Form N-SAR. The regulations require disclosure of information that will identify the securities divested and the magnitude of the divestment, including the issuer's name; exchange ticker symbol; Committee on Uniform Securities Identification Procedures ("CUSIP") number; total number of shares or, for debt securities, principal amount divested; and dates that the securities were divested. Item 6(b)(1)-(5) of Form N-CSR; Items 133.A-E of Form N-SAR. In addition, if the registered investment company continues to hold any securities of the divested issuer, it is required to disclose the exchange ticker symbol; CUSIP number; and total number of shares or, for debt securities, principal amount of such securities, held on the date of filing. Item 6(b)(6) of Form N-CSR; Item 133.F of Form N-SAR. While a registered investment company is not required to include disclosure under the relevant Item, the limitation on actions provided in Section 13(c) does not apply with respect to a divestment that is not disclosed. Instruction 1 to Item 6(b) of Form N-CSR; Instruction to Item 133 of Form N-SAR.

11 Sudan Accountability and Divestment Act of 2007, Pub. L. 110-174, 121 Stat. 2516 (2007); Investment Company Act Release No. 28254 (Apr. 24, 2008) [73 FR 23328, 23328 (Apr. 30, 2008)] (adoption of Item 6(b) of Form N-CSR and Item 133 of Form N-SAR).

instructions to the items contain references to the Sudan Divestment Act. Specifically, Instruction 1 to Item 6(b) of Form N-CSR and the Instruction to Item 133 of Form N-SAR each include a statement that Section 13(c) of the Investment Company Act was added by the Sudan Divestment Act. In addition, the heading to the Instruction to Item 133 of Form N-SAR includes a reference to the Sudan Divestment Act.

The requirements of Item 6(b) of Form N-CSR and Item 133 of Form N-SAR apply to divestment of securities in accordance with Section 13(c) of the Investment Company Act. Therefore, we have determined that the items are broad enough to apply to disclosure of divestment of securities in accordance with the amendments to Section 13(c) added by the Iran Divestment Act without substantive revision. However, we have determined that it is appropriate to make technical revisions that remove the references to the Sudan Divestment Act from the forms and require disclosure of a Section 13(c) divestment to specify whether it is undertaken pursuant to the Sudan Divestment Act or the Iran Divestment Act.

Specifically, in accordance with the Iran Divestment Act, we are amending our forms to delete the references to the Sudan Divestment Act from Instruction 1 to Item 6(b) of Form N-CSR, the Instruction to Item 133 of Form N-SAR, and the heading to the Instruction to Item 133 of Form N-SAR. We are also amending the termination provisions in Item 6(b) of Form N-CSR and Item 133 of Form N-SAR to eliminate the references to termination of the Sudan Divestment Act and to provide, more generically, that the disclosure requirements terminate one year after the first date on which all statutory provisions that underlie Section 13(c) of the Investment Company Act (i.e., the provisions of both the Sudan Divestment Act and the Iran Divestment Act) have terminated. Finally, we are amending Item 6(b) of Form N-CSR and Item 133 of Form N-SAR to require that any registrant that divests itself of securities in accordance with Section 13(c) of the Investment Company Act must disclose the name of the statute that added the provision of Section 13(c) in accordance with which the securities were divested (i.e., the "Sudan Accountability and Divestment Act" or the "Comprehensive Iran Sanctions, Accountability, and Divestment Act").[12] We are adding this requirement so that it will be clear from the disclosure which provision of Section 13(c) is being relied upon in connection with the divestment.

II. Procedural and Other Matters

Under the Administrative Procedure Act ("APA"), notice and public comment procedures are not required when an agency, for good cause, finds "that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[13] As discussed in this document, because no substantive revisions to our forms requiring Section 13(c) divestment disclosure are necessary to conform them to Section 203(b) of the Iran Divestment Act, the Commission believes that good cause exists to dispense with a public notice and comment period for these amendments. We have determined that only technical revisions to our forms are appropriate to make the existing forms consistent with the Iran Divestment Act. The technical amendments to Forms N-CSR and N-SAR remove references to the Sudan Divestment Act from Item 6(b) of Form N-CSR and Item 133 of Form N-SAR. The technical amendments also require that any registrant that divests itself of securities in accordance with Section 13(c) of the

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12 Item 6(b)(7) of Form N-CSR; Item 133.G. of Form N-SAR.

13 5 U.S.C. 553(b)(B).

Investment Company Act must disclose the name of the statute under which the securities were divested. Because these revisions merely revise Item 6(b) of Form N-CSR and Item 133 of Form N-SAR to make them consistent with a newly enacted statute, Section 203 of the Iran Divestment Act, the Commission finds that the amendments are technical in nature and that publishing the amendments for comment is unnecessary.[14]

Publication of a substantive rule not less than 30 days before its effective date is required by the APA except as otherwise provided by the agency for good cause.[15] For the same reasons described above with respect to notice and opportunity for comment, the Commission finds that there is good cause for making the technical amendments to each of the forms effective on the date of publication in the Federal Register.

The form amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[16] The titles for the collections of information are "Form N-CSR under the Investment Company Act of 1940 and Securities Exchange Act of 1934, Certified Shareholder Report," and "Form N-SAR under the Investment Company Act of 1940, Semi-Annual Report for Registered Investment Companies." Form N-CSR (OMB Control No. 3235-0570) under the Exchange Act and the Investment Company Act is used by registered management

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14 This finding also satisfies the requirements of 5 U.S.C. 808(2) (if a federal agency finds that notice and public comment are "impractical, unnecessary or contrary to the public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines"), allowing the amendments to become effective notwithstanding the requirement of 5 U.S.C. 801.

The amendments do not require analysis under the Regulatory Flexibility Act. See 5 U.S.C. 601(2) (for purposes of Regulatory Flexibility Act analysis, the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking).

15 5 U.S.C. 553(d).

16 44 U.S.C 3501 et seq.

investment companies filing certified shareholder reports. Form N-SAR (OMB Control No. 3235-0330) under the Exchange Act and the Investment Company Act is used by registered investment companies to file periodic reports with the Commission. 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.

We do not believe that the technical amendments necessitate an increase in the current PRA burden estimates for Form N-CSR and Form N-SAR. When the forms were originally amended to implement the Sudan Divestment Act, we estimated that approximately 15% of all registered investment companies had an objective of investing internationally.[17] We also conservatively assumed that every investment company portfolio that had an international investment strategy would disclose a divestment in accordance with the Sudan Divestment Act on each semi-annual filing, for a total of approximately 1,000 such filings per year.[18] Since then, however, it appears that there have been less than ten total filings by investment companies disclosing a divestment in accordance with the Sudan Divestment Act.[19] Based on this experience, we do not believe that it is appropriate to adjust our existing estimate upwards to reflect additional filings for divestments in accordance with the Iran Divestment Act.

We also do not believe that the technical amendments necessitate a decrease in the current PRA burden estimates for Form N-CSR and Form N-SAR. Because we do not know the extent to which divestments in accordance with the Iran Divestment Act

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17 Investment Company Act Release No. 28254, supra note 11, at 23330.

18 See id. (6,743 annual and semi-annual filings on Form N-CSR x 15% of filings on Form N-CSR) + (90 filings on Form N-SAR x 15% of filings on Form N-SAR) = 1,025 filings.

19 Based on the Commission staff's review of filings made with the Commission.

will occur, we believe that it is appropriate to maintain a conservative assumption that each Form N-CSR and N-SAR filing by an international portfolio will have a disclosure either with respect to the Sudan Divestment Act or the Iran Divestment Act. In addition, any decrease in the estimates would be insignificant relative to the total current PRA burden estimates for Form N-CSR and Form N-SAR because the estimated current PRA burden for the Section 13(c) disclosure is itself insignificant relative to the total burden estimates for these forms, i.e., 510 hours (out of a total burden of 138,662.5 hours, or 0.37%)[20] for Form N-CSR and 10 hours (out of a total burden of 107,213 hours, or 0.01%)[21] for Form N-SAR.

Section 23(a)(2) of the Exchange Act[22] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) also prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 3(f) of the Exchange Act[23] requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Section 2(c) of the Investment Company Act[24] requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is consistent

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20 Investment Company Act Release No. 28254, supra note 11, at 23330.

21 Id.

22 15 U.S.C. 78w(a)(2).

23 15 U.S.C. 78c(f).

24 15 U.S.C. 80a-2(c).

with the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Because the amendments are technical in nature, we do not anticipate that any competitive advantages or disadvantages would be created. We do not expect that the amendments, as technical amendments, will have an effect on efficiency, competition, or capital formation. Moreover, the Commission is taking this action to make Forms N-CSR and N-SAR consistent with the Iran Divestment Act. Thus, any costs and benefits and other economic effects resulting from these amendments are mandated under the Act.

III. Statutory Authority

The Commission is adopting amendments to Form N-SAR and Form N-CSR pursuant to authority set forth in Section 203(b) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 and Sections 10(b), 13, 15(d), 23(a), and 36 of the Exchange Act [15 U.S.C. 78j(b), 78m, 78o(d), 78w(a), and 78mm], and Sections 8, 13(c), 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-13(c), 80a-24(a), 80a-29, and 80a-37].

List of Subjects

17 CFR Part 249

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF FORM AMENDMENTS

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

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

2. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

3. Form N-SAR (referenced in §§ 249.330 and 274.101) is amended by:

a. In paragraph E. of Item 133, deleting the word "and";

b. In paragraph F. of Item 133, revising "filing." to read "filing; and";

c. Adding new paragraph G. to Item 133;

d. Revising the sentence immediately following new paragraph G. to Item 133;

e. In the heading to the Instruction to Item 133, deleting the phrase "in Accordance with the Sudan Accountability and Divestment Act of 2007"; and

f. In the first sentence of the Instruction to Item 133, deleting the phrase ", which was added by the Sudan Accountability and Divestment Act of 2007". The addition and revision read as follows:

Note: The text of Form N-SAR does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM N-SAR

*   *   *   *   *

133.   *   *   *

G. Name of the statute that added the provision of Section 13(c) in accordance with which the securities were divested.

This item 133 shall terminate one year after the first date on which all statutory provisions that underlie Section 13(c) of the Investment Company Act of 1940 have terminated.

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4. Form N-CSR (referenced in §§ 249.331 and 274.128) is amended by:

a. In paragraph (b)(5) of Item 6, deleting the word "and";

b. In paragraph (b)(6) of Item 6, revising "filing." to read "filing; and";

c. Adding new paragraph (7) to Item 6(b);

d. Revising the sentence immediately following new paragraph (7) to Item 6(b); and

e. In Instruction 1 to paragraph (b) of Item 6, deleting the phrase ", which was added by the Sudan Accountability and Divestment Act of 2007".

The addition and revision read as follows:

Note: The text of Form N-CSR does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM N-CSR

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Item 6. Investments.

(a) * * *

(b) * * *

(7) Name of the statute that added the provision of Section 13(c) in accordance with which the securities were divested.

This Item 6(b) shall terminate one year after the first date on which all statutory provisions that underlie Section 13(c) of the Investment Company Act of 1940 have terminated.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

October 13, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 229, 230, 240, and 249

[RELEASE NOS. 33-9150, 34-63091; FILE NO. S7-26-10]

RIN 3235-AK76

ISSUER REVIEW OF ASSETS IN OFFERINGS OF ASSET-BACKED SECURITIES

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing new requirements in order to implement Section 945 and a portion of Section 932 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act"). First, we are proposing a new rule under the Securities Act of 1933 to require any issuer registering the offer and sale of an asset-backed security ("ABS") to perform a review of the assets underlying the ABS. We also are proposing amendments to Item 1111 of Regulation AB that would require an ABS issuer to disclose the nature of its review of the assets and the findings and conclusions of the issuer's review of the assets. If the issuer has engaged a third party for purposes of reviewing the assets, we propose to require that the issuer disclose the third-party's findings and conclusions. We also are proposing to require that an issuer or underwriter of an ABS offering file a new form to include certain disclosure relating to third-party due diligence providers, to implement Section 15E(s)(4)(A) of the Securities Exchange Act of 1934, a new provision added by Section 932 of the Act.

DATES: Comments should be received on or before November 15, 2010.

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

Electronic Comments:

- Use the Commission's Internet comment form

(http://www.sec.gov/rules/proposed.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-26-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File Number S7-26-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website 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 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Eduardo Aleman, Special Counsel, Division of Corporation Finance, at (202) 551-3430, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing amendments to Item 1111[1] of

1 17 CFR 229.1111.

Regulation AB[2] (a subpart of Regulation S-K). We also are proposing to add Rule 193[3] under the Securities Act of 1933[4] (the "Securities Act") and Rule 15Ga-2[5] and Form ABS-15G[6] under the Securities Exchange Act of 1934 (the "Exchange Act").[7]

I. Background

This release is one of several we are required to issue to implement provisions of the Act.[8] This release proposes a new rule and certain amendments to implement Section 7(d) of the Securities Act,[9] which was added by Section 945 of the Act. In addition, we are proposing a new rule and form to implement Section 15E(s)(4)(A) of the Exchange Act,[10] which was added by Section 932 of the Act.

Section 945 of the Act amends Section 7 of the Securities Act to require the Commission to issue rules relating to the registration statement required to be filed by an issuer of ABS. Pursuant to new Section 7(d), the Commission must issue rules to require that an issuer of an ABS perform a review of the assets underlying the ABS, and disclose the nature of such review.[11] Section 7(d) requires that we adopt these rules not later than 180 days after enactment.

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2 17 CFR 229.1100 through 17 CFR 229.1123.

3 17 CFR 230.193.

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

5 17 CFR 240.15Ga-2.

6 17 CFR 249.ABS-15G.

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

8 Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

9 15 U.S.C. 77g(d).

10 15 U.S.C. 78o-7(s)(4)(A).

11 We note that recently adopted amendments to a safe harbor rule by the Federal Deposit Insurance Corporation require, in residential mortgage-backed securities offerings, sponsors to disclose a third-party diligence report on compliance with origination standards and the representations and warranties made with respect to the

Section 932 of the Act adds new Section 15E(s)(4)(A) of the Exchange Act, which also relates to the review of assets underlying an ABS. Section 15E(s)(4)(A) requires an issuer or underwriter of any ABS to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.[12] Because the substance of new Section 7(d) of the Securities Act is related to new Section 15E(s)(4)(A) of the Exchange Act, we are considering both provisions added by the Act together.

II. Proposed Rules

A. Proposed Requirement that an ABS Issuer Perform a Review of the Assets

We are proposing new Rule 193 under the Securities Act to require issuers of ABS to perform a review of the assets underlying registered ABS offerings.[13] This rule would implement Securities Act Section 7(d)(1),[14] as added by Section 945 of the Act.

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assets. See Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After September 30, 2010, Final Rule, Federal Deposit Insurance Corporation, (Sept. 27, 2010).

[12] We will propose rules to implement the rest of Section 15E(s)(4) at a later date. Section 15E(s)(4)(B) requires a provider of third-party due diligence services to provide a certification to any nationally recognized statistical rating organization ("NRSRO") rating the transaction. Section 15E(s)(4)(C) requires the Commission to establish the form and content of such certification, and Section 15E(s)(4)(D) requires the Commission to adopt rules requiring an NRSRO to disclose the certification to the public. The Act requires that final regulations under Section 15E(s)(4) be adopted not later than one year after enactment.

[13] The requirement under this proposal to perform a review should not be confused with, and is not intended to change, the due diligence defense against liability under Securities Act Section 11 [15 U.S.C. 77k] or the reasonable care defense against liability under Securities Act Section 12(a)(2) [15 U.S.C. 77l(a)(2)]. Our proposed rule is designed to require a review of the underlying assets by the issuer and to provide disclosure of the nature, findings and conclusions of such review.

[14] 15 U.S.C. 77g(d)(1).

1. Application of the Proposed Rule

Section 7(d)(1) relates to an asset-backed security, as defined in new Section 3(a)(77) of the Exchange Act.[15] This new statutory definition ("Exchange Act-ABS") is broader than the definition of "asset-backed security" in Regulation AB[16] and includes securities typically offered and sold in private transactions. Nevertheless, we have concluded that the review requirements mandated by Section 7(d)(1) apply only to registered offerings of ABS because Section 7(d)(1) requires the Commission to issue rules "relating to the registration statement." Therefore, the rule we are proposing today that would require an ABS issuer to perform a review of the assets applies to issuers of ABS in registered offerings and not issuers of ABS in unregistered offerings.

2. New Securities Act Rule 193

Rule 193 would require an issuer to perform a review of the assets underlying an ABS in a transaction that will be registered under the Securities Act. Rule 193 would not specify the level or type of review an issuer is required to perform.[17] We expect that the issuer's level and

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15 15 U.S.C. 78c(a)(77). This definition was added by Section 941(a) of the Act.

16 See Item 1101(c)(1) of Regulation AB [17 CFR 229.1101(c)(1)].

17 We understand that various levels and types of review may be performed in a securitization. For example, commentators on a recent proposing release on asset-backed securities have identified that the type of review conducted by a sponsor of a securitization of sub-prime mortgage loans typically falls into three general categories. First, a credit review examines the sample loans to ascertain whether they have been originated in accordance with the originator's underwriting guidelines. This would include a review of whether the loan characteristics reported by the originator are accurate and whether the credit profile of the loans is acceptable to the sponsor. A second type of review could be a compliance review which examines whether the loans have been originated in compliance with applicable laws, including predatory lending and Truth in Lending statutes. Third, a valuation review entails a review of the accuracy of the property values reported by the originators for the underlying collateral. This could include a review of each original appraisal to assess whether it appeared to comply with the originator's appraisal guidelines, and the appropriateness of the comparables used in the original appraisal process. See comment letter from The Commonwealth of Massachusetts Office of the Attorney General ("Massachusetts AG comment letter") on Asset-Backed Securities, SEC Release No. 33-9117 (April 7, 2010) [75 FR 23328] (the "2010 ABS Proposing Release"). The comment letters are available at http://www.sec.gov/comments/s7-08-10/s70810.shtml.

type of review of the assets may vary depending on the circumstances. For example, the level or type of review may vary among different asset classes. While proposed Rule 193 would not require a particular level or type of review, we note that, if adopted, required responsive disclosure would describe the level and type of review. We believe the disclosure requirements below will give investors an ability to evaluate the level and adequacy of the issuer's review of the assets.

Rule 193 would not specify the type or level of review an issuer is required to perform or require that a review be designed in any particular manner, although as set out below, we are requesting comment on whether and, if so, how the Commission should specify the nature of the review.[18] We believe that the nature of review may vary depending on numerous circumstances and factors which could include, for example, the nature of the assets being securitized and the degree of continuing involvement by the sponsor. For example, in offerings of residential mortgage-backed securities ("RMBS"), where the asset pool consists of a large group of loans, it may be appropriate, depending on all the facts, to review a sample of loans large enough to be representative of the pool, and then conduct further review if the initial review indicates that further review is warranted. By contrast, for ABS where a significant portion of the cash flow will be derived from a single obligor or a small group of obligors, such as ABS backed by a small number of commercial loans ("CMBS"), it may be appropriate for the review to include every pool asset. Moreover, in ABS transactions where the asset pool composition turns over

[18] Given the 180-day statutory deadline prescribed by the Act, we have not attempted to describe a type of review that may be appropriate for various different asset classes; we believe that devising various levels of review applicable to each different asset class would require a more extensive undertaking than is feasible in the time provided.

rapidly because it contains revolving assets, such as credit card receivables or dealer floorplan receivables, a different type of review may be warranted than in ABS transactions involving term receivables, such as mortgage or auto loans.

While proposed Rule 193 would not specify a particular type or level of review, we note that under our proposal, prospectus disclosure of the nature of review would be required. We believe the disclosure requirements described below will give investors an ability to evaluate the level and adequacy of the issuer's review of the assets. We request comment below on whether disclosure, without mandating the nature of the review to be conducted, is sufficient.

While we are not proposing the nature of the review that would be required, we note that some of the data points proposed in the 2010 ABS Proposing Release describe the type of review items that may be relevant to the review that must be performed to comply with Rule 193.[19] In our proposals requiring enhanced disclosure for an ABS offering, we proposed to require

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[19] Our proposal for asset-level data points in our 2010 ABS Proposing Release, which remains outstanding, provides examples of the kind of information that the issuer could undertake to review in order to comply with proposed Rule 193. For example, in the case of RMBS, the Commission proposed requiring, for each loan in the pool, standardized disclosure of, among others, credit score, employment status, and income of the obligor and how that information was verified. Some specific data points that were proposed include:

> The appraised value used to approve the loan, original property valuation type, and most recent appraised value, as well as the property valuation method, date of valuation, and valuation confidence scores;
> Combined and original loan-to-value ratios and the calculation date;
> Obligor and co-obligor's length of employment, whether they are self-employed and the level of verification (e.g., not verified, stated and not verified, or direct independent verification with a third-party of the obligor's current employment); and
> Obligor and co-obligor's wage and other income and a code that describes the level of verification.

For income of the obligor, the issuer would be required, if adopted, under our 2010 ABS Proposing Release to indicate what level of review of the income was conducted. One possible level of review would be that income was verified by previous W-2 forms or tax returns and year-to-date pay stubs, if the obligor was salaried. Another possibility would be that the income was verified for the last 24 months through W-2 forms, pay stubs, bank statements, and/or tax returns. As noted, we are not proposing specific standards for the review required by proposed Rule 193. While the Commission believes these data points may be relevant, they are intended to serve only as examples of items that we anticipate an issuer would consider reviewing in order to comply with proposed Rule 193. These proposals remain outstanding as we consider comments received on the 2010 ABS Proposing Release.

prospectuses for public offerings of ABS and ongoing Exchange Act reports to contain specified asset-level information about each of the assets in the pool.[20] The asset-level information would be provided according to proposed standards and in a tagged data format.[21]

Proposed Rule 193 would require that the asset review be conducted by the issuer of the ABS.[22] The issuer, for purposes of this rule, would be the depositor or sponsor of the securitization. A sponsor typically initiates a securitization transaction by selling or pledging to a specially-created issuing entity a group of financial assets that the sponsor either has originated itself or has purchased in the secondary market.[23] In some instances, the transfer of assets is a two-step process: the financial assets are transferred by the sponsor first to an intermediate entity, the depositor or the issuer, and then the depositor transfers the assets to the issuing entity for the particular asset-backed transaction. The issuing entity is typically a statutory trust.[24] In cases where the originator and sponsor may be different, including in transactions involving a so-

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[20] Some asset classes such as credit card receivables and stranded costs would be exempt from this rule; however, credit card ABS would be required to provide grouped account data.

[21] In addition, Section 942 of the Act adds new Section 7(c) to the Securities Act requiring the Commission to adopt regulations requiring each issuer of an asset-backed security to disclose, for each tranche or class of security, standardized information regarding the assets backing that security.

[22] Under Securities Act Rule 191 (17 CFR 230.191), the depositor for the asset-backed securities acting solely in its capacity as depositor to the issuing entity is the "issuer" for purposes of the asset-backed securities of that issuing entity. "Depositor" means the depositor who receives or purchases and transfers or sells the pool assets to the issuing entity. See Item 1101 of Regulation AB. For asset-backed securities transactions where there is not an intermediate transfer of the assets from the sponsor to the issuing entity, the term depositor refers to the sponsor. For asset-backed securities transactions where the person transferring or selling the pool assets is itself a trust, the depositor of the issuing entity is the depositor of that trust. See id.

[23] As defined in Item 1101 of Regulation AB, the "sponsor" means the person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity. See 17 CFR 229.1101(l). Where there is not a two-step transfer, the term "depositor" refers to the sponsor.

[24] See Asset-Backed Securities, Release No. 33-8518 (Dec. 22, 2004) [70 FR 1506] ("2004 Regulation AB Adopting Release") at Section III.B.3. The issuing entity is designed to be a passive entity, and in order to meet the definition of ABS issuer in Regulation AB its activities must be limited to passively owning or holding the pool of assets, issuing the ABS supported or serviced by those assets, and other activities reasonably incidental thereto.

called "aggregator," the review may be performed by the sponsor, but we propose that a review performed by an unaffiliated originator would not satisfy proposed Rule 193. The originator may have different interests in the securitization, especially if the securitization involves many originators where each originator may have contributed a very small part of the assets in the entire pool, and may have differing approaches to the review.[25]

If an issuer engages a third party for purposes of reviewing the pool assets, then an issuer may rely on the third-party's review to satisfy its obligations under proposed Rule 193 provided the third party is named in the registration statement and consents to being named as an "expert" in accordance with Section 7 of the Securities Act and Rule 436 under the Securities Act.[26] We are aware that, at least with respect to RMBS, there is a specialized industry of third-party due diligence firms.[27] These firms typically are retained to review, for example, the accuracy of loan level data.[28] Allowing issuers to contract with a third-party due diligence provider[29] is consistent with Section 15E(s)(4) of the Exchange Act which, as discussed further below, requires the issuer or underwriter of an ABS to make publicly available the findings and conclusions of a

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25 In the case of so-called aggregators, the sponsor acquires loans from many other unaffiliated sellers before securitization.

26 Section 7 of the Securities Act requires the consent of any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement. The third-party's findings and conclusions must also be disclosed in a registration statement and a consent from the third party must be obtained in accordance with Section 7.

27 See Testimony of Vicki Beal, Senior Vice President Clayton Holdings, Before the Financial Crisis Inquiry Commission (Sept. 23, 2010), available at http://www.fcic.gov/hearings/pdfs/2010-0923-Beal.pdf.

28 See, e.g., Vikas Bajaj and Jenny Anderson, Inquiry Focuses on Withholding of Data on Loans, N.Y. TIMES, January 12, 2008; E. Scott Reckard, Sub-prime Mortgage Watchdogs Kept on Leash; Loan Checkers Say Their Warnings of Risk Were Met with Indifference, LOS ANGELES TIMES, March 17, 2008, at C1.

29 In this release, we refer to third parties engaged for purposes of reviewing the assets also as third-party due diligence providers.

third-party due diligence report and requires a third-party due diligence provider that is employed by a nationally recognized statistical rating organization ("NRSRO"), an issuer or an underwriter to provide a written certification to the NRSRO that produces a credit rating. Under Section 15E(s)(4) of the Exchange Act, the Commission is required to establish the appropriate format and content for the certifications "to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for a nationally recognized statistical rating organization to provide an accurate rating."[30] We believe that a "third party engaged for purposes of performing a review" is a broad category that would include any third party on which the issuer relies to review assets in the pool. We believe that the third party engaged by the issuer to perform a review of the assets for purposes of complying with Rule 193 likely would be the same third-party due diligence providers whose reports must be made publicly available by an issuer or underwriter for purposes of Section 15E(s)(4)(A), although we seek comment on whether that is appropriate.

Request for Comment

1. Does our proposed rule to require the issuer of ABS in a registered transaction to perform a review of the assets adequately address Section 7(d)(1) of the Securities Act, as added by Section 945 of the Act? Is this proposal, coupled with the proposed disclosure requirements described below, sufficient to carry out the purposes of Section 7(d)(1) of the Act? Can investors evaluate for themselves the sufficiency of the review undertaken by the issuer? Will issuers undertake a meaningful review absent a minimum review standard?

[30] As noted above, we will address these requirements in a subsequent rulemaking.

2. Should we instead mandate a minimum level of review that must be performed on the pool of assets? Would requiring a minimum level of review better carry out the mandate of Securities Act Section 7(d)(1), which imposes a new review requirement, separate from the disclosure requirement in Section 7(d)(2)?[31] If so, what level of review would be appropriate? For instance, should we require that the review, at a minimum, provide reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects?[32] We note that the federal securities laws currently require that disclosure in the prospectus not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements not misleading.[33] Therefore, we would expect that issuers are currently performing some level of review in order to provide them sufficient comfort to believe that the prospectus disclosure is accurate. A reasonable assurance level would be similar to the standard that companies use in designing and maintaining disclosure controls and procedures required

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31 We note that this section is not limited to requiring disclosure; the section imposes an obligation to conduct a review and to disclose the nature of the review. In other contexts, we have previously adopted rules pursuant to a legislative mandate that required issuers or other parties to take (or not take) particular action. See e.g., Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Release No. 33-8238 (June 5, 2003) (adopting rules requiring management of companies subject to the Exchange Act's reporting requirements to establish and maintain adequate internal control over financial reporting for the company as directed by Section 404 of the Sarbanes-Oxley Act of 2002); See also Insider Trades During Pension Fund Blackout Periods, Release No. 34-47225 (Jan. 22, 2003) (adopting rules to give effect to Section 306(a) of the Sarbanes-Oxley Act of 2002), which prohibits directors or executive officers of any issuer of an equity security from conducting transactions in the issuer's securities during a pension plan blackout period. The Act also imposes other substantive requirements, such as requiring securitizers to retain 5% risk. See Section 941 of the Act.

32 Thus, for example, if the prospectus disclosed that the loans are limited to borrowers with a specified minimum credit score, or certain income level, the review, as designed, would be required to provide reasonable assurance that the loans in the pool met this criterion.

33 See Securities Act Section 11 [15 U.S.C. 77k] and Securities Act Sections 12 [12 U.S.C. 77l]. See also Securities Act Section 17 [15 U.S.C. 77q], Exchange Act Section 10(b) [15 U.S.C. 78j] and Rule 10b-5 under the Exchange Act [17 CFR 240.10b-5].

under Exchange Act Rule 13a-15.[34] Our rules generally "require an issuer to maintain disclosure controls and procedures to provide reasonable assurance that the issuer is able to record, process, summarize and report the information required in the issuer's Exchange Act reports" within appropriate time frames, and companies have been subject to these requirements for many years.[35]

- If we required that the review, at a minimum, provide reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects, would issuers and their advisers be familiar with this reasonable assurance level and understand how that level would apply in the context of a review of assets underlying ABS?[36]
- Would a different level of assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects be appropriate? If so, what level and why?
- Should a minimum standard require that the review be not just designed but also

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[34] See Exchange Act Rule 13a-15 [17 CFR 240.13a-15].

[35] See Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, at Section F.4, Release No. 33-8238 (June 5, 2003). See also Certification of Disclosure in Companies' Quarterly and Annual Reports, Release No. 34- 8124 (June 14, 2002). ABS issuers must provide in Form 10-K an assessment by each party participating in the servicing function regarding its compliance with specified servicing criteria set forth in Item 1122 of Regulation AB. See 17 CFR 229.1122. A registered public accounting firm must issue an attestation report on such party's assessment of compliance. See id.

[36] Although ABS issuers are not subject to Rule 13a-15, ABS issuers that also issue corporate securities are familiar with it. We previously have recognized that, because the information ABS issuers are required to provide differs significantly from that provided by other issuers, and because of the structure of ABS issuers as typically passive pools of assets, the certification requirements should be tailored specifically for ABS issuers. See Certification of Disclosure in Companies' Quarterly and Annual Reports, Release No. 34-8124; See also Revised Statement: Compliance by Asset-Backed Issuers with Exchange Act Rules 13a-14 and 15d-14, Statement by the Staff of the Division of Corporation Finance (Feb. 21, 2003), available at http://www.sec.gov/divisions/corpfin/8124cert.htm.

effected to provide reasonable assurance that the disclosure was accurate?

- Is there a minimum level of review that would be more appropriate or useful to investors without imposing impracticable burdens and costs on issuers?
- How, if at all, should any such standard of review affect current law regarding antifraud liability? How, if at all, should any such standard of review affect the due diligence defense against liability under Securities Act Section 11[37] and the reasonable care defense against liability under Securities Act Section 12(a)(2)[38]?
- Should the rule further specify the types of matters – e.g., credit – that should be covered by the review?
- In addition, should the rule further specify the level of review? For example, should it set out parameters to determine whether sampling is appropriate?

3. We note that in the 2010 ABS Proposing Release, we proposed requiring that the underlying transaction agreement in a transaction relying on certain Commission safe harbors for an exemption from the Securities Act contain a provision requiring the issuer to provide to any initial purchaser, security holder, and designated prospective purchaser the same information as would be required in a registered transaction.[39] Similar to the approach in the 2010 ABS Proposing Release, should we condition the safe harbors for an exemption from registration provided in Regulation D and Securities Act Rule 144A on a requirement that the underlying transaction agreement for the ABS contain a

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37 15 U.S.C. 77k.

38 15 U.S.C. 77l(a)(2).

39 See discussion in Section VI of the 2010 ABS Proposing Release.

representation that the issuer performed a review that complies with proposed Rule 193? Alternatively, if we adopt Rule 193 with some minimum standard of review, should we condition the safe harbors for an exemption from registration provided in Regulation D and Securities Act Rule 144A simply on a requirement that the issuer perform a review of the underlying assets? If so, should we also require that the issuer represent in the transaction agreement that it will certify such review or provide disclosure regarding the nature of the issuer's review and findings and conclusions?

4. Should we specify the types of review that should be performed? For example, should we require that the review verify the accuracy of the data entry of loan information into the loan tape, containing data about the loans in the pool (e.g., loan-to-value ratio, debt-to-income ratio)? Should the rule establish a standard requiring a review sufficient to determine whether the underlying assets meet the underwriting criteria? Should any required review entail reviewing borrowers' income levels to determine borrowers' ability to repay the underlying loans? Should the rule establish a standard for reviewing whether the loans have been originated in compliance with applicable laws, including predatory lending and Truth in Lending statutes? Should we establish standards for a review of the accuracy of the property values reported by the originators for the underlying collateral?[40] Could each such type of review be conducted across all asset classes (e.g., residential mortgages, commercial mortgages, credit card receivables, resecuritizations)? What standards would be appropriate for each asset class or across all

[40] See, e.g., joint comment letter from American Society of Appraisals, American Society of Farm Managers and Rural Appraisers, and National Association of Independent Fee Appraisers on the 2010 ABS Proposing Release (recommending standards of appraisal).

asset classes of asset-backed securities?

5. Should we explore devising review standards for each particular asset class and consider proposing more detailed standards for the nature of review at a later date? If so, how?

6. Should our rules, as proposed, permit issuers to rely on a third party that was hired by the issuer to perform the required review of the assets under Rule 193? Should we, as proposed, condition the ability to rely on a third party for this purpose on the third-party's review satisfying the requirements of Rule 193? When we adopt rules in the future to establish the appropriate format and content for the certifications required pursuant to Exchange Act Section 15E(s)(4)(B), we will be required to do so in a manner "to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for a nationally recognized statistical rating organization to provide an accurate rating."[41] Should we condition reliance on third parties for purposes of Rule 193 upon satisfaction of that standard? How else could the proposal better effectuate Exchange Act Section 15E(s)(4)?[42]

7. If an originator performs a review of the assets and provides the findings and conclusions of its review to the issuer and the originator is not affiliated with the sponsor of the securitization, should we allow an issuer to rely on the originator's review of the assets in order to satisfy the issuer's review requirements? If so, should the information relating to the originator's review be treated similarly to third-party reviews? As described above,

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41 Section 15E(s)(4)(C) of the Exchange Act.

42 Section 15E(s)(4)(A) of the Exchange Act requires issuers to make publicly available the findings and conclusions of "any third-party due diligence report."

under our proposal, an issuer would be permitted to rely on a third party to conduct the Rule 193 review provided the review satisfied the requirements of Rule 193 and the third party is named in the registration statement and consents to being named as an expert in accordance with Section 7 of the Securities Act and Rule 436 under the Securities Act.[43] If we allow such reviews to satisfy Rule 193, should the findings and conclusions of third-party originators who conduct Rule 193 reviews likewise be subject to expert liability?

8. Is there any other party that an issuer should be allowed to rely upon in order to satisfy the review required by proposed Rule 193? For example, should an issuer be permitted to rely upon the underwriter of the offering? If so, how should we treat the findings and conclusions of that party? Should that party's findings and conclusions be subject to expert liability? If not, how can we ensure that such parties would take appropriate responsibility for any findings included in the issuer's registration statement?

9. We propose to permit an issuer to rely upon a third party that is engaged for purposes of performing a review of the assets to satisfy Rule 193. Is "third party engaged for purposes of performing a review of the pool assets" an appropriate description? If not, what is a more appropriate description? What entities should be considered a "third party engaged for purposes of performing a review"? Should such third-party reviewers include accountants who, for example, perform reviews and prepare reports pursuant to agreed-upon procedures? Should such third-party reviewers include attorneys who, for

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[43] If an issuer relies on a third party to perform the review of the assets, the third party would be an expert under Securities Act Section 11 [15 U.S.C. 77k] and its consent must be included as an exhibit to the registration statement. See Section 7 of the Securities Act.

example, provide opinions as to the perfection of the security interest in the collateral?[44] Are there policy reasons why a particular type of third-party reviewer should be excluded from this requirement? We note that the issuer would remain responsible for its disclosure under the federal securities laws, including disclosure regarding pool assets, even if it engages a third party to perform the review required by Rule 193. Should the proposed rule be revised to clarify this point?

10. It appears that the scope of third-party due diligence providers is broad enough to include appraisers and engineers for purposes of Section 15E(s)(4). Is there a basis for a different approach? Should this vary among different asset classes? For example, should the requirements differ depending on whether the asset class for the securities is commercial mortgages or residential mortgages? We are aware that for certain types of ABS offerings (e.g., CMBS offerings) an issuer may receive numerous reports from appraisers and engineers regarding the property underlying the loan.

11. As discussed below, Exchange Act Section 15E(s)(4)(A) requires an issuer or underwriter of ABS to make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. How does new Exchange Act Section 15E(s)(4)(A) impact the analysis here? Should the third parties whose findings and conclusions must be made publicly available under Exchange Act Section 15E(s)(4)(A) be the same group of third parties that are engaged for the review of the assets for purposes of proposed Rule 193? If not, how can we appropriately differentiate between the groups of third-party due diligence providers? In other words, how should

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44 See, e.g., John Arnholz & Edward E. Gainor, Offerings of Asset-Backed Securities § 6.06 (2007 Supplement).

the rule describe the nature of the work performed by third parties subject to Section 15E(s)(4)(A) versus the nature of the work performed by third parties employed by an issuer whose findings and conclusions should be required to be disclosed in a registration statement if such parties should be different?

12. We have previously noted the potential conflict of interest arising from the "issuer pays" model for NRSROs in which an NRSRO is paid by the arranger of a structured finance product to rate the product.[45] Are third-party due diligence firms subject to the same type of potential conflicts of interest as credit rating agencies operating under the "issuer pays" model? If so, is there a way to mitigate this potential conflict?

13. Are there other potential conflicts relating to a third-party due diligence provider that we should address? How should we encourage the quality of third-party reviews? Should a third party be required to be independent if the review will be used to satisfy Rule 193? If so, do we need to define "independent"? How should we define it? Should we require disclosure relating to the affiliations of the third party? Item 1119 of Regulation AB[46] requires disclosure of affiliations among participants in the securitization. Should we revise Item 1119 to require disclosure regarding affiliations between a third-party due diligence provider and the parties listed in Item 1119?

B. <u>Proposed Disclosure Requirements</u>

1. <u>Registered Offerings</u>

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45 <u>See</u>, <u>e.g.</u>, <u>Proposed Rules for Nationally Recognized Statistical Rating Organizations</u>, Release No. 34-57967 (June 16, 2008) [73 FR 36212].

46 17 CFR 229.1119.

Item 1111 of Regulation AB[47] outlines several aspects of the pool that the prospectus disclosure for ABS should cover. We are proposing amendments to Item 1111 to require disclosure regarding the nature of the issuer's review of the assets under proposed Rule 193 and the findings and conclusions of the review. In addition, we are re-proposing amendments from our 2010 ABS Proposing Release to require disclosure regarding the composition of the pool as it relates to assets that do not meet disclosed underwriting standards, as we believe this information would promote a better understanding of the impact of the review on the composition of the pool assets.

a. Nature of Review

We are proposing new Item 1111(a)(7) of Regulation AB to require that an issuer of ABS disclose the nature of the review it conducts to satisfy proposed Rule 193. This would include whether the issuer has hired a third-party firm for the purpose of reviewing the assets. In either case, we expect that this would include a description of the scope of the review, such as whether the issuer or a third party conducted a review of a sample of the assets or what kind of sampling technique was employed (i.e., random or adverse). This proposed requirement would implement Securities Act Section 7(d)(2),[48] as added by the Act.

b. Findings and Conclusions

In order to harmonize this provision with the language used in Exchange Act Section 15E(s)(4)(A), under proposed Item 1111(a)(7), the issuer would be required to disclose the findings and conclusions of any review performed by the issuer or by a third party engaged for

47 17 CFR 229.1111.

48 15. U.S.C. 77g(d)(2).

purposes of reviewing the assets. Although Section 7(d) of the Securities Act does not require our rules to mandate that the issuer disclose the findings and conclusions of a review in its registration statement, we believe this information is important for investors to consider along with the information in the registration statement relating to the nature of the issuer's review and the findings and conclusions of third-party due diligence providers, as required to be publicly disclosed by Securities Act Section 7(d) and Exchange Act Section 15E(s)(4)(A). We believe that disclosure of the findings and conclusions of the review would provide investors with a better picture of the assets than only the nature of the review and a better ability to evaluate the review.

As noted above, Section 15E(s)(4)(A) of the Exchange Act requires an issuer or underwriter of any ABS to make publicly available the findings and conclusions of any third-party due diligence report obtained by an issuer or underwriter. Exchange Act Section 15E(s)(4)(A) does not apply to an issuer who itself performs the review of the underlying assets. We believe that it is important to consider these two provisions together to minimize the difference in the required disclosure based merely on whether the issuer performs the review, or instead hires a third party to perform the review.[49] Consequently, as noted above, for registered offerings of ABS, proposed Item 1111(a)(7) would require disclosure of the findings and conclusions of the issuer or a third-party reviewer. We believe this approach would avoid incentives for "regulatory arbitrage" based merely on whether the review of assets was

49 As one commentator has noted, the issuer or underwriter "may decide that it is easier not to retain such an outside firm than to have to describe its procedures and the information it reviewed and then provide a certification to the ratings agency....In short, given the choice, issuers and underwriters might prefer the easier course of doing nothing." Examining Proposals to Enhance the Regulation of Credit Rating Agencies: Testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, 111th Congress, 1st session, p. 6 (2009) (Testimony of John Coffee).

performed internally by the issuer, or whether instead the issuer hired a third party to perform the review. We are concerned that the intent of Exchange Act Section 15E(s)(4)(A) may be frustrated, and investor protection may not be served, if issuers who hired third-party loan review firms to perform a review of the assets were required to make publicly available the findings and conclusions of a review of pool assets, but issuers who performed the review themselves were not, because it could create an incentive for issuers to conduct the review themselves to avoid making publicly available the findings and conclusions of any review of the assets underlying the ABS.

c. Disclosure Regarding Exception Loans

We also are re-proposing additional requirements that we had previously proposed in the 2010 ABS Proposing Release. In the 2010 ABS Proposing Release, we proposed to detail and clarify the type of disclosure that is required to be provided for ABS offerings with respect to deviations from disclosed underwriting standards. We proposed to require that disclosure regarding the inclusion in the pool of assets that deviate from the disclosed underwriting criteria be accompanied by specific data about the amount and characteristics of those assets that did not meet the disclosed standards. We also proposed to require disclosure of what compensating or other factors, if any, were used to determine that the asset should be included in the pool, despite not having met the originator's specified underwriting standards. The commentators that submitted comments on these proposed requirements in the 2010 ABS Proposing Release were generally supportive.[50]

[50] See, e.g., comment letters from Mortgage Bankers Association, Community Mortgage Banking Project, Realpoint, LLC, CFA Institute, and American Securitization Forum; but see comment letter from IPFS Corporation.

We are re-proposing an amendment to Item 1111 in this release to require similar disclosure.[51] As re-proposed, Item 1111(a)(8) of Regulation AB would require issuers to disclose how the assets in the pool deviate from the disclosed underwriting criteria and include data on the amount and characteristics of those assets that did not meet the disclosed standards. Issuers would be required to disclose the entity (e.g., sponsor, originator, or underwriter) who determined that such assets should be included in the pool, despite not having met the disclosed underwriting standards, and what factors were used to make the determination. For example, this could include compensating factors or a determination that the exception was not material. If compensating or other factors were used, issuers would be required to provide data on the amount of assets in the pool that are represented as meeting each factor and the amount of assets that do not meet those factors. As discussed in the 2010 ABS Proposing Release, we believe that these revisions would further detail and clarify the type of disclosure that is required to be provided for ABS offerings with respect to deviations from disclosed underwriting standards and help elicit important information in areas that became problematic in the recent financial crisis. We also believe that this information would help provide investors with a fuller understanding of the quality and extent of the issuer's review of the assets (through hiring a third-party or otherwise) and how that relates to a determination to either include a loan in the pool or exclude it from the pool.

The requirements proposed here are substantially similar to what we proposed in the 2010 ABS Proposing Release. However, we are proposing an additional requirement, consistent with one commentator's suggestion, that the issuer disclose the entity (e.g., sponsor, originator or

[51] See proposed Item 1111(a)(8) of Regulation AB.

underwriter) who determined that such assets would be included in the pool, despite not having met the disclosed underwriting standards.[52] We believe that this additional requirement would assist investors in understanding the entities along the securitization chain that may be directing decisions to include exception loans in the pool.

2. Exchange Act Section 15E(s)(4)(A) and new Form ABS-15G

As noted above, Section 932 of the Act amends Exchange Act Section 15E by adding, among other things, a new Section 15E(s)(4)(A) which sets forth the requirement that the issuer or underwriter of any ABS make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter. Unlike Securities Act Section 7(d), which is expressly limited to registered ABS offerings, we believe that the requirements of Exchange Act Section 15E(s)(4)(A) were intended to apply to issuers and underwriters of both registered and unregistered offerings of ABS.[53] In this regard, we note that Section 941 of the Act amends Section 3(a) of the Exchange Act to add a definition of "asset-backed security" and that this definition includes asset-backed securities typically offered and sold in unregistered transactions. Further, unlike Section 945 of the Act, Section 932 does not refer to Section 7 of the Securities Act or registration statements filed under the Securities Act.

For registered ABS offerings, this disclosure, with respect to reports obtained by issuers, would be required to be provided in the prospectus as described above. In order to implement the disclosure requirement for unregistered offerings we are proposing new Rule 15Ga-2 under

[52] See Massachusetts AG comment letter.

[53] We note that "underwriter" is a term that is more typically used in connection with registered offerings, and the parties performing similar functions in unregistered transactions are typically referred to as placement agents or initial purchasers. We use the term "underwriter" here to describe all those persons.

the Exchange Act. Proposed Rule 15Ga-2 would require an issuer of Exchange Act-ABS to file a new Form ABS-15G to disclose the findings and conclusions of any third party engaged for purposes of performing a review obtained by an issuer with respect to unregistered transactions.[54] Rule 15Ga-2 also would require an underwriter of Exchange Act-ABS to file Form ABS-15G with the same information for reports obtained by an underwriter in registered and unregistered transactions. Proposed Form ABS-15G would be filed with the Commission on EDGAR.

We are proposing that Form ABS-15G be required to be filed five business days prior to the first sale of the offering. This requirement, if adopted, would allow investors and NRSROs time to consider the disclosure about a third-party's findings and conclusions regarding its review of the pool assets.[55]

We recognize that public disclosure of information relating to an unregistered offering could raise concerns regarding an issuer's or underwriter's reliance on the private offering

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[54] In a separate release implementing Section 943 of the Act, we are proposing new Form ABS-15G which would be required to be filed by any securitizer that offers asset-backed securities that would be subject to the federal securities laws. See Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Release No. 33-9148 (Oct. 4, 2010) (the "Section 943 Release"). The term "securitizer" is defined in Section 15G of the Exchange Act, as added by the Act. Section 15E(s)(4)(B) – (D) also would require that when third-party due diligence services are employed by an NRSRO, an issuer or an underwriter, the person providing the services give a certification to any NRSRO that produces a rating. Section 15E(s)(4) also requires the Commission to issue rules regarding the format, content and disclosure of the certification. As noted above, the Commission will propose and adopt rules to address the other provisions of Section 15E(s)(4) not later than one year after the date of the Act's enactment.

[55] This five-day time period is intended to be consistent with the proposal in the 2010 ABS Proposing Release that would require that an ABS issuer using a shelf registration statement on proposed Form SF-3 file a preliminary prospectus containing transaction-specific information at least five business days in advance of the first sale of securities in the offering. Commentators' reactions to the proposed five-day requirement in the 2010 ABS Proposing Release were mixed, with some commentators suggesting that five days was longer than investors needed to consider the information in the prospectus (e.g., comment letters from American Bar Association, Bank of America), while other commentators were supportive of the proposed five-day requirement (e.g., comment letter from MetLife, Inc.).

exemptions and safe harbors under the Securities Act.[56] We intend for Form ABS-15G to be used for both registered and unregistered ABS transactions (although as we note below, if the information has already been provided in a prospectus for a registered transaction, it need not be provided again in Form ABS-15G). We are of the view that issuers and underwriters can disclose information required by Rule 15Ga-2 without jeopardizing reliance on those exemptions and safe harbors, provided that the only information made publicly available is that which is required by the proposed rule, and the issuer does not otherwise use Form ABS-15G to offer or sell securities or in a manner that conditions the market for offers or sales of its securities.[57]

Under our proposal, Form ABS-15G would be signed by the senior officer in charge of securitization of the depositor, if the form were filed to include the findings and conclusions of a third party hired by the issuer. We believe that requiring the senior officer in charge of securitization of the depositor to sign the form is consistent with other signature requirements for filings relating to asset-backed securities.[58] If the form included the findings and conclusions of a third party engaged by the underwriter, then the form would be signed by a duly authorized officer of the underwriter. We believe that requiring Form ABS-15G to be signed by a duly authorized officer of the underwriter would provide an incentive for the person who signs the form to review it for accuracy.

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56 See 15 U.S.C. 77d(2), 17 CFR 230.144A, 17 CFR 230.501-508.

57 Filing proposed Form ABS-15G would not foreclose the reliance of an issuer on the private offering exemption in the Securities Act and the safe harbor for offshore transactions from the registration provisions in Section 5 [15 U.S.C. 77e]. However, the inclusion of information beyond that required in proposed Rule 15Ga-2, may jeopardize such reliance by constituting a public offering or conditioning the market for the ABS being offered under an exemption.

58 See, e.g., signature requirement for Form 10-K (17 CFR 249.312). It is also consistent with our proposed signature requirements for the registration statement for ABS in the 2010 ABS Proposing Release.

As discussed above, because we are proposing that, for registered offerings, the findings and conclusions of the report of a third party that is engaged by the issuer for purposes of asset review would be required to be included in a prospectus that is required to be filed with the Commission,[59] an issuer that has filed such information on EDGAR would satisfy the Exchange Act Section 15E(s)(4)(A) requirement to make publicly available a third-party report obtained by an ABS issuer. Thus, an ABS issuer that has disclosed the findings and conclusions of a third-party due diligence provider in the first prospectus that is required to be filed under Rule 424 of the Securities Act[60] and filed in accordance with Rule 424 would not be required to file a Form ABS-15G with the same information. However, any underwriter that has hired a third-party due diligence provider for the registered offering would still be required to file Form ABS-15G with the findings and conclusions of that third-party due diligence provider.

The market for Exchange Act-ABS is global.[61] Securitizers in the United States may sell ABS to offshore purchasers as part of a registered or unregistered offering. As proposed, these transactions would be subject to the requirements of proposed Rule 15Ga-2. In addition, U.S. investors may participate in offerings of ABS that are primarily offered by foreign securitizers to purchasers outside the United States. For example, a small proportion of a primarily offshore offering of ABS may be made available to U.S. investors pursuant to Section 4(2) of the

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59 In the 2010 ABS Proposing Release, we proposed to require that an asset-backed issuer that offers securities off of a shelf registration statement file a preliminary prospectus at least five business days before first sale. We anticipate that this information would be required to be included in such preliminary prospectus, should we adopt that proposal.

60 17 CFR 230.424.

61 Indeed, the International Organization of Securities Commissions (IOSCO) cites the recent crisis in the subprime markets, stemming from defaulted mortgage loans in the United States and affected by issues related to liquidity and transparency, as evidence of the interrelation of today's global markets. See Report on the Subprime Crisis – Final Report, Report of the Technical Committee of IOSCO, May 2008, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf.

Securities Act or Rule 144A under that Act.

We recognize that Exchange Act Section 15E(s)(4)(A) does not specify how its requirements apply to offshore transactions. As noted, consistent with Section 15E(s)(4)(A), proposed Rule 15Ga-2 would require issuers and underwriters to disclose information about unregistered transactions, including those sold in unregistered transactions outside the United States. Securities that are sold in foreign markets and assets originated in foreign jurisdictions may be subject to different laws, regulations, customs and practices which can raise questions as to the appropriateness of the disclosures called for under Form ABS-15G. Although our proposed rules are required by the Act, and we believe the added protections of our rules would benefit investors who purchase securities in these offerings, we are mindful that the imposition of a filing requirement in connection with private placements of ABS in the United States may result in foreign issuers seeking to avoid the filing requirement by excluding U.S. investors from purchasing portions of ABS primarily offered outside the United States, thus depriving U.S. investors of diversification and related investment opportunities.

<u>Request for Comment</u>

14. Are our disclosure proposals appropriate? Should we provide more specific requirements regarding the information that must be provided about the nature and scope of the review? If so, what should we require?

15. Should we consider Securities Act Section 7(d) and Exchange Act Section 15E(s)(4)(A) together and require disclosure of the findings and conclusions of the issuer's or third party's review of the assets, as proposed? Should we, instead, implement Section 15E(s)(4)(A) as part of the later rulemaking under Section 15E?

16. Should we require, as proposed, disclosure relating to assets that deviate from the disclosed origination underwriting criteria?

17. Should we require, as proposed, disclosure of the entity who determined that assets that did not meet the disclosed criteria should be included in the pool, despite not having met the disclosed underwriting criteria? Should issuers be required to disclose, as proposed, what factors were used to make the determination? Would this provide useful information for investors?

18. Is requiring the filing of information regarding the findings and conclusions of the third-party due diligence provider's report on proposed Form ABS-15G on EDGAR an appropriate way for issuers in unregistered offerings and for underwriters in registered and unregistered offerings to make this information publicly available? Should we allow website posting of the information instead? If so, how can we ensure the materials remain public? What advantages does website posting have over requiring that the information be filed on EDGAR? How do we ensure that investors and market participants have access to such information? What would be the liability implications of allowing the information to be posted on a website as an alternative to filing on EDGAR? Are there other appropriate means of making the findings and conclusions "publicly available"?

19. As discussed in request for comment number 10 above, we are aware that for certain types of ABS offerings an issuer may receive numerous reports from appraisers and engineers regarding the property underlying the loan. To what extent do the findings and conclusions of these reports help the issuer in performing its review? We are aware that

CMBS issuers often provide the results of such reports to the "B-piece purchaser" to the extent that the findings of those reports differ from the representations and warranties regarding the assets in the underlying transaction agreements. Should we require that the issuer disclose all of the findings and conclusions provided to a B-piece buyer for purposes of the required disclosure in the registration statement? To what extent do the findings and conclusions of these reports assist rating agencies rating ABS? Should we require, for purposes of Section 15E(s)(4)(A), the findings and conclusions of such reports to be disclosed only to the extent that those findings and conclusions differ from the representations and warranties or the complete list of findings and conclusions provided to a B-piece buyer?

20. Should we provide a temporary hardship exemption from electronic submission of Form ABS-15G with the Commission for filers who experience unanticipated technical difficulties that prevent timely preparation and submission of an electronic filing? Are there any reasons that ABS issuers and underwriters would not be able to submit Form ABS-15G on EDGAR in a timely fashion? If so, what would be an appropriate format for the filing? Would a paper filing be useful to investors and other market participants? Is timely availability of an electronic filing of this information important? If so, should we instead require that the information be posted on a website on the same day it was due to be filed on EDGAR, but require that the filer submit a confirming electronic copy of the information within a prescribed number of business days (e.g., six) of filing the information in paper?[62]

[62] See Rule 201 of Regulation S-T [17 CFR 232.201].

21. Is there any reason Exchange Act Section 15E(s)(4)(A) should not apply to both registered and unregistered ABS transactions? If the requirement applies to both registered and unregistered transactions, should the universe of ABS offerings that are subject to the requirement be defined, as proposed, as an offering of asset-backed securities, as that term is defined in Section 3(a)(77) of the Exchange Act? Should the requirement be instead applicable to some other subcategory of asset-backed securities? For example, existing Exchange Act Section 15E(i) refers to a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. Should our rule refer to this description of an asset-backed security instead of the proposed reference to Exchange Act Section 3(a)(77)?[63]

22. Should we exempt any issuers, underwriters or other parties from this requirement? Should we exempt issuers and underwriters of ABS that are not rated by an NRSRO from having to make publicly available the findings and conclusions of third-party due diligence reports?[64] As proposed, Rule 15Ga-2 would apply to issuers and underwriters of ABS that are exempted securities as defined in Section 3(a)(12) of the Exchange Act, including government securities and municipal securities. Should such exempted

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[63] Rules relating to NRSROs have used this terminology, and we have said that this refers to a "broad category of financial instrument that includes, but is not limited to, asset-backed securities such as residential mortgage-backed securities and to other types of structured debt instruments such as collateralized debt obligations, including synthetic and hybrid CDOs, or collateralized loan obligations." See, e.g., fn. 3 of Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34-61050 (Nov. 23, 2009)[74 FR 63832].

[64] For example, Fannie Mae and Freddie Mac are government sponsored enterprises ("GSEs") that purchase mortgage loans and issue or guarantee mortgage-backed securities ("MBS"). MBS issued or guaranteed by these GSEs have been, and continue to be, exempt from registration under the Securities Act and reporting under the Exchange Act. These securities have not been, and are not currently, rated by a credit rating agency.

securities be exempt from this provision?[65]

23. Would the proposed requirement that Form ABS-15G be filed five business days prior to first sale provide investors with sufficient time to review the findings and conclusions contained therein? Would it provide NRSROs with sufficient time to take the included information into account in determining a rating? If not, what would be a more appropriate filing deadline and why? Are five business days also appropriate in unregistered offerings? Is there reason to require a different number of days in unregistered offerings?

24. Is our proposed signature requirement for Form ABS-15G appropriate? Is it necessary? Conversely, are there other appropriate individuals that are better suited to sign the form?

25. Should issuers of registered ABS offerings be required to provide notice on Form ABS-15G that they have provided information relating to the third-party due diligence report obtained by the issuer in a prospectus that is filed with the Commission?

26. Where an issuer, underwriter or NRSRO employs a third-party due diligence provider, Section 15E(s)(4)(B) of the Exchange Act also requires that the person providing the due diligence services provide to the NRSRO a written certification in the format and containing content to be determined by the Commission. The Commission is required to prescribe this form and content not later than one year after enactment of the Act. Although we are not proposing to implement this requirement in this release, we request comment on the appropriate format and content for this certification and how we can

[65] Exchange Act "exempted securities" include government securities and municipal securities, as defined under the Exchange Act. For example, MBS issued by the Government National Mortgage Association are fully modified pass-through securities guaranteed by the full faith and credit of the United States government. See http://www.ginniemae.gov/.

appropriately coordinate the rules and requirements proposed in this release with that statutory requirement.

27. Are there any extra or special considerations relating to offshore sales of ABS that we should take into account in our rules? Should our rules permit issuers or underwriters to exclude information from Form ABS-15G with respect to assets underlying "foreign-offered ABS," and if so, should foreign-offered ABS be defined to include Exchange Act-ABS that were initially offered and sold solely in accordance with Regulation S, the payments to holders of which are in non-U.S. currency, that are governed by non-U.S. law, and have foreign assets (i.e., assets that are not originated in the United States) that comprise at least a majority of the value of the asset pool? For this purpose, should the foreign asset composition threshold be higher or lower (e.g., 40%, 60%, or 80%)? Would another definition be more appropriate?

28. Should our rules require issuers that are foreign private issuers[66] to provide information on Form ABS-15G for those Exchange Act-ABS that are to be offered and sold in the United States pursuant to an exemption in an unregistered offering, as proposed? Instead, should our rules only require disclosure about Exchange Act-ABS as to which more than a certain percentage (e.g., 5%, 10% or 20%) of any class of such ABS is sold to U.S. persons?

29. Should we include requirements tailored to revolving asset master trusts? For example, should we include a disclosure requirement in Exchange Act Form 8-K requiring that the issuer provide updated disclosure on its review or due diligence with respect to accounts

[66] 17 CFR 240.3b-4.

or assets that are added to the pool after the offering transaction has been completed? Should this be a requirement for each Form 10-D or should it be provided on a quarterly basis instead?

III. General Request for Comment

We request comment on the specific issues we discuss in this release, and on any other approaches or issues that we should consider in connection with the proposed amendments. We seek comment from any interested persons, including investors, asset-backed issuers, sponsors, originators, servicers, trustees, disseminators of EDGAR data, industry analysts, EDGAR filing agents, and any other members of the public.

IV. Paperwork Reduction Act

Certain provisions of the proposed rule amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).[67] The Commission is submitting these proposed amendments and proposed rules to the Office of Management and Budget (OMB) for review in accordance with the PRA.[68] An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:[69]

(1) "Form ABS-15G" (a proposed new collection of information);

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67 44 U.S.C. 3501 et seq.

68 44 U.S.C. 3507(d) and 5 CFR 1320.11.

69 The paperwork burden from Regulation S-K is imposed through the forms that are subject to the requirements in those regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to Regulation S-K.

(2) "Form S-1" (OMB Control No. 3235-0065);

(3) "Form S-3" (OMB Control No. 3235-0073); and

(4) "Regulation S-K" (OMB Control No. 3235-0071).

Compliance with the proposed amendments would be mandatory. Responses to the information collections would not be kept confidential and there would be no mandatory retention period for proposed collection of information.

Our PRA burden estimates for the proposed amendments are based on information that we receive on entities assigned to Standard Industrial Classification Code 6189, the code used with respect to ABS, as well as information from outside sources.[70] When possible, we base our estimates on an average of the data that we have available for the years 2004 through 2009.

1. Form ABS-15G

Form ABS-15G is a new collection of information that relates to proposed disclosure requirements for issuers or underwriters of any ABS. Under the proposed amendments, issuers or underwriters would be required to make publicly available the findings and conclusions of any third party engaged by the issuer or underwriter for the purposes of performing a review of the underlying assets. The burden assigned to Form ABS-15G reflects the cost of preparing and filing the form on EDGAR. The proposed Form ABS-15G would be filed by issuers of unregistered offerings of ABS, and underwriters of registered and unregistered offerings of ABS. During 2004 through 2009, there was an average of 958 registered offerings of ABS per year. We assume for purposes of this PRA that third-party due diligence reports typically are obtained

70 We rely on two outside sources of ABS issuance data. We use the ABS issuance data from Asset-Backed Alert on the initial terms of offerings, and we supplement that data with information from Securities Data Corporation (SDC).

only in RMBS and CMBS transactions. This assumption is based on our belief that the smaller the average loan in the pool of assets and the higher the frequency with which the pool loans revolve the less likely it is that there will be a third-party due diligence report. We estimate that RMBS and CMBS comprised 54% (or 517) of the registered offerings during the above time frame.[71] We assume that not all offerings of RMBS and CMBS will involve a third-party due diligence report. We estimate that 75% of RMBS and CMBS offerings would involve a third-party due diligence report. Thus, we estimate that 388 of all registered offerings (958 x 0.54 x 0.75) involve the hiring of a third-party due diligence provider by an underwriter. Because issuers would include the findings and conclusions of any third-party due diligence report in a prospectus in registered offerings, only underwriters would file a Form ABS-15G in registered ABS offerings.

In addition, over the period 2004 through 2009, the average number of Rule 144A ABS offerings per year was 716.[72] Because there may be additional ABS offerings that would have been subject to the requirement to file Form ABS-15G (e.g., offerings of asset-backed securities that relied upon Section 4(2) for an exemption from registration), we assume that there would be a total of 800 offerings of asset-backed securities that could be subject to our proposed Form ABS-15G filing requirement. Using the same assumptions and percentage estimates as above, we estimate that 324 (800 x 0.54 x 0.75) of all unregistered ABS offerings involve the hiring of a third-party due diligence provider by the issuer and underwriter or placement agent. Therefore, we estimate that approximately 712 (388+324) Forms ABS-15G would be filed annually. Our

71 This estimate is based on data from Securities Data Corporation (SDC).

72 This is based on ABS issuance data from Asset-Backed Alert and information from SDC.

burden estimate is based on the assumption that the issuer's or underwriter's costs would be limited since Rule 15Ga-2 only requires that issuers or underwriters make publicly available the findings and conclusions they obtained from a third-party. We estimate that the burden to an issuer or underwriter of making the findings and conclusions of a third-party publicly available will be approximately 5 hours to prepare, review and file the Form ABS-15G. This would amount to 3,560 burden hours (5 hours x 712 forms). We allocate 75%, or 2,670 (0.75 x 3,560), of those hours to internal burden hours and 25% for professional costs at $400 per hour for total outside costs of $356,000 ($400 x 0.25 x 3,560).

2. Rule 15Ga-2

Rule 15Ga-2 contains the requirements for disclosure that an issuer must provide in Form ABS-15G filings described above. The collection of information requirements, however, are reflected in the burden hours estimated for Form ABS-15G. Therefore, Rule 15Ga-2 does not impose any separate burden.

3. Forms S-1 and S-3

We are proposing amendments to Item 1111 of Regulation AB to increase the disclosure that would be required in offerings of ABS registered on either Forms S-1 or S-3. The disclosure required under Item 1111 would include disclosure that otherwise would be required by proposed Exchange Act Rule 15Ga-2 (which implements Section 15E(s)(4)(A) of the Exchange Act), as well as additional information about issuer reviews not required by proposed Rule 15Ga-2. The amendment to Item 1111 would require issuers to disclose how the assets in the pool deviate from the disclosed underwriting criteria, and include data on the amount and characteristics of those assets that did not meet the disclosed standards. Issuers would be required to disclose the entity who determined that such assets should be included in the pool and what factors were used to make the determination. Under proposed Rule 193, if an issuer employs a third party to perform the review, the third party must be named in the registration statement and consent to being named as an expert in accordance with Securities Act Rule 436. Thus, we anticipate that issuers will incur a burden in obtaining a consent from the third party.

We believe that the proposed requirements would increase the annual incremental burden to issuers by 30 hours per form.[73] For registration statements, we estimate that 25% of the burden of preparation is carried by the company internally and that 75% of the burden is carried by outside professionals retained by the registrant at an average cost of $400 per hour. From 2004 through 2009, an estimated average of four offerings was registered annually on Form S-1 by ABS issuers. We believe that the proposed requirements would result in an increase to the internal burden to prepare Form S-1 of 30 burden hours (0.25 x30 x 4) and an increase in outside costs of $36,000 ($400 x 0.75 x 30 x 4). During 2004 through 2009, we estimate an annual average of 929 offerings of ABS registered on Form S-3. Therefore, we believe that the proposed requirements would result in an increase to the internal burden to prepare Form S-3 filings of 6,968 burden hours (0.25 x 30 x 929) and a total cost of $8,361,000 (400 x 0.75 x 30 x 929).

Regulation S-K

Regulation S-K includes the item requirements in Regulation AB and contains the disclosure requirements for filings under both the Securities Act and the Exchange Act. In 2004,

[73] This does not reflect burdens associated with the review that would be required as a result of proposed Rule 193, which we believe does not impose a collection of information requirement for purposes of our PRA analysis.

we noted that the collection of information requirements associated with Regulation S-K as it applies to ABS issuers are included in Form S-1 and Form S-3.[74] The proposed changes would revise Regulation S-K. The collection of information requirements, however, are reflected in the burden hours estimated for the various Securities Act and Exchange Act forms related to ABS issuers. The rules in Regulation S-K do not impose any separate burden. Consistent with historical practice, we have retained an estimate of one burden hour for Regulation S-K for administrative convenience.

Form	**Current Annual Responses**	**Proposed Annual Responses**	**Current Burden Hours**	**Increase in Burden Hours**	**Proposed Burden Hours**	**Current Professional Costs**	**Increase in Professional Costs**	**Proposed Professional Costs**
S-1	1,168	1,168	247,982	30	248,012	$297,578,400	$36,000	$297,614,400
S-3	2,065	2,065	236,959	6,968	243,927	$284,350,500	$8,361,000	$292,711,500
Form ABS-15G	-	712	-	2,670	2,670	-	$356,000	$356,000
Total				9,668			$8,753,000	

<u>Request for Comment</u>

We request comments in order to evaluate (1) whether the proposed collection of information is necessary for the proper functioning of the agency, including whether the information would have practical utility; (2) the accuracy of our estimate of the burden of the proposed collection of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) whether there are way to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

74 <u>See</u> 2004 Regulation AB Adopting Release.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-26-10. Request for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-26-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Benefit-Cost Analysis

The proposed amendments to our regulations for ABS relate to requiring an issuer of an ABS to perform a review of the assets underlying the security. We are proposing rules that are intended to implement the requirements under new Section 7(d) of the Securities Act. We also are proposing rules that are intended to implement part of new Section 15E(s)(4) of the Exchange Act. First, we are proposing a new Securities Act rule to require issuers of registered offerings of asset-backed securities to perform a review of the assets underlying the asset-backed securities. Second, we also are proposing new requirements in Regulation AB to require disclosure regarding:

- The nature of the review of assets conducted by an ABS issuer;
- The findings and conclusions of a review of assets conducted by an issuer or third party;
- Data on assets in the pool that do not meet the underwriting standards; and
- Disclosure regarding which entity determined that the assets should be included in the pool, despite not having met the underwriting standards and what factors were considered in making this determination.

We also are proposing to require that an issuer or underwriter of any Exchange Act-ABS be required to file the findings and conclusions of a third-party due diligence report on a new form filed on EDGAR.

A. Benefits

The proposed amendments are designed to increase investor protection by implementing the requirement on issuers to perform a review of the underlying assets and disclose the nature of the review. This should lead to enhanced transparency in offerings of ABS, and result in an increase in investors' understanding of the underlying pool of assets. We believe that the proposal to require the issuer to perform a review of the assets underlying an ABS is likely to result in an improvement in the quality of securitized loan pools to the extent that these reviews are able to identify non-compliant or otherwise low-quality assets. It also will allow the public to determine the adequacy and level of due diligence services provided by a third party which is consistent with the purposes of Section 932 of the Act.[75] We expect that requiring a review of the assets will result in loan pools of higher quality.

[75] See S. Rep. No. 111-176, at 121 (2010).

Further, the description of the nature of the review and disclosure of findings and conclusions should encourage more rigorous asset reviews, whether by issuers or third parties engaged to perform the asset reviews. These disclosures would complement the requirement to perform a review by improving their quality. We also believe that the proposal to make publicly available on EDGAR the findings and conclusions of third-party due diligence reports in ABS offerings will allow the public to better assess and more easily determine the adequacy and level of due diligence services provided by a third party. This benefit of the proposed rule is consistent with the purposes of Section 932 of the Act as indicated in the legislative history of the Act which states that "many analysts point to the decline of due diligence as a factor that contributed to the poor performance of asset-backed securities during the crisis."[76] We also note the reference in the Act's legislative history to a need to address the lack of due diligence regarding information on which ratings are based.[77] Finally, although issuers in registered offerings would not be required to use a third party to satisfy the review requirement, as a condition to such use, a third party would be required to consent to being named in the registration statement and thereby accept potential expert liability, which should increase the quality of that review. In registered offerings, the potential expert liability for the findings of third-party reviews provides accountability and creates stronger incentives to perform high-quality reviews that protect investors. The resulting disclosures reduce the information risk of investing in these securities. Our proposal to require disclosure by the issuer of the nature, findings and conclusions of its review could result in improved asset review practices.

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[76] See id.

[77] See id.

Moreover, this could be useful to investors if they prefer investing in securities about which there is disclosure indicating a more robust review over investing in securities about which the disclosure indicates a less robust review.

The proposed requirement to disclose exception loans should provide important information to investors regarding the characteristics of the pool that may otherwise not be publicly known. For those issuers that currently provide asset-level information about the pool, an investor might be able to determine some information about the number of exception loans; however, even where this could be determined, the proposals would reduce investors' cost of information production by reducing duplicative efforts on their part to gather such data on their own or purchase it through data intermediaries. We also are proposing to require more information about the entities that have determined that an asset that deviates from underwriting standards should, nonetheless, be included in the pool. Because third-party asset review providers typically work for sponsors, there is potentially a conflict of interest when a sponsor can waive or overrule the third-party's conclusions that insufficient compensating factors exist to allow inclusion of an asset that does not meet the underwriting standards governing the pool.[78] We expect that information about which entity made the determination to include an asset in the pool despite not having met the underwriting standards will provide investors with information to gauge whether the decision to accept such loans otherwise may be subject to a conflict of interest. We also expect this will reduce the cost of information asymmetry and could be useful information to investors because investors may be able to price a securitization of a pool of assets more accurately, and to credit rating agencies in assigning more informed credit ratings.

[78] See e.g., comment letter from Massachusetts AG.

Our proposal to require disclosure of the nature of the review, as well as the findings and conclusions of any such review, may increase investor confidence in the market for ABS. This proposal, in conjunction with the proposal to require that issuers perform a review, could allow investors to better understand the information about the asset pool and credit risk of the asset pool including whether the asset pool consists of loans to borrowers without the ability to repay the loans, or is composed of loans made to creditworthy borrowers.

In addition, Section 15E(s)(4)(A) of the Exchange Act, as added by Section 932 of the Act, which requires issuers and underwriters to make the findings and conclusions of third-party due diligence reports publicly available, is aimed at improving the quality of information received by rating agencies issuing ratings on asset-backed securities in registered and unregistered offerings.[79] We have proposed to make this information publicly available on EDGAR. By requiring the proposed Form ABS-15G to be filed on EDGAR, the information that would be required would be housed in a central repository that would preserve continuous access to the information.

B. Costs

The proposed rule would implement the requirement that all issuers of registered ABS offerings perform a review of the underlying assets and that those issuers disclose the nature of their review. Although some issuers of ABS may currently perform a review of the underlying assets, ABS issuers in registered offerings may incur additional costs to perform more extensive reviews, whether the issuer performs the review itself, or hires a third-party to perform the review. It is possible that by not establishing a minimum level of review and leaving the

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79 See id.

determination of the appropriate level of review to each individual issuer, a lack of a uniform standard could result in investors having difficulty comparing the level of review and the disclosures about the review among various issuers and asset classes.

It is possible that by not establishing a minimum level of review and leaving the determination of the appropriate level of review to each individual issuer, some issuers who otherwise may have performed a more thorough review to meet a proposed minimum level of review may design their reviews to accomplish no more than what is required by the rule.

As proposed, Rule 193 permits an issuer to rely on a third party to perform the required review, provided the review satisfies the standard in Rule 193 and the third party consents to be named in the registration statement. Some asset classes may not have third-party due diligence providers available to be engaged to conduct a review. In instances where an issuer must conduct the review, we believe that the costs of conducting these reviews will not exceed the costs of engaging third parties to conduct the reviews. Third-party due diligence providers are not registered with the Commission and some may not be subject to professional standards. Further, it is possible that third-party providers may lack sufficient capabilities to provide the review for which they are retained. However, our rules would subject third-party due diligence providers in registered transactions to potential expert liability for the disclosure regarding the findings and conclusions of their review of the assets. For certain firms, however, in particular smaller due diligence entities that may lack the financial resources to cover their potential liabilities, expert liability may not be a significant deterrent because these firms have less financial resources exposed to potential liability and may not be as concerned about losing potential claims compared to firms that have more financial resources exposed to liability. This may create a burden on both qualified providers of due diligence and the securitizers that hire them.

We acknowledge that this requirement would impose costs on issuers and third-party due diligence providers, and they may be required to adjust their practices (and prices in the case of third parties) to account for this new requirement.

Finally, for unregistered offerings, the disclosure of the results of an asset review is required only for third-party reviews. This may indirectly result in discouraging issuers and underwriters from obtaining third-party reviews in unregistered offerings.

Our proposals requiring issuers to disclose the nature of the review as well as the findings and conclusions of such review will impose a disclosure burden. In addition, filers will make the information proposed to be required available on EDGAR, which requires obtaining authorization codes and adherence to formatting instructions. For purposes of the PRA, we estimate that the new disclosure would cause an increase in the total cost of preparing Forms S-1 and S-3 of $13,995,000. In addition, for purposes of the PRA, we estimate that the cost for including third-party findings in Form ABS-15G would be $356,000.

Request for Comment

We seek comments and empirical data on all aspects of this Benefit-Cost Analysis including identification and quantification of any additional costs and benefits. Specifically, we ask the following:

- What would be the costs to an issuer of performing a review of the underlying assets? How would this compare to the cost of hiring a third-party provider to perform the review?

- What would be the additional costs arising from the application of expert's liability to third-parties performing reviews for issuers?

VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a) of the Exchange Act[80] 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[81] and Section 3(f) of the Exchange Act[82] require the Commission, when engaging in rulemaking that requires it to consider 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. Below, we address these issues for each of the proposed, substantive changes to offerings of ABS.

As a result of the financial crisis and subsequent events, the market for securitization has declined due, in part, to perceived uncertainty about the accuracy of information about the pools backing the ABS and perceived problems in the securitization process that affected investors' willingness to participate in these offerings.[83] Greater transparency of the review performed on the underlying assets would decrease the uncertainty about pool information and, thus, should help investors price these products more accurately. The proposed requirements are likely to

80 15 U.S.C. 78w(a).

81 15 U.S.C. 77b(b).

82 15 U.S.C. 78c(f).

83 See, e.g., David Adler, A Flat Dow for 10 Years? Why it Could Happen, BARRONS (Dec. 28, 2009).

positively affect pricing, efficiency, and capital allocation in ABS capital markets.

Finally, the introduction of expert liability on the third-party review providers may have consequences for the competition in this market. The possibility of expert liability may provide an incentive for due diligence providers to improve the quality of their reviews. Thus, one possible market outcome is for reviewers to compete on the quality of their services, because competing on price accompanied by lower quality may cease to be economically viable given the potential liability.

On the other hand, the possibility of expert liability may not be a significant deterrent for smaller due diligence providers that do not have the financial resources to cover their potential liabilities. This may adversely affect competition in both the market for the provision of due diligence and the market for ABS. Diligent providers of asset reviews may be pressured to decrease their standards, their prices or both. In addition, ABS with reviews obtained from such parties may affect the pricing of competing securities. Alternatively, the possibility of expert liability could be an incentive for due diligence providers to improve their capabilities.

In summary, taken together the proposed amendments and regulations implement Congress' mandate under the Act and are designed to improve investor protection, improve the quality of the assets underlying an ABS, and increase transparency to market participants. We believe that the proposals also would improve investors' confidence in asset-backed securities and help recovery in the asset-backed securities market with attendant positive effects on efficiency, competition and capital formation.

We request comment on our proposed amendments. We request comment on whether our proposals would promote efficiency, competition, and capital formation. Commentators are requested to provide empirical data and other factual support for their views, if possible.

VII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[84] a rule is "major" if it has resulted, or is likely to result in:

- an annual effect on the U.S. economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposed amendments would be a "major rule" for purposes of the Small Business Regulatory Enforcement Fairness Act. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment, or innovation.

VIII. Regulatory Flexibility Act Certification

The Commission hereby certifies pursuant to 5 U.S.C. 605(b) that the proposals contained in this release, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposals relate to the registration, disclosure and reporting requirements for asset-backed securities under the Act, the Securities Act and the Exchange Act. Securities Act Rule 157[85] and Exchange Act Rule 0-10(a)[86] defines an issuer,

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84 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

85 17 CFR 230.157.

86 17 CFR 240.0-10(a).

other than an investment company, to be a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year. As the depositor and issuing entity are most often limited purpose entities in an ABS transaction, we focused on the sponsor in analyzing the potential impact of the proposals under the Regulatory Flexibility Act. Based on our data, we only found one sponsor that could meet the definition of a small broker-dealer for purposes of the Regulatory Flexibility Act.[87] In addition, we do not believe that any underwriter of ABS would meet the definition of a small entity for purposes of the Regulatory Flexibility Act.[88] Accordingly, the Commission does not believe that the proposals, if adopted, would have a significant economic impact on a substantial number of small entities.

IX. Statutory Authority and Text of Proposed Rule and Form Amendments

We are proposing the new rules and amendments contained in this document under the authority set forth in Sections 6, 7, 10, 19(a), and 28 of the Securities Act, and Sections 3(b), 15E, 15G, 23(a), 35A and 36 of the Exchange Act.

List of Subjects in 17 CFR Parts 229, 230, 240, and 249

Advertising, Reporting and recordkeeping requirements, Securities.

For the reasons set out above, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 — REGULATION S-K

1. The authority citation for part 229 continues to read in part as follows:

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87 This is based on data from Asset-Backed Alert.

88 This is based on data from Asset-Backed Alert.

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77z–3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 777iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u–5, 78w, 78ll, 78mm, 80a–8, 80a–9, 80a–20, 80a–29, 80a–30, 80a–31(c), 80a–37, 80a–38(a), 80a–39, 80b–11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Amend §229.1111 by:

a. Revising the introductory text to paragraph (a):

b. Adding paragraphs (a)(7) and (a)(8).

The revision and additions read as follows:

§229.1111 (Item 1111) Pool assets.

* * * * *

(a) Information regarding pool asset types and selection criteria. Provide the following information:

* * * * *

(7)(i) The nature of a review of the assets performed by an issuer or sponsor (required by §230.193), including whether the issuer of any asset-backed security engaged a third party for purposes of performing a review of the pool assets underlying an asset-backed security; and

(ii) The findings and conclusions of the review of the assets by the issuer, sponsor, or third party described in paragraph (7)(i) of this section.

Instruction to Item 1111(a)(7): If the issuer has engaged a third party for purposes of performing the review of assets, the issuer must provide the name of the third-party reviewer and comply with the requirements of §230.436 of this chapter.

(8) If any assets in the pool deviate from the disclosed underwriting criteria, disclose how those assets deviate from the disclosed underwriting criteria and include data on the amount and characteristics of those assets that did not meet the disclosed standards. Disclose which entity (e.g., sponsor, originator, or underwriter) determined that those assets should be included in the pool, despite not having met the disclosed underwriting standards, and what factors were used to make the determination, such as compensating factors or a determination that the exception was not material. If compensating or other factors were used, provide data on the amount of assets in the pool that are represented as meeting each such factor and the amount of assets that do not meet those factors.

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

3. 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.

* * * * *

Section 230.193 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

4. Add §230.193 to read as follows:

§230.193 Review of underlying assets in asset-backed securities transactions.

An issuer of an "asset-backed security", as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)), offering and selling such a security pursuant to a registration statement shall perform a review of the pool assets underlying the asset-backed security. The issuer may conduct the review or an issuer may employ a third party engaged for purposes of performing the review provided the third party is named in the registration statement and consents to being named as an expert in accordance with §230.436 of this chapter.

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

5. The authority citation for part 240 is amended by adding authority for §240.15Ga-2 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.

* * * * *

Section 240.15Ga-2 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

6. Add §240.15Ga-2 to read as follows:

§ 240.15Ga-2 Findings and conclusions of third-party due diligence reports.

(a) The issuer or underwriter of any "asset-backed security" (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)) shall file Form ABS-15G (17 CFR 249.1300) containing the findings and conclusions of any report of a third party engaged for purposes of performing a review of the pool assets obtained by the issuer or underwriter five business days prior to the first sale in the offering.

(b) If the issuer in a registered offering of asset-backed securities has included the information required by paragraph (a) of this section in the first prospectus that is required to be filed under 17 CFR 230.424 for that offering and filed in accordance with 17 CFR 230.424, then the issuer is not required to file Form ABS-15G (17 CFR 249.1300) to include the same information.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

7. The authority citation for part 249 is amended by adding an authority for §249.1300 to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Section 249.1300 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

* * * * *

8. Add Subpart O and Form ABS-15G (referenced in §249.1300) to Part 249 to read as follows:

Subpart O – Forms for Securitizers of Asset-Backed Securities

§249.1300 Form ABS-15G, Asset-backed securitizer report pursuant to Section 15G of the Securities Exchange Act of 1934

This form shall be used for reports of information required by Rule 15Ga-1 (§240.15Ga-1 of this chapter) and Rule 15Ga-2 (§240.15Ga-2 of this chapter).

Note: The text of Form ABS-15G does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM ABS-15G

ASSET-BACKED SECURITIZER
REPORT PURSUANT TO SECTION 15G OF
THE SECURITIES EXCHANGE ACT OF 1934

Check the appropriate box to indicate the filing obligation to which this is form is intended to satisfy:

___ Rule 15Ga-1 under the Exchange Act (17 CFR 240.15Ga-1)
___ Rule 15Ga-2 under the Exchange Act (17 CFR 240.15Ga-2)

Date of Report (Date of earliest event reported)______________________

Commission File Number of securitizer: ____________________
Central Index Key Number of securitizer: ___________________

____
Name and telephone number, including area code, of the person to contact in connection with this filing

For filings under Rule 15Ga-2, also provide the following information:

Central Index Key Number of depositor: ___________________________
Commission File Number of depositor (if applicable):________________

____
(Exact name of issuing entity as specified in its charter)

Central Index Key Number of issuing entity (if applicable): ___________________
Commission File Number of issuing entity (if applicable): ______________________

Central Index Key Number of underwriter (if applicable): ___________________
Commission File Number of underwriter (if applicable): ______________________

GENERAL INSTRUCTIONS

A. Rule as to Use of Form ABS-15G.

This form shall be used to comply with the requirements of Rules 15Ga-1 and 15Ga-2 under the Exchange Act (17 CFR 240.15Ga-1 and 17 CFR 240.15Ga-2).

B. Events to be Reported and Time for Filing of Reports.

1. Forms filed under Rule 15Ga-1. In accordance with Rule 15Ga-1, file the information required by Part I in accordance with Item 1.01, Item 1.02, or Item 1.03, as applicable. If the filing deadline for the information occurs on a Saturday, Sunday or holiday on which the Commission is not open for business, then the filing deadline shall be the first business day thereafter.
2. Forms filed under Rule 15Ga-2. In accordance with Rule 15Ga-2, file the information required by Part II no later than five business days prior to the first sale of securities in the offering.

C. Preparation of Report.

This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the report on paper meeting the requirements of Rule 12b-12 (17 CFR 240.12b-12). The report shall contain the number and caption of the applicable item, but the text of such item may be omitted, provided the answers thereto are prepared in the manner specified in Rule 12b-13 (17 CFR 240.12b-13). All items that are not required to be answered in a particular report may be omitted and no reference thereto need be made in the report. All instructions should also be omitted.

D. Signature and Filing of Report.

1. Forms filed under Rule 15Ga-1. Any form filed for the purpose of meeting the requirements in Rule 15Ga-1 must be signed by the senior officer in charge of securitization of the securitizer.
2. Forms filed under Rule 15Ga-2. Any form filed for the purpose of meeting the requirements in Rule 15Ga-2 must be signed by the senior office in charge of securitization of the depositor if information required by Item 2.01 is required to be provided and must be signed by a duly authorized officer of the underwriter if information required by Item 2.02 is required to be provided.
3. Copies of report. If paper filing is permitted, three complete copies of the report shall be filed with the Commission.

INFORMATION TO BE INCLUDED IN THE REPORT

PART I – REPRESENTATION AND WARRANTY INFORMATION

Item 1.01 Initial Filing of Rule 15Ga-1 Representations and Warranties Disclosure

If any securitizer (as that term is defined in Section 15G(a) of the Securities Exchange Act of 1934), issues an asset-backed security (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934), or organizes and initiates an asset-backed securities transaction by selling or transferring an asset, either directly or indirectly, including through an affiliate, to the issuer, provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) at the time the securitizer, or an affiliate commences its first offering of the asset-backed securities after [compliance or effective date of the final rule], if the underlying transaction agreements contain a covenant to repurchase or replace an underlying asset for breach of a representation or warranty.

Item 1.02 Periodic Filing of Rule 15Ga-1 Representations and Warranties Disclosure

Each securitizer which was required to provide the information required by Item 1.01 of this form shall provide the disclosures required by Rule 15Ga-1 (17 CFR 240.15Ga-1) as of the end of each calendar month, to be filed not later than 15 calendar days after the end of such calendar month.

Item 1.03 Notice of Termination of Duty to File Reports under Rule 15Ga-1

If any securitizer has no asset-backed securities outstanding (as that term is defined in Section 3(a)(77) of the Securities Exchange Act of 1934) held by non-affiliates, provide the date of the last payment on the last asset-backed security outstanding that was issued by or issued by an affiliate of the securitizer.

PART II- ASSET REVIEW INFORMATION

Item 2.01 Findings and Conclusions of a Third Party Engaged by the Issuer to Review Assets

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any report by a third party engaged by the issuer for the purpose of reviewing assets underlying an asset-backed security.

Item 2.02 Findings and Conclusions of a Third-Party Engaged by the Underwriter to Review Assets

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any third-party engaged by the underwriter for the purpose of reviewing assets underlying an asset-backed security.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the reporting entity has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

____ (Depositor, Securitizer, or Underwriter)

Date ____

____ (Signature)*

*Print name and title of the signing officer under his signature.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: October 13, 2010.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 242

Release No. 34-63107; File No. S7-27-10

RIN 3235-AK74

Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: In accordance with Section 765 ("Section 765") of Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Securities and Exchange Commission ("SEC" or "Commission") is proposing Regulation MC under the Securities Exchange Act of 1934 ("Exchange Act") for clearing agencies that clear security-based swaps ("security-based swap clearing agencies") and for security-based swap execution facilities ("SB SEFs") and national securities exchanges that post or make available for trading security-based swaps ("SBS exchanges"). Regulation MC is designed to mitigate potential conflicts of interest that could exist at these entities. Specifically, the Commission seeks to mitigate the potential conflicts of interest through conditions and structures relating to ownership, voting, and governance of security-based swap clearing agencies, SB SEFs, and SBS exchanges.

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

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-27-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-27-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F St., NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Proposals relating to security-based swap clearing agencies: Catherine Moore, Senior Special Counsel, at (202) 551-5710; and Joseph P. Kamnik, Special Counsel, at (202) 551-5710; Office of Clearance and Settlement, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010; proposals relating to security-based swap execution facilities and national securities exchanges that post or make available for trading security-based swaps: Nancy Burke-Sanow, Assistant Director, at (202) 551-5621; Molly Kim, Special Counsel, at (202) 551-5644; Steven Varholik, Special Counsel, at (202) 551-5615; Sarah Schandler, Attorney, at (202) 551-7145; and Iliana Lundblad, Attorney, at (202) 551-5871; Office of Market Supervision, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is proposing new Regulation MC under the Exchange Act relating to conflicts of interest with respect to security-based swap clearing agencies, SB SEFs, and SBS exchanges.

I. Introduction

On July 21, 2010, the President signed the Dodd-Frank Act into law.[1] The Dodd-Frank Act was enacted to, among other purposes, promote the financial stability of the United States by improving accountability and transparency in the financial system.[2] Title VII of the Dodd-Frank Act provides the Commission and the Commodity Futures Trading Commission ("CFTC") with the authority to regulate over-the-counter ("OTC") derivatives in light of the recent financial crisis, which demonstrated the need for enhanced regulation in the OTC derivatives market. The Dodd-Frank Act is intended to close loopholes in the existing regulatory structure and to provide the Commission and the CFTC with effective regulatory tools to oversee the OTC swaps market, which has grown exponentially in recent years and is capable of affecting significant sectors of the U.S. economy.

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1 The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, H.R. 4173).

2 See Pub. L. No. 111-203, Preamble.

The Dodd-Frank Act provides that the CFTC will regulate "swaps," the Commission will regulate "security-based swaps," and the CFTC and the Commission will jointly regulate "mixed swaps."[3] The Dodd-Frank Act amends the Exchange Act to require, among other things, the following: (1) transactions in security-based swaps must be cleared through a clearing agency if they are of a type that the Commission determines must be cleared, unless an exemption from mandatory clearing applies; (2) transactions in security-based swaps must be reported to a registered security-based swap data repository or the Commission; and (3) if a security-based swap is subject to a clearing requirement, it must be traded on a registered trading platform, i.e.,

3 Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System ("Federal Reserve"), shall jointly further define the terms "swap," "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," "eligible contract participant," and "security-based swap agreement." These terms are defined in Sections 721 and 761 of the Dodd-Frank Act and, with respect to the term "eligible contract participant," in Section 1a(18) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 1a(18), as re-designated and amended by Section 721 of the Dodd-Frank Act. Further, Section 721(c) of the Dodd-Frank Act requires the CFTC to adopt a rule to further define the terms "swap," "swap dealer," "major swap participant," and "eligible contract participant," and Section 761(b) of the Dodd-Frank Act permits the Commission to adopt a rule to further define the terms "security-based swap," "security-based swap dealer," "major security-based swap participant," and "eligible contract participant," with regard to security-based swaps, for the purpose of including transactions and entities that have been structured to evade Title VII of the Dodd-Frank Act. Finally, Section 712(a) of the Dodd-Frank Act provides that the Commission and CFTC, after consultation with the Federal Reserve, shall jointly prescribe regulations regarding "mixed swaps" as may be necessary to carry out the purposes of Title VII. To assist the Commission and CFTC in further defining the terms specified above, and to prescribe regulations regarding "mixed swaps" as may be necessary to carry out the purposes of Title VII, the Commission and the CFTC have requested comment from interested parties. See Securities Exchange Act Release No. 62717 (August 13, 2010), 75 FR 51429 (August 20, 2010) (File No. S7-16-10) (advance joint notice of proposed rulemaking regarding definitions contained in Title VII of the Dodd-Frank Act) ("Definitions Release").

a SB SEF or SBS exchange, unless no facility makes such security-based swap available for trading.[4]

II. Mandated Rulemaking on Mitigating Conflicts of Interest

Section 765 of the Dodd-Frank Act requires the Commission to adopt rules to mitigate specified conflicts of interest.[5] Section 765(a) requires the Commission to adopt rules, which rules may include numerical limits on the control of, or the voting rights with respect to, any security-based swap clearing agency, or on the control of any SB SEF or SBS exchange, by specified entities, such as a bank holding company with total consolidated assets of $50 billion or more,[6] a nonbank financial company,[7] an affiliate of such bank holding company or nonbank

4 See Section 761 of the Dodd-Frank Act, added as Section 3(a)(77) of the Exchange Act, 15 U.S.C. 78(c)(a), which defines the term "security-based swap execution facility" to mean "a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility that (A) facilitates the execution of security-based swaps between persons; and (B) is not a national securities exchange." See Pub. L. No. 111-203, Section 761. The Dodd-Frank Act amends the CEA to provide for a similar regulatory framework with respect to transactions in swaps regulated by the CFTC.

5 See Pub. L. No. 111-203, Section 765.

6 The term "bank holding company" has the meaning set forth in Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) ("Bank Holding Company Act"), and generally means any company that has control over any bank or over any company that is or becomes a bank holding company by virtue of the Bank Holding Company Act.

7 Under Section 765(a) of the Dodd-Frank Act, the term "nonbank financial company" has the meaning set forth in Section 102 of the Dodd-Frank Act, and generally means a company, other than a bank holding company, national securities exchange, clearing agency, SB SEF, registered security-based swap data repository, board of trade designated as a contract market ("DCM"), derivatives clearing organization, swap execution facility ("SEF") or registered swap data repository, that is predominantly engaged in financial activities (including through a branch in the U.S., if such company is incorporated or organized in a country other than the U.S.). See Pub. L. No. 111-203, Section 102 for the complete definition.

financial company, a security-based swap dealer,[8] or a major security-based swap participant (collectively, "Specified Entities").[9]

Section 765(b) – captioned "Purposes" – provides that the Commission shall adopt such rules if it determines they are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition or mitigate conflicts of interest in connection with a security-based swap dealer's or major security-based swap participant's conduct of business with, a security-based swap clearing agency, SB SEF, or SBS exchange and in which such security-based swap dealer or major security-based swap participant has a material debt or equity investment.[10] Section 765(b) sets forth a number of underlying policy objectives for the Commission's rulemaking – improving governance, mitigating systemic risk, promoting competition, and mitigating conflicts of interest with respect to security-based swap clearing

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8 Pursuant to Section 761 of the Dodd-Frank Act, the term "security-based swap dealer" is added as Section 3(a)(71) of the Exchange Act, 15 U.S.C 78c(a), and generally means any person who (A) holds themselves out as a dealer in security-based swaps; (B) makes a market in security-based swaps; (C) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (D) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. See Pub. L. No. 111-203, Section 761 for the complete definition. See also Definitions Release, 75 FR 51429, supra note 3.

9 Pursuant to Section 761 of the Dodd-Frank Act, the term "major security-based swap participant" is added as Section 3(a)(67) of the Exchange Act, 15 U.S.C 78c(a), and generally means any person (A) who is not a security-based swap dealer; and (B)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding positions held for hedging or mitigating commercial risk; (II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (III) that is a financial entity that (a) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking regulator; and (b) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission. See Pub. L. No. 111-203, Section 761 for the complete definition. See also Definitions Release, 75 FR 51429, supra note 3.

10 See Pub. L. No. 111-203, Section 765(b).

agencies, SB SEFs, and SBS exchanges. In considering proposed rules to mitigate conflicts of interest, the Commission is mindful that, in some instances, certain of these diverse policy objectives may be in tension with others. For example, as described in Section III.A.2.a below, with respect to security-based swap clearing agencies, the statutory objective of promoting competition, which may be furthered through enhanced access to cleared products and clearing venues, may to some extent be in tension with the objective of minimizing systemic risk through effective risk management of the clearing agency.

Section 765(c) of the Dodd-Frank Act also provides that in adopting rules under Section 765, the Commission shall consider any conflicts of interest arising from the amount of equity ownership and voting by a single investor; the ability of owners to vote, cause the vote of, or withhold votes entitled to be cast on any matters by the holders of the ownership interest; and the governance arrangements of any derivatives clearing organization that clears swaps, or swap execution facility or board of trade designated as a contract market that posts swaps or makes swaps available for trading.[11]

The Commission is cognizant that the proposed rules discussed herein, as well as other proposals that the Commission may consider in the coming months to implement the Dodd-Frank Act, if adopted, could significantly affect – and be significantly affected by – the nature and scope of the security-based swaps market in a number of ways. For example, the Commission recognizes that if the measures proposed in this release are adopted and are too onerous for new entrants, they could hinder the further development of a market for security-

11 See Pub. L. No. 111-203, Section 765(c). Although this provision refers to swaps and to entities regulated by the CFTC, the Commission believes that the Congress intended it to refer to security-based swaps and to security-based swap clearing agencies, SB SEFs, and SBS exchanges, because Section 765 pertains to transactions in security-based swaps and persons and entities related thereto.

based swaps by unduly discouraging competition and the formation of new security-based swap clearing agencies and of new SB SEFs or SBS exchanges. On the other hand, if the Commission adopts rules that are too permissive, conflicts of interest may be inadequately mitigated and such conflicts may incentivize restricting access to centralized clearing and lack of transparency in the trading of security-based swaps as described in detail in Section III below. The Commission is also mindful that the further development of the security-based swaps market may alter the calculus for future regulation of conflicts of interest. As commenters review the instant proposals, they are urged to consider generally the role that regulation may play in fostering or limiting the development of the market for security-based swaps (or, vice versa, the role that market developments may play in changing the nature and implications of regulation) and specifically to focus on this issue with respect to the proposals to mitigate conflicts of interest for security-based swap clearing agencies, SB SEFs, and SBS exchanges.

The Commission must adopt the rules required by Section 765 of the Dodd-Frank Act by January 17, 2011, which is 180 days after enactment of the Dodd-Frank Act.[12] The Commission therefore is proposing Regulation MC under the Exchange Act to mitigate conflicts of interest with respect to security-based swap clearing agencies, SB SEFs, and SBS exchanges.

This proposed rulemaking is among the first that the Commission has considered in connection with its mandates under the Dodd-Frank Act, and the Commission is mindful of the considerations raised by this timing. In particular, under the prescribed timeframes of the Dodd-

12 Section 726 of the Dodd-Frank Act similarly requires the CFTC to adopt rules designed to mitigate conflicts of interest with respect to entities under its jurisdiction that clear or trade swaps. See Pub. L. No. 111-203, Section 726. The Commission preliminarily believes that an entity that registers with the Commission as either a security-based swap clearing agency or a SB SEF is likely to register also with the CFTC as a derivatives clearing organization or swap execution facility, respectively. As a result, the Commission staff and the CFTC staff have consulted and coordinated with one another regarding their respective agencies' proposed rules to mitigate conflicts of interest.

Frank Act, the Commission must propose rules required by Section 765 before it has the opportunity to consider proposed rules that also are likely to affect the development of security-based swap clearing agencies, SB SEFs, and SBS exchanges, as well as the security-based swaps market overall. The Commission also notes that the market for security-based swaps is in a nascent stage of development compared to the markets for equity securities and listed options and that the market for security-based swaps could develop further as the Dodd-Frank Act is fully implemented and these transactions continue to move to central clearing and trading on organized markets.

III. Discussion of Potential Conflicts of Interest

A. Security-Based Swap Clearing Agencies

1. Current Regulatory Structure

Credit market events from the last few years have demonstrated that a security-based swaps market operating without meaningful regulation[13] and central counterparties[14] can pose systemic risks. In November 2008, under the auspices of the President's Working Group on Financial Markets, the Secretary of the Department of the Treasury, the Chairs of the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, the CFTC, and the Commission established as a policy objective for the OTC derivatives market that regulators and prudential supervisors require participants in a central counterparty ("CCP")

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[13] See, generally, Policy Objectives for the OTC Derivatives Market, The President's Working Group on Financial Markets (November 14, 2008) (available at http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf).

[14] See The Role of Credit Derivatives in the U.S. Economy before the H. Agric. Comm., 110th Cong. (2008) (Statement of Erik Sirri, Director of the Division of Trading and Markets, Commission) (available at http://agriculture.house.gov/testimony/110/110-49.pdf).

arrangement to clear all eligible contracts through that CCP.[15] In furtherance of this policy objective, the Commission, the Federal Reserve, and the CFTC signed a Memorandum of Understanding that established a framework for consultation and information sharing on issues related to central counterparties for the OTC derivatives market.[16]

The Commission has taken steps to help foster the prompt development of CCPs. In particular, the Commission acted to authorize the clearing of OTC security-based swaps by permitting certain clearing agencies to clear credit default swaps ("CDS") on a temporary conditional basis.[17] Today, a significant volume of CDS transactions is cleared centrally and

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15 See supra note 13. See also Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (March 13, 2008) (available at http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf) and Progress Update on March Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (October 2008) (available at http://www.treas.gov/press/releases/reports/q4progress%20update.pdf).

16 See Memorandum of Understanding Between the Board of Governors of the Federal Reserve System, the U.S. Commodity Futures Trading Commission, and the U.S. Securities and Exchange Commission Regarding Central Counterparties for Credit Default Swaps (November 14, 2008) (available at http://www.treas.gov/press/releases/reports/finalmou.pdf).

17 The Commission authorized five entities to clear credit default swaps. See Securities Exchange Act Release Nos. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) and 61973 (April 23, 2010), 75 FR 22656 (April 29, 2010) (CDS clearing by ICE Clear Europe Limited); 60373 (July 23, 2009), 74 FR 37740 (July 29, 2009) and 61975 (April 23, 2010), 75 FR 22641 (April 29, 2010) (CDS clearing by Eurex Clearing AG); 59578 (March 13, 2009), 74 FR 11781 (March 19, 2009), 61164 (December 14, 2009), 74 FR 67258 (December 18, 2009) and 61803 (March 30, 2010), 75 FR 17181 (April 5, 2010) (CDS clearing by Chicago Mercantile Exchange Inc.); 59527 (March 6, 2009), 74 FR 10791 (March 12, 2009), 61119 (December 4, 2009), 74 FR 65554 (December 10, 2009) and 61662 (March 5, 2010), 75 FR 11589 (March 11, 2010) (CDS clearing by ICE Trust US LLC); 59164 (December 24, 2008), 74 FR 139 (January 2, 2009) (temporary CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) (collectively, "CDS Clearing Exemption Orders"). LIFFE A&M and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

the Commission monitors the activities of these clearing agencies.[18]

The Exchange Act does not impose specific requirements regarding the ownership structure of a clearing agency. As a result, clearing agencies may operate under a variety of appropriate organizational structures provided that they have the capacity to meet the standards in Section 17A of the Exchange Act.[19] Certain clearing agencies registered with the Commission are owned either by participants or by securities exchanges.[20] Other clearing agencies, such as the security-based swap clearing agencies that, once registered, would be required to comply with proposed Regulation MC, are subsidiaries of or partly-owned by publicly traded companies.[21] These entities are not wholly-owned by participants or exchanges and may have different governance related issues than the securities clearing agencies currently registered with the Commission.

Upon the effective date of Title VII of the Dodd-Frank Act, clearing agencies that clear and settle security-based swap transactions will be subject to a number of regulatory obligations that are intended to promote the policy objectives of the Dodd-Frank Act, including increased

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18 To date most cleared CDS transactions have cleared at ICE Trust US LLC ("ICE Trust") or ICE Clear Europe Limited ("ICE Clear Europe"). As of October 8, 2010, ICE Trust had cleared approximately $7.1 trillion notional amount of CDS contracts based on indices of securities and approximately $490 billion notional amount of CDS contracts based on individual reference entities or securities. As of October 8, 2010, ICE Clear Europe had cleared approximately €3.09 trillion notional amount of CDS contracts based on indices of securities and approximately €560 billion notional amount of CDS contracts based on individual reference entities or securities. See https://www.theice.com/marketdata/reports/ReportCenter.shtml.

19 See 78q-1(b)(3)(A).

20 The Depository Trust and Clearing Corporation ("DTCC") is participant-owned and has three separate subsidiaries that are registered clearing agencies which function as quasi-utilities. The Options Clearing Corporation is owned by five unaffiliated options exchanges.

21 These clearing agencies include ICE Trust US LLC, ICE Clear Europe Limited, Eurex Clearing AG, and Chicago Mercantile Exchange Inc.

clearing of security-based swaps and effective risk management. Accordingly, security-based swap clearing agencies will be required to be registered with, and regulated by, the Commission under Section 17A.[22] In addition, all registered clearing agencies must comply with the standards in Section 17A, which include, but are not limited to, maintaining rules for promoting the prompt and accurate clearance and settlement of securities transactions, assuring the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, fostering cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, removing impediments to and perfecting the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, protecting investors and the public interest.[23] A registered clearing agency is also required to provide fair access to clearing and to have the capacity to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible, as well as to safeguard securities and funds in its custody or control or for which it is responsible.[24]

Pursuant to Section 765 of the Dodd-Frank Act, the Commission must identify the nature and sources of any conflicts of interest relating to the voting interests in and governance of a security-based swap clearing agency that may interfere with achieving the policy objectives

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22 Section 763(b) of the Dodd-Frank Act adds new Section 17A(k) to the Exchange Act, which authorizes the Commission to exempt, conditionally or unconditionally, a security-based swap clearing agency from registration if the Commission determines it is subject to comparable, comprehensive supervision and regulation by the CFTC or appropriate government authorities in the home country of the security-based swap clearing agency. See Pub. L. No. 111-203, Section 763(b).

23 See 15 U.S.C. 78q-1(b)(3)(F). Section 17A of the Exchange Act also includes standards that help to mitigate conflicts of interest. See infra Section IV.C. for a discussion of these standards.

24 15 U.S.C. 78q-1(b)(3)(A), (B), and (F).

described above or with the clearing agency complying with the regulatory mandates of Section 17A of the Exchange Act described above, including the obligation to adopt rules consistent with the protection of investors and the public interest.

2. Sources of Conflicts of Interest

The Commission's experience in monitoring the activities of the clearing agencies engaged in clearing CDS has provided it with insight into the potential sources of conflicts of interest that may exist at security-based swap clearing agencies. Since shortly after the enactment of the Dodd-Frank Act, the Commission staff and staff from the CFTC have met with interested persons to learn more about potential conflicts. Moreover, on August 20, 2010, the staff of the Commission and CFTC held a joint public roundtable in part to gain further insight into the sources of conflicts of interest at security-based swap clearing agencies, SB SEFs, and SBS exchanges, as well as methods for mitigating conflicts of interest ("Conflicts Roundtable").[25] Panelists from this roundtable included industry and non-industry participants.[26]

Drawing on these experiences, the Commission has reviewed the potential for conflicts of interest at security-based swap clearing agencies in accordance with Section 765 of the Dodd-Frank Act and has identified those conflicts that could affect access to clearing agency services, products eligible for clearing, and risk management practices of the clearing agencies. Preliminarily, the Commission believes that the most significant conflicts of interest that may

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25 See Securities Exchange Act Release No. 62725, 75 FR 51305 (August 19, 2010). The Commission solicited comments on the Conflicts Roundtable (comments received by the Commission are available at http://sec.gov/cgi-bin/ruling-comments?ruling=4-609&rule_path=/comments/4-609&file_num=4-609&action=Show_Form&title=SEC%2DCFTC Roundtable on Swaps and Security%2DBased Swaps%3A Notice of roundtable discussion and request for comment).

26 The transcript of the Conflicts Roundtable is available on the CFTC's website at http://cftc.gov/ucm/groups/public/@newsroom/documents/file/derivative9sub082010.pdf.

have an adverse effect on statutory goals in Section 765 of the Dodd-Frank Act are those that arise when a small number of participants,[27] including participants that are Specified Entities and including related persons of the participants,[28] exercise undue control or influence over a security-based swap clearing agency.

The Commission has identified three key areas where it believes a conflict of interest of participants who exercise undue control or influence over a security-based swap clearing agency could adversely affect the central clearing of security-based swaps. First, participants could limit access to the security-based swap clearing agency, either by restricting direct participation in the security-based swap clearing agency or restricting indirect access by controlling the ability of non-participants to enter into correspondent clearing arrangements.[29] Second, participants could limit the scope of products eligible for clearing at the security-based swap clearing agency, particularly if there is a strong economic incentive to keep a product traded in the OTC market for security-based swaps. Third, participants could use their influence to lower the risk management controls of a security-based swap clearing agency in order to reduce the amount of collateral they would be required to contribute and liquidity resources they would have to expend as margin or guaranty fund to the security-based swap clearing agency.

Each of these potential conflicts of interest could limit the benefits of a security-based swap clearing agency in the security-based swaps market, and even potentially cause substantial harm to that market and the broader financial markets, as described below. Conflicts of interest

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27 The term "participant" when used with respect to a clearing agency has the meaning set forth in Section 3(a)(24) of the Exchange Act, 15 U.S.C 78c(a), and shall include Specified Entities. See proposed Rule 700(o) under Regulation MC.

28 See infra Section IV.A.3. for a discussion of "related person" in the context of a security-based swap clearing agency.

29 See, generally, Matthew Leising and Shannon D. Harrington, "Wall Street Dominance of Swaps Must End, Brokers Say (Update 1)," Bloomberg (March 16, 2010).

in these areas could also potentially undermine the mandatory clearing requirement in Section 763 of the Dodd-Frank Act, thereby affecting transparency, investor protection, risk management, efficiency, and competition in the security-based swaps market.[30]

a. Limitations on Open Access to Security-Based Swap Clearing Agencies

The Commission believes that the increased use of central clearing for security-based swaps should help to promote robust risk management, foster greater efficiencies, improve investor protection, and promote transparency in the market for security-based swaps. For these reasons, the Commission has encouraged the use of central clearing for security-based swaps.[31] A consequence of increased use of central clearing services, however, is that participants that control or influence a security-based swap clearing agency may gain a competitive advantage in the security-based swaps market by restricting access to the clearing agency. If that occurred, financial institutions and marketplaces that do not have access to central clearing would have limited ability to trade in or list security-based swaps. This problem would continue to exist after the mandatory clearing requirement under Section 763 of the Dodd-Frank Act becomes effective, because financial institutions may be required either to submit security-based swaps for central clearing or face heightened capital or margin requirements associated with bilateral agreements.

30 See Pub. L. No. 111-203, Section 763(a). Section 763(a) of the Dodd-Frank Act adds new Section 3C to the Exchange Act, which requires clearing for certain security-based swaps. Specifically, Section 3C(a)(1) provides that "It shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency that is registered under the Exchange Act or a clearing agency that is exempt from registration under the Exchange Act if the security-based swap is required to be cleared."

31 See CDS Clearing Exemption Orders, supra note 17.

Market participants generally obtain access to a clearing agency in one of two ways: (1) directly, by becoming a participant in a clearing agency or (2) indirectly, by entering into a correspondent clearing arrangement with a participant in a clearing agency.[32] There are several ways that both direct and indirect access to a security-based swap clearing agency could be restricted if persons who make decisions for or act on behalf of the clearing agency have a conflict of interest because of their incentives to further their own business interests outside of the security-based swap clearing agency. Participants may seek to limit the number of other direct participants in a security-based swap clearing agency in order to limit competition and increase their ability to maintain higher profit margins. A security-based swap clearing agency that is controlled by a limited number of participants might also adopt policies and procedures that are designed to unduly restrict access, or have the effect of unduly restricting access, to the clearing agency by other participants in ways that are unrelated to sound risk management practices.[33] At the same time, affording greater access to the clearing agency at some point may come at the expense of sound risk management practices.

The Commission recognizes that security-based swap clearing agencies must establish reasonable participation standards in order to ensure the participants in the clearing agency do not expose it to unacceptable risk or otherwise adversely affect the performance of the clearing agency, particularly during periods of market stress. However, participant standards may have the effect of restricting access to the clearing agency. On the one hand, panelists at the Conflicts Roundtable and others have raised the concern that participation requirements could be

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32 Correspondent clearing is an arrangement between a current participant of a clearing agency and a non-participant that desires to use the clearing agency for clearance and settlement services.

33 An example of such restrictive policies and procedures would be a clearing agency establishing prohibitively high participation standards so that only the largest financial institutions qualify as participants.

unnecessarily restrictive and primarily designed to limit the number of entities that are permitted to become direct participants in the clearing agency.[34] While appropriate participation standards are necessary for the sound operation of the security-based swap clearing agency, unduly high standards may needlessly exclude persons who are otherwise qualified to clear security-based swaps. On the other hand, some panelists at the Conflicts Roundtable also suggested that increasing access can come at the expense of sound risk management practices.[35]

Access could also be restricted by the way that clearing members determine executable end-of-day settlement prices. Since there is currently no exchange or other venue that publishes security-based swap prices, the Commission has required security-based swap clearing agencies to publish end-of-day settlement prices and any other prices with respect to cleared security-based swaps that the security-based swap clearing agency may use to calculate mark-to-market requirements.[36] To ensure that end-of-day settlement prices are reliable and consistent, a security-based swap clearing agency may require that the price submission be executable.[37] The

34 See, generally, Swaps and Derivatives Market Association, "Lessening Systemic Risk: Removing Final Hurdles to Clearing OTC Derivatives" (available at http://media.ft.com/cms/fe51a538-78d7-11df-a312-00144feabdc0.pdf) ("SDMA Letter"). See also Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps, comments of Darrell Duffie ("[W]e want to be very careful that the members of a central clearing counterparty that determine what gets cleared . . .are the members that have . . . the right social incentives to create competition.") (available at http://cftc.gov/ucm/groups/public/@newsroom/documents/file/derivative9sub082010.pdf at 62).

35 See supra note 25.

36 See, e.g., CDS Clearing Exemption Orders, supra note 17.

37 As part of their internal processes, security-based swap clearing agencies generally calculate end-of-day settlement prices for each product in which they hold a cleared interest each business day. See, e.g., Letter from Kevin McClear, ICE Trust, to Elizabeth Murphy, Secretary, Commission, December 4, 2009, and letter from Ann K. Shuman, Managing Director and Deputy General Counsel, CME, to Elizabeth Murphy, Secretary, Commission, December 14, 2009. One method for calculating an end-of-day settlement price for open positions is based on prices submitted by participants. As part of this

security-based swap clearing agency, however, might not permit an entity to rely on a third party to provide an executable end-of-day settlement price. This could potentially prevent all but the largest dealer firms from having direct access to the clearing agency as they may be the only firms that have the processes to determine executable end-of-day settlement prices.[38]

In situations where direct access is limited by reasonable participation standards, non-participant firms may be able to access the security-based swap clearing agency through correspondent clearing arrangements with direct participants. Correspondent clearing is common in securities markets as well as in futures markets. However, the non-participant firms ultimately would be required to enter into a correspondent clearing arrangement with a participant in order to have the transactions submitted to the security-based swap clearing agency. Thus, the success of correspondent clearing arrangements depends on the willingness of security-based swap participants to enter into such arrangements with non-participant firms that may act as direct competitors to the participants. Given that current participants may have an incentive to restrict access to potential competitors, correspondent clearing arrangements may not be readily established while only the large dealer firms are direct participants in the security-based swap clearing agency.

In addition, procedural barriers may prohibit a firm from having indirect access to a security-based swap clearing agency. For example, although there are no overt restrictions on indirect access at the currently exempted security-based swap clearing agencies, many of the processing platforms by which participants submit transactions to the security-based swap

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mark-to-market process, the security-based swap clearing agency may periodically require participants to execute certain security-based swap trades at the applicable end-of-day settlement price. This is designed to ensure that participants' submitted prices reflect their best assessment of the value of their open positions on a daily basis. Id.

38 See SDMA Letter, supra note 34.

clearing agency do not have the functionality to allow a non-participant firm to submit a trade with a customer to the security-based swap clearing agency through a correspondent arrangement with a direct member.

Prohibitively burdensome or restrictive direct participation standards and lack of availability of correspondent clearing arrangements effectively deny non-participant firms access to the security-based swap clearing agency's services and, accordingly, create a substantial competitive advantage for those firms that are direct participants in the security-based swap clearing agency. As previously noted, this competitive advantage would become even more significant after the mandatory clearing requirement for security-based swaps in the Dodd-Frank Act becomes effective.

b. <u>Limitations on the Scope of Products Eligible for Clearing</u>

As discussed above, Congress found and the Commission believes that increased use of central clearing would provide significant benefits to the security-based swaps market and mitigate systemic risk, particularly during times of financial crisis. Central clearing of security-based swaps likely would result in lower spreads and lower transaction costs for end-users. A participant in a security-based swap clearing agency might, however, derive greater revenues from its activities in the OTC market for security-based swaps than it would from sharing in the profits of a security-based swap clearing agency in which it holds a financial interest. As a result, the increased use of central clearing may be contrary to the economic interests of some participants to a security-based swap clearing agency. Such participants or their related persons could therefore seek to have the security-based swap clearing agency limit the types of security-based swaps that are eligible for clearing at a security-based swap clearing agency over which they exercise influence or control.[39]

A further incentive for a clearing agency controlled by participants to restrict the products that are eligible for clearing at the security-based swap clearing agency may be to control a security-based swap's price transparency. Trading in the OTC derivatives market is currently dominated by a small number of firms.[40] Prior to the use of clearing agencies to clear security-based swaps, end-users had to transact directly with a small number of firms to trade in security-based swaps without the benefit of publicly available pricing data. Security-based swap clearing agencies provide greater price transparency by making certain price data available to the public and thereby helping to reduce the information asymmetry that benefits firms in the OTC market.[41] Publicly available pricing data may result in reducing the spreads and reduce the profit per trade for firms that have dominated the OTC market.

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39 Representative Barney Frank, who chaired the conference committee that reconciled the House Bill and the Senate Bill, referred to this specific concern when discussing the amendment adding Section 765 to the Dodd-Frank Act. Chairman Frank stated, "The purpose of this in part is to get many more derivatives cleared. But the clearing houses have the right to refuse them if they say the transactions aren't suitable for clearing. We believe that some banks have an interest in not having them cleared. So we don't want entities that have an interest and [sic] there being no clearing, owning the clearing houses. That's why this is an important amendment to us, and it was passed after considerable debate on the House floor." House-Senate Conf. Comm. Holds Markup on HR 4173, Financial Regulatory Overhaul Bill, June 24, 2010, reprinted in CQ Congressional Transcripts, 111th Cong. 182 (2010) (statement of Barney Frank, Chairman, House Comm. On Fin. Serv.).

40 See Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2010. ("Derivatives activity in the U.S. banking system continues to be dominated by a small group of large financial institutions. Five large commercial banks represent 97% of the total banking industry notional amounts....")

41 See Darrell Duffie, Ada Li, and Theo Lubke, "Policy Perspectives on OTC Derivatives Market Infrastructure," Federal Reserve Bank of New York Staff Report No. 424, dated January 2010, as revised March 2010 ("Even after an OTC derivatives product has achieved relatively active trading . . . dealers have an incentive to maintain the wide bid-

While certain security-based swaps may be suitable for central clearing, the Commission recognizes the possibility that some security-based swaps may not be suitable for clearing if their risks cannot be adequately managed by the security-based swap clearing agency. Clearing products whose risks cannot be adequately managed may increase the potential of a default of a participant or even the failure of the security-based swap clearing agency.[42] This in turn could adversely affect systemic risk, as participants and their customers would likely have significant funds and securities tied to the clearing agency and would be dependent on the continued operations of a security-based swap clearing agency in order to enter into new transactions in security-based swaps. This again highlights the potential tensions between sound risk management and the increased use of central clearing services. Expanding the number and scope of products cleared would in some cases be in the best interests of the security-based swap clearing agency and the security-based swaps market generally, because it provides processing efficiencies and replaces bilateral counterparty risk. However, allowing a greater number and scope of products to be centrally cleared would in some cases be harmful to the security-based swap clearing agency and the security-based swaps market, if sound risk management standards are compromised in order to clear those products.

The Commission is mindful of the need to balance goals associated with promoting the central clearing of security-based swaps and assuring that proposed rules are designed to increase the number of products eligible for central clearing with the goals associated with effective risk management. The Commission is also aware that any rules that it may ultimately adopt relating

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ask spreads that they can obtain in the OTC market. . . . Thus, from the viewpoint of profits, dealers may prefer to reduce the migration of derivatives trading from the OTC market to central exchanges.").

42 Section 763(a) adds new Section 3C(d)(3)(A) to the Exchange Act, which prohibits the Commission from requiring any clearing agency to accept a security-based swap for central clearing. See Pub. L. No. 111-203, Section 763(a).

to conflicts of interest may affect this balance. The Commission believes, however, that decisions regarding the products that are eligible for clearing by a security-based swap clearing agency should not be subject to undue influence by parties that have a financial interest in keeping such products from being centrally cleared, while also noting that non-participants may have an interest in increasing access, which potentially could serve to compromise effective risk management.

c. Reduced Risk Management Controls

Security-based swap clearing agencies will perform a critical function in mitigating financial risk for market participants. The Commission believes that through uniform margining and other risk controls, including controls over market-wide concentrations that cannot be implemented effectively when counterparty risk management is decentralized, security-based swap clearing agencies would help to prevent a single market participant's failure from destabilizing other market participants and, ultimately, the broader financial system.

Although participants may seek to raise risk management controls in order to restrict access to the clearing agency or protect their financial stake in the clearing agency, they might also seek to lower certain risk management controls such as margin requirements in order to release collateral that they may wish to use for other purposes. Furthermore, as security-based swap clearing agencies become more established and the mandatory clearing requirement under Section 763 is implemented, more security-based swaps will likely be centrally cleared and clearing participants will be required to provide a substantially larger amount of liquid collateral to security-based swap clearing agencies in the form of margin. As a result, participants may be willing to accept greater risk than is prudent for the security-based swap clearing agency in order to reduce the amount of their margin contributions. A reduction in risk management controls ultimately could function to increase systemic risk by increasing the potential for a financial loss that must be borne by the participants of the security-based swap clearing agency.[43]

The Commission recognizes that participants generally have a financial incentive to ensure that the security-based swap clearing agency collects sufficient margin from each participant. A clearing agency's rules and procedures typically provide that in the event of a participant default, losses exceeding a participant's individual margin contribution may be satisfied from a guaranty fund composed of contributions from all participants. As a result, participants have a unique financial incentive to ensure that the security-based swap clearing agency has sufficient collateral from each participant to withstand a participant default in almost all market conditions. However, participant defaults occur infrequently and the incentive for participants to protect their guaranty fund contributions may have less weight than the incentive to reduce margin requirements in order to release margin collateral for immediate use.

A non-participant does not contribute to a guaranty fund and may not have the same incentives as a participant with respect to establishing and maintaining sufficiently robust participant margin requirements. Non-participants' incentives may be to focus less on risk management and focus more on allowing more participants to be admitted to the clearing agency and more products to be made eligible for central clearing.

d. Implications for Ownership and Governance

As described above, conflicts of interest may arise if participants exercise undue control or influence over a security-based swap clearing agency. This influence, typically acquired

43 Such a scenario would arise, for example, where a defaulting participant has contributed insufficient margin to meet its obligations to the security-based swap clearing agency.

through an ownership stake in the clearing agency, generally may be exercised by participants through either (i) voting interests in the security-based swap clearing agency or (ii) participation in the governance of the security-based swap clearing agency, such as by selecting (or influencing the selection of) the directors of the security-based swap clearing agency.[44] In either case, undue control or influence may be particularly acute if (i) the participants are part of the process for nominating the directors, even if such participants are not themselves directors, or (ii) the election of directors is subject to concentrated voting power in a small number of participants, especially if such participants also dominate much of the trading in security-based swaps and could use their controlling position to maintain or extend their dominant market position.

In addition, it is important to consider the likely incentives of individual directors, once they are on the Board, when they are governing the security-based swap clearing agency.[45] Directors of a security-based swap clearing agency owe a fiduciary duty to the security-based swap clearing agency and all of its shareholders. In addition, among other obligations, the Board as a whole is ultimately responsible for overseeing the clearing agency's compliance with the regulatory obligations of security-based swap clearing agencies under the Dodd-Frank Act and

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44 Section 765 of the Dodd-Frank Act authorizes the Commission to adopt rules regarding conflicts of interest of Specified Entities at security-based swap clearing agencies in general. However, the Commission preliminarily believes that those entities that are participants in a security-based swap clearing agency will have a conflict of interest that could be acted upon to adversely affect the development of the market for security-based swaps consistent with the policy objectives of Section 765 of the Dodd-Frank Act.

45 The Commission's discussion in this Release of the motivations or incentives of directors of a clearing agency, SB SEF, or SBS exchange comes in the context of requiring modes of governance that permit consideration of a variety of perspectives. As noted throughout this Release, a company's directors have a duty to all the company's shareholders, and the Commission does not regard any directors as simply surrogates for a particular group of shareholders. The Commission's discussion is intended to forestall possible conflicts and does not reflect findings that particular conflicts are present.

the Exchange Act, including the open and fair access requirements. At the same time, however, directors may be subject to different perspectives when fulfilling these duties and roles. Although the Commission recognizes that incentives and motivations may vary among directors and over time for a range of reasons – and therefore it is not possible to predict precisely how any individual director will address a particular matter – directors who are appointed by or related to participants ("participant-related directors") may on balance be more likely to reflect the views of participants than would directors who are not appointed by or related to participants ("non-participant-related directors").[46]

In light of these dynamics, as between the two categories of directors, participant-related directors, like participants themselves, may on balance be more likely to favor reducing or minimizing the risk exposure of the clearing agency, potentially at the expense of more open access. In addition, participant-related directors may also be more likely to favor restricting access to the clearing agency, which as discussed above would serve to preserve profits that participants earn through trading security-based swaps in the OTC markets.

In contrast, non-participant-related directors may, on balance, be more likely to seek to maximize the value of the enterprise, which, in addition to sound risk management, may involve increasing the revenues of the security-based swap clearing agency, such as by expanding the number and scope of products being cleared. Moreover, at a minimum it would seem less likely that non-participant-related directors would favor unduly restricting access to the clearing agency and its services. Thus, non-participant-related directors may be inclined to favor expanded

[46] This distinction between participant-related and non-participant-related directors may be most significant where the clearing agency is (i) a publicly-owned corporation, or part of a publicly owned corporation, or (ii) otherwise owned by persons other than participants. The Commission recognizes that ownership structures for clearing agencies may take other forms, including ownership solely by participants, in which case the incentives and perspectives of the directors may be somewhat different.

access to products and services, which may increase the amount of risk that the clearing agency must successfully manage. The interest in expanded access to products and services may be especially relevant in the early stages of a clearing agency's development, when establishing a new entity as a viable clearing agency is especially important.

The Commission recognizes that other factors may also affect director incentives and behavior. For example, it may be argued that participant-related directors may in general have greater risk management expertise and experience than non-participant-related directors, and that non-participant-related directors may tend to defer to the views or judgment of participants or participant-related directors on risk matters, with the effect that open access may be unduly compromised in favor of risk management. On the other hand, it may be argued that qualified non-participant-related directors with sufficient risk management expertise can be readily found, and in any event these directors' independence of participants would justify their heightened involvement on the Board.

In addition, directors may face other conflicts of interest. For example, there may be conflicts between the competing interests of different shareholders – whether or not participants – which could have implications for director behavior, as discussed more fully below. There also may be a tension between the directors' incentives to maximize profits and their duties to oversee the security-based swap clearing agency's compliance with applicable legal restrictions which, although not necessarily unique to clearing agencies, may nevertheless affect how they decide any particular matter.

As described more fully below, the proposed rules are intended to strike a balance among these various considerations by allowing participants to maintain a significant voice within a security-based swap clearing agency while also imposing ownership limitations and independent director requirements to mitigate the potential influences of participant owners and participant-related directors.

e. Request for Comments Regarding Identified Conflicts of Interest

The Commission requests comment on the conflicts of interest it has identified with respect to security-based swap clearing agencies, including the conflicts related to participant standards, product eligibility, and risk management. Do commenters agree with the potential conflict concerns that the Commission has identified? Some parties have questioned the benefits of central clearing generally in terms of reducing systemic risk,[47] potentially suggesting a different analysis with respect to the identified conflicts of interest. What are commenters views on the potential benefits and costs of central clearing and the resulting effect on the conflicts of interest analysis?

What effect would the identified conflicts of interest likely have? Should the Commission focus on any of these conflicts more than others? Are there other existing conflicts concerns that commenters believe warrant scrutiny? If so, what are they and how are they likely to affect security-based swap clearing agencies?

The conflicts of interest discussed in part stem from the current concentrated market structure for security-based swaps. How is the current market structure likely to evolve over time? What effect will that evolution have on the consideration of conflicts of interest? Are there any other conflicts of interest that may result due to expected changes in the security-based swaps market or the clearing of security-based swaps that the Commission should consider? If so, what are they and how are they likely to affect security-based swap clearing agencies?

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47 See, e.g., Craig Pirrong, "The Inefficiency of Clearing Mandates," Cato Institute Policy Analysis No. 665, July 21, 2010.

The central clearing of security-based swaps is still developing and may change significantly as the market for security-based swaps develops. In particular, the new provisions in the Dodd-Frank Act relating to the central clearing of security-based swaps are not yet effective. Once they become effective, security-based swap clearing agencies will be subject to substantially more regulation, which may have an effect on conflicts of interest. How are conflicts of interest likely to change as the central clearing of security-based swaps, and security-based swap clearing agencies, become more established? What potential new conflicts of interest could arise that the Commission should consider? How will potential changes in the trading of security-based swaps affect conflicts of interest at security-based swap clearing agencies? In addition, competitive forces within the security-based swaps market may help to mitigate conflicts of interest, for example, by increasing the number of institutions that trade in security-based swaps and creating a broader market in security-based swaps. How might competition issues affect or change current conflicts of interest? Will competition potentially create different or additional conflicts of interest that the Commission should consider? Will competition potentially mitigate conflicts of interest?

What other parties may have conflicts of interest that would affect whether they should control or participate in the governance of a security-based swap clearing agency? In what circumstances do these conflicts of interest arise? Under certain circumstances, there is the potential that incentives of shareholders to maximize profits could compromise prudent risk management by a security-based swap clearing agency. For example, shareholders could seek to increase revenue from clearing fees by increasing the number of products cleared by the clearing agency beyond those that can be appropriately risk managed or by having the clearing agency expand its services or engage in new lines of business that would expose the security-based swap clearing agency to increased risk. Shareholders that are not users of a security-based swap clearing agency may also not have the same incentives to keep the costs of clearing low. The Commission requests comment on the conflicts of interest that non-participant shareholders may have and the effect such conflicts could have on a security-based swap clearing agency. What are the differences in conflicts of interest between participants and non-participants? What are the different effects these conflicts could have on a security-based swap clearing agency? Which conflicts of interest could potentially cause the greatest harm to the security-based swap clearing agency?

Do persons who are selected to be directors of a security-based swap clearing agency by participants have a conflict of interest based on their status as directors that would affect their ability to act in the best interest of the clearing agency, to act in conformity with the Exchange Act, or to act to meet the policy objectives in Section 765 of the Dodd-Frank Act? Would directors be less likely to act to meet the policy objectives in Section 765 of the Dodd-Frank Act if they are selected by shareholders seeking to maximize the profits of the security-based swap clearing agency? What effect would they likely have on security-based swap clearing agencies? How do participants' conflicts of interest that affect risk management and open access issues compare with non-participants' interests regarding these issues? How do participants' incentives with respect to risk management compare with the incentives of non-participant shareholders or directors? How do the incentives of independent directors differ from the non-independent directors in terms of considering the potential for conflicts of interest?

The Commission also requests comment on the interplay of the identified conflicts of interest, and any additional conflicts of interest identified by commenters, and how that may affect a security-based swap clearing agency. For example, there may at times be a trade-off between risk management standards and open access to the clearing agency. What is the best way to balance these and other potential conflicts of interest in order to assure that the clearing agency has both robust risk management and fair and open access to clearing services? Are there any other conflicts of interest that pose similar trade-offs? What conflicts are these and how should the Commission balance the related concerns?

The Commission recognizes that other conflicts of interest may arise in the governance of security-based swap clearing agencies – for example, there may be a conflict between the interests of certain shareholders. The rules the Commission is proposing today focus on the conflicts of interest presented by the potential influence of participants in the security-based swaps market because, as described above, the Commission believes those conflicts may be most relevant to the development of security-based swap clearing agencies. The Commission recognizes that conflicts of interest may also arise with respect to independent directors and has attempted to achieve a balance between the different incentives of participant-related and non-participant-related directors and the potential benefits each might bring to the Board of a security-based swap clearing agency.

B. Security-Based Swap Execution Facilities and National Securities Exchanges

The Commission has also reviewed the potential for conflicts of interest at SB SEFs and SBS exchanges in accordance with Section 765 of the Dodd-Frank Act and has identified those conflicts that it believes may be mitigated by rules designed to improve the governance of a SB SEF or SBS exchange, promote competition, or mitigate conflicts of interest in connection with the operation of a SB SEF or SBS exchange by a security-based swap execution facility participant ("SB SEF participant")[48] or a member of an SBS exchange ("SBS exchange member")[49] that has an ownership interest in the SB SEF or SBS exchange. As with security-based swap clearing agencies, the Commission preliminarily believes that conflicts of interest that may have an adverse affect on the statutory goals of Section 765 are those that arise when a small number of market participants, including participants that are Specified Entities and including related persons of participants,[50] exercise control or undue influence over a SB SEF or SBS exchange. This influence may be exercised either through ownership of voting interests[51] or participation in the governance of the SB SEF or SBS exchange.

The Commission believes that through ownership of voting interests or ability to influence governance, market participants could exercise influence with respect to the services provided by SB SEFs or SBS exchanges, the rules and policies applicable to participants or members of such entities, and, more generally, the security-based swaps market. When a small group of those same market participants also dominate much of the trading in security-based swaps, control of a SB SEF or SBS exchange by these participants raises a heightened concern.

48 The term "security-based swap execution facility participant" means a person permitted to directly effect transactions on the security-based swap execution facility. See proposed Rule 700(z) under Regulation MC.

49 A "member" when used with respect to a national securities exchange means (i) any natural person permitted to effect transactions on the floor of the exchange without the services of another person acting as broker, (ii) any registered broker or dealer with which such a natural person is associated, (iii) any registered broker or dealer permitted to designate as a representative such a natural person, and (iv) any other registered broker or dealer which agrees to be regulated by such exchange and with respect to which the exchange undertakes to enforce compliance with the provisions of the Exchange Act, the rules and regulations thereunder, and its own rules. See Section 3(a)(3)(A) of the Exchange Act, 15 U.S.C. 78c(a)(3)(A).

50 See infra Section V.A. for a discussion of "related person" in the context of a SB SEF and SBS exchange or facility thereof.

51 See infra Section V.A. for a discussion of the ownership and voting limits of proposed Rule 702 under Regulation MC.

If a SB SEF or a SBS exchange is controlled by a small group of dealers who also dominate trading in the market for security-based swaps, the dealers may have competitive incentives to exert undue influence to control the level of access to the SB SEF or SBS exchange and thus impede competition by other market participants. In other words, participants or members in a SB SEF or SBS exchange, as applicable, might seek to limit the number of direct participants in the trading venue in order to limit competition and increase their ability to maintain higher profit margins. Given such incentives, a SB SEF or SBS exchange that is controlled by a limited number of participants or members might adopt policies and procedures that are designed to restrict access.

Participants or members also might be motivated to restrict the scope of security-based swaps that are eligible for trading at SB SEFs or SBS exchanges if there is a strong economic incentive to keep such swaps in the OTC market. On the other hand, this concern may be mitigated by competitive forces if a greater number and variety of facilities where security-based swaps can be traded are available. A small number of firms currently dominate trading in the OTC derivatives market.[52] Centralized trading of security-based swaps likely would result in lower spreads and lower transaction costs for end-users, particularly as a result of increased pre-trade and post-trade transparency of prices, assuming sufficient trading volume and liquidity.[53] As noted above, increased price transparency might help to eliminate much of the basis for asymmetrical information, reduce spreads, and reduce the profit per trade for firms that dominated the OTC security-based swaps market. As a result, this might create an incentive for participants or members in a SB SEF or SBS exchange, as applicable, to seek to limit the

52 See supra note 40.

53 The Commission will address the issue of transparency of security-based swap pricing and transaction data in a separate rulemaking.

number of security-based swaps that are made available for trading by such venues. The Commission recognizes, however, that there could in certain circumstances be legitimate concerns regarding liquidity or other trading characteristics of a security-based swap that reasonably might justify the decision of participants in a SB SEF or members of a SBS exchange not to make a particular product available for trading on a SB SEF or a SBS exchange. However, decisions regarding the eligibility of security-based swaps for trading on a SB SEF or SBS exchange should not be subject to undue influence by parties that have a financial interest in keeping such products from being centrally traded on a facility or exchange.

Finally, the Commission also believes that a SB SEF or SBS exchange could have potential conflicts of interest between the commercial interests of the SB SEF or SBS exchange or the SB SEF's or SBS exchange's owners and the SB SEF's or SBS exchange's market oversight responsibilities.[54] With respect to these kinds of conflicts of interest, the Commission's proposal is informed, in part, by its experience overseeing national securities exchanges. The Commission notes, however, that a SB SEF's regulatory obligations under Section 763(c) of the Dodd-Frank Act are not identical to those of a national securities exchange's obligations under Section 6 of the Exchange Act.

National securities exchanges are self-regulatory organizations ("SROs") and are statutorily required to comply, and enforce compliance by their members and their associated persons, with the federal securities laws, the rules and regulations thereunder, and their own

[54] An entity that registers as a SB SEF will have oversight responsibility over its market pursuant to the Exchange Act (as amended by the Dodd-Frank Act) and rules adopted thereunder. See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c). Similarly, all national securities exchanges, including those that may post or make available for trading security-based swaps, have oversight responsibilities over their markets and their members pursuant to the Exchange Act. See Section 6 of the Exchange Act, 15 U.S.C. 78(f).

rules.[55] Exchanges also generally operate for-profit markets and, as a result, are concerned with preserving and enhancing their competitive positions vis-à-vis other exchanges.[56] Consequently, exchanges have potential conflicts of interest between carrying out their regulatory obligations to vigorously oversee their members and marketplace and promoting their and their shareholders' economic interests. For example, an exchange could put its interest and that of its members or shareholders ahead of its regulatory responsibilities by failing to take regulatory or enforcement actions or to adequately fund self-regulation. Further, the commercial interests of the shareholders of an exchange may conflict with the regulatory obligations of an exchange. A shareholder may be incentivized to maximize profits through the economic stake it has in the exchange or, if the shareholder is also a member of the exchange, to more directly further its own commercial interests.[57] For example, a shareholder could promote the distribution of the exchange's revenues in a manner that could result in inadequate funding of the exchange's regulatory operations or, if also an exchange member, could use the exchange's disciplinary process potentially to harass or penalize a competitor.

The Commission has considered the conflicts between an exchange's regulatory responsibilities and its commercial interests in operating a marketplace for the trading of securities. To address these types of concerns, the Commission has developed, consistent with the requirements of Section 6 of the Exchange Act,[58] an approach to mitigate conflicts of interest

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55 See Sections 6(b)(1) of the Exchange Act, 15 U.S.C. 78f(b)(1).

56 Historically, national securities exchanges were structured as not-for-profit or similar organizations owned by their members. Exchanges, however, have more recently evolved to become shareholder-owned. See supra note 49 for the definition of "member" as applicable to national securities exchanges.

57 See SRO Governance Proposing Release, 69 FR 71126, infra note 59.

58 See Section 6(b) of the Exchange Act, 15 U.S.C. 78f(b).

for national securities exchanges.[59] Specifically, through its review of proposals filed by exchanges with respect to changes to their ownership and governance structures (generally from member-owned to shareholder-owned organizations) pursuant to Section 19 of the Exchange Act[60] or of applications filed by entities to register as national securities exchanges pursuant to Section 6 of the Exchange Act,[61] the Commission examines the way in which an exchange applies ownership and voting limits and addresses certain governance principles.[62] Namely, the Commission looks to ensure that there are limits on the ability of persons to own and control exchanges by, for example, requiring at a minimum that no person, alone or together with its related persons,[63] be permitted to own more than 40%, and no member, alone or together with its related persons, be permitted to own more than 20%, of the ownership interests of the exchange

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59 See, e.g., Securities Exchange Act Release Nos. 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) (In the Matter of the Applications of EDGX Exchange, Inc., and EGDA Exchange, Inc. for Registration as National Securities Exchanges; Findings, Opinion, and Order of the Commission) ("Exchange Act Release No. 61698"); 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (In the Matter of the Application of BATS Exchange, Inc. for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission) ("Exchange Act Release No. 58375"). In 2004, the Commission proposed rules relating to: the fair administration and governance of SROs; disclosure and regulatory reporting by SROs; recordkeeping requirements by SROs; ownership and voting limitations for SROs; and listing and trading of affiliated securities by SROs. The Commission has not taken action on these proposed rule changes. See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) ("SRO Governance Proposing Release").

60 15 U.S.C. 78s.

61 15 U.S.C. 78f.

62 See, e.g., Securities Exchange Act Release Nos. 62158 (May 24, 2010), 75 FR 30082 (May 28, 2010) (order approving the demutualization of the Chicago Board Options Exchange, Incorporated ("CBOE")) and 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (order approving the merger of New York Stock Exchange, Inc. ("NYSE") and Archipelago and NYSE's demutualization).

63 Generally, a "related person" means, with respect to any person, any other person, directly or indirectly, controlling, controlled by, or under common control with such person or any person acting in concert with such person.

or be entitled to vote shares in excess of 20%.[64] Further, the Commission also looks to ensure that an exchange provide fair representation of members in the selection of directors and the administration of its affairs, consistent with the requirement in Section 6(b)(3) of the Exchange Act,[65] that an exchange is organized in a manner that allows it to carry out the purposes of the Exchange Act pursuant to Section 6(b)(1) of the Exchange Act,[66] and that it provides fair

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64 See, e.g., Exchange Act Release No. 61698, 75 FR at 13156, supra note 59. The exchange's Board may waive the voting and ownership limits if it makes certain findings, including a finding that such a waiver would be consistent with the exchange's self-regulatory obligations. The board, however, may not waive these limits for any exchange members. Moreover, the exchange must file such waiver with the Commission as a proposed rule change for approval before it could be implemented.

The ownership limits currently in place for exchanges generally apply to any ownership interest. See, e.g., Exchange Act Release No. 61698, 75 FR 13151, supra note 59; Amended and Restated Certificate of Incorporation of BATS Global Markets, Inc., Article FIFTH. In contrast, proposed Rule 702 would apply ownership limits only with respect to those shares or other interests entitled to vote. See infra Section V.A. for a discussion of the differences between the ownership and voting limits in proposed Rule 702 and those limits currently in place for exchanges.

65 15 U.S.C. 78f(b)(3). Pursuant to Section 6(b)(3), the Commission generally requires, at a minimum, that at least 20% of the directors on the board be selected by exchange members. The Commission also requires that exchange members be permitted to participate in the nomination process of such representative directors and that they have the right to petition for alternative candidates. See, e.g., Securities Exchange Act Release No. 58375, 73 FR at 49500, supra note 59.

66 15 U.S.C. 78f(b)(1). Pursuant to Section 6(b)(1), the Commission generally requires, at a minimum, that the number of non-industry directors on the exchange's board equal or exceed the number of industry directors. Generally, a "non-industry director" is someone who is not subject to regulation by the exchange, is not a broker or dealer or an officer, director, or employee of a broker or dealer, is not associated with an entity that is affiliated with a broker or dealer, and has neither a material ownership interest nor investment in a broker or dealer. See, e.g., CBOE By-Laws, Article III, Section 3.1. Some exchanges also have "independent directors." Typically, an independent director has no material relationship with the exchange or an exchange member. See, e.g., Amended and Restated By-Laws of BATS Exchange, Inc., Article I(m). For example, an officer or director of a listed issuer generally is considered a non-industry director rather than an independent director. The definitions of "non-industry" and "independent" do, however, differ across exchanges.

procedures for disciplining members, consistent with the requirements in Sections 6(b)(6) and 6(b)(7) of the Exchange Act.[67]

The Commission's recognition of potential conflicts of interest at exchanges and its approach to date in reviewing and approving measures designed to mitigate those conflicts of interest are a useful point of reference as the Commission identifies, and develops proposals to mitigate, the conflicts of interest potentially faced by SB SEFs and SBS exchanges as the trading of security-based swaps moves to regulated markets. However, as noted above, the Commission recognizes that a SB SEF's regulatory obligations are not the same as a national securities exchange's regulatory obligations.

The Commission in 2004 proposed rules to promote the fair administration and governance of, and to impose ownership and voting limitations on, national securities exchanges and registered national securities associations.[68] Among other things, the proposal would have required an exchange to: have a Board composed of a majority of independent directors; maintain fully independent nominating, compensation, and audit committees; separate its regulatory obligations and business functions by establishing a fully independent regulatory oversight committee ("ROC") or equivalent structure; and limit ownership and voting control by members.[69] This proposal was intended to improve the governance of certain SROs by establishing independence standards for the board of directors ("Board") and key committees and by minimizing conflicts of interest by instituting ownership and voting limitations and the

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[67] 15 U.S.C. 78f(b)(6) and (7). To find an exchange's disciplinary rules to be consistent with the Exchange Act, the Commission generally requires that disciplinary processes be balanced and include industry member participation. See, e.g., Exchange Act Release No. 61698, 75 FR at 13160, n. 124, supra note 59.

[68] See SRO Governance Proposing Release, 69 FR 71126, supra note 59.

[69] Id.

separation of the exchange's regulatory obligations and commercial interests. Although the Commission has not acted further on this proposal, a number of exchanges have adopted some of the governance concepts on their own initiative[70] and all of the exchanges registered under Section 6 of the Exchange Act have adopted ownership and/or voting limitations, with the Commission's approval.[71]

Each potential conflict of interest identified in this Section III.B. could limit the benefits of centralized trading in the security-based swaps market and potentially undermine the mandatory trading requirement in new Section 3C(h) of the Exchange Act, thereby negatively affecting efficiency and competition in the security-based swaps market.[72] Further, while the Commission believes that its past application of statutory requirements has been appropriate to improve the governance of, and mitigate the conflicts of interest for, exchanges, given the difference in the structure of the OTC derivatives market and the markets for exchange-listed securities, it also believes that potential conflicts of interest in SBS exchanges can and should be

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70 See, e.g., CBOE By-Laws, Article III, Board of Directors ("Board of Directors" must have a majority of "Non-Industry Directors") and Article IV, Committees ("Regulatory Oversight Committee" must consist of at least three directors, all of whom shall be "Non-Industry Directors"); By-Laws of the NASDAQ Stock Market LLC ("Nasdaq"), Article III, Board of Directors, Section 2, Qualifications ("Board of Directors" must have a majority of "Non-Industry Directors") and Section 5, Committees Composed Solely of Directors (Regulatory Oversight Committee must consist of at least three members, each of whom shall be a "Public Director" and an "independent director" as defined in Nasdaq Rule 4200).

71 See, e.g., Amended and Restated Certificate of Incorporation of BATS Global Markets, Inc., Article FIFTH.

72 See Pub. L. No. 111-203, Section 763(a). Section 3C(h) of the Exchange Act imposes a mandatory trading requirement, which provides that counterparties shall execute a transaction in a security-based swap subject to the clearing requirement of Section 3C(a)(1) on an exchange or a registered SB SEF or a SB SEF that is exempt from registration pursuant to Section 3D(e) of the Exchange Act.

further examined.[73] Namely, unlike exchange-listed securities, trading in the OTC derivatives market is currently dominated by a small group of dealers.[74] Although mechanisms in place to address conflicts of interest among members, shareholders, and exchanges would help mitigate some concerns about conflicts of interest that could result from dealer control of the current security-based swaps market, the Commission believes that additional measures may be necessary to effectively mitigate conflict of interest concerns. For example, applying standards approved for exchanges to SB SEFs and SBS exchanges, as described above, may not alone adequately address the potential concern that a small group of dealers could gain control over such entities and limit security-based swaps from trading on, and participant or member access to, a centralized market. Accordingly, the Commission is proposing rules for SB SEFs and SBS exchanges that are designed to mitigate the potential conflicts of interest that it has identified in

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73 Within the past several years, the Commission has reviewed and assessed comprehensively the governance structure of each national securities exchange, either in connection with a significant transaction by the exchange or as part of its application for registration as a national securities exchange. See, e.g., Securities Exchange Act Release Nos. 58324 (August 7, 2008), 73 FR 46936 (August 12, 2008) (order approving The NASDAQ OMX Group, Inc.'s ("Nasdaq OMX") acquisition of the Boston Stock Exchange, Inc. ("BSE")); 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (order approving Nasdaq OMX's acquisition of the Philadelphia Stock Exchange, Inc. ("Phlx")); 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (order approving the business combination between NYSE and Euronext N.V.); 56955 (December 13, 2007), 72 FR 71979 (December 19, 2007) (order approving acquisition of International Securities Exchange, Inc. ("ISE") by Eurex Frankfurt AG); Exchange Act Release No. 58375, 73 FR at 49500, supra note 59; 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) (order approving application of C2 Options Exchange, Incorporated to register as a national securities exchange); Exchange Act Release No. 61698, 75 FR at 13156, supra note 59; 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (order approving Nasdaq's application to register as a national securities exchange).

74 See supra note 40.

the context of the security-based swaps market, including ownership limitations and governance requirements, as more fully described below.[75]

The Commission has considered the mechanisms in place to mitigate conflicts of interest at national securities exchanges in developing its proposals to mitigate conflicts of interest for SB SEFs and SBS exchanges. The Commission notes that there are similarities and differences between the exchange-listed markets and the market for security-based swaps that merit consideration in crafting appropriate proposals to mitigate conflicts of interest for SB SEFs and SBS exchanges. National securities exchanges list and trade cash equity securities and options pursuant to a well-developed body of their own rules, as well as Commission rules, and compete actively with each other and with other non-exchange trading venues for market share and revenues associated with trading volume. The markets for cash equity securities and listed options are generally liquid, trading is widely dispersed, and there are numerous trading venues and market participants. Unlike the well-established cash equity and options markets, the security-based swaps market is at an earlier stage of development and, as noted above, is currently dominated by a small number of dealers. Further, the regulatory structure governing the security-based swaps market will not be completely realized until all provisions of the Dodd-Frank Act and any rules promulgated thereunder are fully implemented. However, like exchanges, SB SEFs may have shareholder-owners who also may be SB SEF participants and may compete with any other SB SEF to the extent that they trade the same security-based swaps. In addition, although SB SEFs would not be SROs and therefore would not be subject to the same obligations under the Exchange Act as SROs, they nonetheless will be subject to regulatory

75 As of the date of this release, the Commission has not proposed rules regarding the scope, registration requirements, and operation of a SB SEF, including the types of entities that would qualify for registration as a SB SEF.

responsibilities under Section 763(c) of the Dodd-Frank Act and, as a result, will have to establish rules and enforce compliance with those rules by their participants.[76] Thus, the conflicts of interest that the Commission has experienced with exchanges may be similar, although not necessarily identical, to the conflicts of interest that SB SEFs and SBS exchanges may face. The Commission nevertheless is mindful of the need to mitigate conflicts of interest for SB SEFs and SBS exchanges without unduly restricting the ability of trading facilities to be formed or the emergence of a competitive market for the trading of security-based swaps.

The Commission requests comment on the types of conflicts of interest it has identified with respect to SB SEFs and SBS exchanges, including the listing and trading of security-based swaps on SB SEFs and SBS exchanges. Has the Commission identified all of the significant potential conflicts concerns? Do commenters disagree with any potential conflicts concerns that the Commission has identified? What other conflicts concerns may exist, if any?

As discussed above, the Commission seeks to minimize the conflicts of interest for national securities exchanges through ownership limitations and governance requirements. Are the conflicts of interest relating to exchanges, which could elect to trade swaps and thus become SBS exchanges, different than the conflicts of interest relating to SB SEFs, and, if so, how? To what extent, if any, should the Commission draw on its experience with conflicts of interest that may arise in the exchange context and with efforts to mitigate those conflicts and apply that experience in assessing conflicts of interest that may arise in the context of SB SEFs and SBS exchanges? What are the differences and similarities between the conflicts of interest that the Commission has encountered with respect to national securities exchanges and the conflicts of interest that it has identified with respect to SB SEFs and SBS exchanges?

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[76] See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c).

Further, are the conflicts of interest relating to SBS exchanges different than the conflicts of interest relating to exchanges that do not post or make available for trading security-based swaps? If there are no differences, should the Commission propose to adopt rules to mitigate conflicts of interest with respect to national securities exchanges that are not SBS exchanges or are the existing approaches to mitigating conflicts of interest for such exchanges sufficient?

The Commission also requests comment on potential changes in these conflicts of interest. The Commission recognizes that the conflicts of interest that may exist today with respect to the trading of security-based swaps by SB SEFs and SBS exchanges may evolve over time and that, as this market evolves, the conflicts of interest that the Commission has identified for SB SEFs and SBS exchanges may change. The centralized trading of security-based swaps is still developing and may change significantly as the market for security-based swaps develops. In particular, the provisions in the Dodd-Frank Act relating to the centralized trading of security-based swaps are not yet effective. Once they become effective, market participants that trade security-based swaps will be subject to substantially more regulation, which may have an effect on the conflicts of interest at SB SEFs and SBS exchanges. What are commenters' views on whether and how conflicts of interest for SB SEFs and SBS exchanges may evolve over time and how the Commission should respond to such changes? How are conflicts of interest likely to change as the centralized trading of security-based swaps and SB SEFs and SBS exchanges become more established? Are the conflicts of interest identified by the Commission likely to change as the trading of security-based swaps moves to regulated markets that must provide for impartial access and, if so, how? What potential new conflicts of interest could arise that the Commission should consider? How will potential changes in the clearing of security-based swaps affect conflicts of interest at SB SEFs and SBS exchanges? In addition, competitive forces within the security-based swaps market may help to mitigate conflicts of interest, for example, by increasing the number of institutions that trade security-based swaps and creating a broader market for security-based swaps. How will competition issues affect or change current or identified conflicts of interest? Will competition potentially create different or additional conflicts of interest that the Commission should consider? Would the Commission's proposal to apply to SB SEFs and SBS exchanges standards to mitigate conflicts of interest that are similar to those approved for national securities exchanges influence whether those conflicts of interest will increase, diminish, or remain unchanged over time?

Are there any other conflicts of interest that warrant examination? What other parties may have conflicts of interest that would affect whether they should control or participate in the governance of a SB SEF or SBS exchange? In what circumstances would these conflicts of interest arise? For example, might non-participant or non-member shareholders have a conflict of interest? What would be the differences in conflicts of interest between participants and non-participants or members and non-members that would affect the SB SEF or SBS exchange?

Would persons who are selected to be directors of a SB SEF or SBS exchange by participants or members have conflicts of interest based on their status as directors that would affect their ability to act in the best interest of the entity or in conformity with the Exchange Act, or to act to meet the policy objectives in Section 765 of the Dodd-Frank Act? Would directors be less likely to act to meet the policy objectives in Section 765 of the Dodd-Frank Act if they are selected by shareholders seeking to maximize the profits of the SB SEF or SBS exchange? How would participants' or members' potential conflicts of interest concerning open access and products traded compare to non-participants' or non-members' conflicts on such issues? How do the incentives of independent directors differ from those of non-independent directors with respect to increasing access or promoting competition?

IV. Discussion of Proposed Regulation MC: Mitigation of Conflicts of Interest of Security-Based Swap Clearing Agencies

Section 765 directs the Commission to adopt rules to mitigate conflicts of interest, which rules may include numerical limits on control of, or voting rights with respect to, any security-based swap clearing agency. The Commission preliminarily believes that requirements applicable to both governance and voting interests can play an essential role in mitigating conflicts of interests. However, the Commission recognizes that the nature of the governance, ownership and voting requirements to mitigate conflicts may differ depending on the conflicts of interest of the persons making decisions on behalf of the security-based swap clearing agency. In particular, the nature of the ownership and voting power of stockholders of the security-based swap clearing agency plays a role in determining the nature of the conflicts of interest that directors of the security-based swap clearing agency will face.

As previously noted, the Commission preliminarily believes that conflicts of interest may arise when a small number of participants exercise control or undue influence over a security-based swap clearing agency. Conflicts of interest may also arise, however, simply because directors and other decision-makers at a security-based swap clearing agency have multiple interests and goals, including maximizing profit for the benefit of shareholders and imposing risk restraints that may limit short-term profits, among others.

In seeking to address conflicts of interests, the imposition of governance restrictions may lessen the need to impose certain voting limitations, while the imposition of certain voting limitations may alleviate the need to impose certain governance restrictions. Accordingly, the

Commission is proposing two alternative approaches with respect to voting limitations and governance that would place differing levels of emphasis on each of these factors.[77]

The proposed rule would allow the security-based swap clearing agency to elect between the two alternatives. The first alternative places an emphasis on voting limitations while also imposing certain governance restrictions ("Voting Interest Focus Alternative").[78] The second alternative places an emphasis on governance restrictions while also imposing certain voting limitations ("Governance Focus Alternative").[79] Although the Commission is proposing two separate alternatives, the Commission may also consider adopting only one alternative as the final rule or may combine aspects of each proposed alternative and adopt it as a single rule.[80]

In addition, the existing standards in Section 17A of the Exchange Act also help to mitigate conflicts of interest at registered clearing agencies and will be applied in addition to any standards adopted by the Commission under the Dodd-Frank Act.[81]

A. Alternative I: Voting Interest Focus Alternative

As more fully described below, under the Voting Interest Focus Alternative, the Commission is proposing limitations on the voting interests held by individual participants of a security-based swap clearing agency and by participants acting collectively as a group. In

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77 See proposed Rule 701(a) and (b) of Regulation MC.

78 See proposed Rule 701(a) under Regulation MC.

79 See proposed Rule 701(b) under Regulation MC.

80 See infra Section VIII requesting comment on whether alternatives with or without modifications should be allowed and whether certain requirements in each alternative should be combined to form a single approach.

81 See discussion infra Section IV.C. Security-based swap clearing agencies will be required to be registered with the Commission under Section 17A of the Exchange Act upon the effective date of Title VII and, as a result, must comply with the standards in Section 17A that are applicable to all registered clearing agencies.

addition, the Commission is proposing certain requirements related to governance that would give independent directors a strong role in overseeing the security based-swap clearing agency.

1. Voting Interest Focus Alternative: Individual Voting Limitation

The Voting Interest Focus Alternative would provide that a security-based swap clearing agency may not permit a participant, either alone or together with its related persons, to (1) beneficially own, directly or indirectly, any interest in the security-based swap clearing agency that exceeds 20% of any class of securities, or other ownership interest, entitled to vote of such security-based swap clearing agency or (2) directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap clearing agency that exceeds 20% of the voting power of any class of securities or other ownership interest of such security-based swap clearing agency.[82] This proposed limitation on individual participant voting interest is designed to prevent any individual participant from owning, on a direct or indirect basis, a voting interest that would allow it to act on conflicts of interest in the security-based swap clearing agency to the detriment of such security-based swap clearing agency and the security-based swaps market.

The terms "beneficial ownership," "beneficially owns" or any derivatives thereof would be defined in reference to Rule 13d-3 under the Exchange Act, Determination of Beneficial Ownership.[83] The concept of beneficial ownership in Rule 13d-3 is designed to encompass any

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82 See proposed Rule 701(a)(1)(i) and (ii) under Regulation MC.

83 See proposed Rule 700(b) under Regulation MC, which provides that the terms "beneficial ownership," "beneficially owns," or any derivative thereof would be defined as having the same meaning, with respect to any security or other ownership interest, as set forth in §240.13d-3, as if (and whether or not) such security or other ownership interest were a voting equity security registered under Section 12 of the Exchange Act (15 U.S.C. 78l); provided that to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act (15 U.S.C. 78m(d)(3)), such person

person or group of persons that may be able to act to influence or control an issuer. The Commission proposes to use the same definition of beneficial ownership in this rule because it also would describe those persons or groups of persons that may be able to act to influence or control a security-based swap clearing agency. However, to the extent any participant beneficially owns any security or other ownership interest solely because such participant is a member of a group within the meaning of Section 13(d)(3) of the Exchange Act, such participant would not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person had the power to direct the vote of such security or other ownership interest. The Commission proposes to exclude beneficial ownership that results solely from being a member of a group to provide more certainty to those that would be required to comply with the limitations, in light of the effect of exceeding the ownership limit – i.e., that the participant will be divested of the excess interest.

While the Commission has not previously adopted voting interest limitations for registered clearing agencies in the other securities markets, the security-based swaps market present a different potential concern with respect to conflicts of interests. In the securities markets for which clearing agencies currently registered with the Commission provide clearance and settlement services,[84] there are significantly more dealers and participants. The incentives of participant-owners of these registered clearing agencies are generally aligned with those of the clearing agency: to accept for clearing as many participants that can meet reasonable participation standards and as many transactions that fit into the clearing agencies' risk

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shall not be deemed to beneficially own such security or other ownership interest, unless such person has the power to direct the vote of such security or other ownership interest.

84 The four clearing agencies registered with the Commission that have active business operations include: The Depository Trust Company, The National Securities Clearing Corporation, The Fixed Income Clearing Corporation, and The Options Clearing Corporation.

management structure. Furthermore, the OTC derivatives market has a relatively high concentration of market activity among a limited number of dealers[85] that earn significant revenues from the currently opaque OTC market.[86] The existing cash equities and listed options markets, on the other hand, are transparent and widely disbursed over a range of market participants. As previously discussed, participants in a security-based swap clearing agency may have incentives to limit participation in the clearing agency and to limit the scope of products cleared. Moreover, the Commission's experience regulating security-based swap clearing agencies along with the views expressed by market participants suggest that security-based swap clearing agencies may be particularly susceptible to conflicts of interest.[87] The Commission preliminarily believes that prohibiting a participant and its affiliates and related persons from having more than a 20% voting interest in a security-based swap clearing agency, taking into account the other requirements under the Voting Interest Focus Alternative as described below, would establish a sufficiently high threshold to preclude any one participant from exerting undue influence over the security-based swap clearing agency. The 20% threshold proposed for participant voting interests in a security-based swap clearing agency is similar to the threshold that the Commission previously proposed for national securities exchanges and national securities associations, is the same as the threshold now being proposed for SBS exchanges and SB SEFs, and is consistent with the limits currently in place with respect to national securities exchanges.[88]

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85 See supra note 40.

86 Id (stating that U.S. commercial banks reported trading revenues of $8.3 billion in the first quarter of 2010).

87 See supra notes 26 and 34.

88 As previously noted, national securities exchanges generally prohibit exchange members, alone or together with their related persons, from owning more than 20% of the exchange

2. Voting Interest Focus Alternative: Aggregate Voting Limitation

The Voting Interest Focus Alternative would provide that a security-based swap clearing agency may not permit a participant, either alone or together with its related persons, to in the aggregate with any other security-based swap clearing agency participants and their related persons (1) beneficially own, directly or indirectly, any interest in the security-based swap clearing agency that exceeds 40% of any class of securities, or other ownership interest, entitled to vote of such security-based swap clearing agency or (2) directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap clearing agency that exceeds 40% of the voting power of any class of securities or other ownership interest of such security-based swap clearing agency.[89] Under the individual participant voting limitation and without this aggregate limitation on voting interest, five entities that have voting interests of 20% could control the security-based swap clearing agency. Since a small number of dealers currently control the OTC derivatives market,[90] the Commission preliminarily believes that this aggregate limitation on voting interest is a necessary corollary to the individual participant voting limitation. The 40% aggregate limitation on voting interest, which is consistent with limits used in similar contexts,[91] would restrict participants' ability to collectively acquire a majority voting interest, while maintaining the integrity of the 20% individual participant limitation.

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or being entitled to vote shares in excess of 20%. See, e.g., Securities Exchange Act Release No. 61698, 75 FR at 13156, supra note 59.

89 See proposed Rule 701(a)(1)(iii) and (iv) under Regulation MC.

90 See supra note 40.

91 As previously noted, the Commission has generally prohibited any person, alone or together with its related persons, from owning more than 40% of a national securities exchange. See, e.g., Securities Exchange Act Release No. 61698, 75 FR at 13156, supra note 59.

3. Voting Interest Focus Alternative: Indirect or Affiliate Ownership and Ownership through Related Persons

The Voting Interest Focus Alternative would also address conflicts of interest created by indirect voting interests of the security-based swap clearing agency because a rule that limits only direct voting interests could be circumvented by holding the interest through an affiliated party or by holding an interest in a controlling entity. For purposes of determining a security-based swap clearing agency participant's voting interest, the proposed rule would, as indicated in the description of the rules above, combine such person's interest with those of its "related persons."[92]

The Commission proposes to define the term "related person" to include persons whose relationship with respect to a participant would likely cause them to have the same conflicts of interest with respect to the security-based swap clearing agency (e.g., "affiliate," "immediate family member," and "person associated with a participant in a security-based swap clearing agency"). Specifically, proposed Rule 700(u) would define "related person" as that term relates to security-based swap clearing agencies as: (i) any affiliate[93] of a participant in a security-based swap clearing agency; (ii) any person associated with a participant in a security-based swap

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92 See proposed Rule 700(u) of Regulation MC.

93 The term "affiliate" would be defined as any person that, directly or indirectly, controls, is controlled by, or is under common control with, the person. See proposed Rule 700(a) under Regulation MC. "Control" would be defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. Any person that (i) is a director, general partner, or officer exercising executive responsibility (or having similar status or function); (ii) directly or indirectly has the right to vote 25% or more of a class of voting securities or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that person. See proposed Rule 700(e) under Regulation MC.

clearing agency;[94] (iii) any immediate family member[95] of a participant in the security-based swap clearing agency that is a natural person, or any immediate family member of the spouse of such person, who, in each case, has the same home as the participant in the security-based swap clearing agency, or who is a director or officer of the security-based swap clearing agency or any of its parents or subsidiaries; and (iv) any immediate family member of a person associated with a participant in the security-based swap clearing agency that is a natural person, or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the participant in the security-based swap clearing agency, or who is a director or officer of the security-based swap clearing agency, or any of its parents or subsidiaries.

A voting interest limitation of 20% for an individual participant of a security-based swap clearing agency and an aggregate voting interest limitation of 40% for all participants of a security-based swap clearing agency is intended to restrict the ability of security-based swap

94 There is currently not a definition for a "person associated with a participant in a clearing agency" in the Exchange Act or in Commission rules. However, the Commission believes that the definition for the term "person associated with a member" in Section 3(a)(21) of the Exchange Act should be used as the basis for the definition of the term "person associated with a participant in a security-based swap clearing agency," as the purposes of the two defined terms are similar. Accordingly, the Commission proposes to define the term "person associated with a participant in a security-based swap clearing agency" as (1) any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions); (2) any person directly or indirectly controlling, controlled by, or under common control with such security-based swap dealer or major security-based swap participant; or (3) any employee of such security-based swap dealer or major security-based swap participant. This term does not include any person associated with a participant in a security-based swap clearing agency whose functions are solely clerical or ministerial. See proposed Rule 700(r) of Regulation MC.

95 The term "immediate family member" would be defined in the proposed rules as a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's house. See proposed Rule 700(i) under Regulation MC.

clearing agency participants to exercise undue influence over the governance of a security-based swap clearing agency for their own self-interest. At the same time, these voting limitations would still permit participants to hold significant economic interests in a security-based swap clearing agency.

4. Voting Interest Focus Alternative: Divestiture and Voting Restriction Requirement

In order to assure that a security-based swap clearing agency maintains the proposed voting interest limitations, the Commission is proposing to require security-based swap clearing agencies to have rules in place for the divestiture of voting interests that exceed the prescribed limitations.[96] The Commission preliminarily believes that in order for the voting limitations to be effective, the rule must require security-based swap clearing agencies to take action to reduce participants' and participants' related persons' voting interests.

The Commission is proposing to provide security-based swap clearing agencies flexibility in determining how to implement this divesture requirement. Any rules adopted by a security-based swap clearing agency must assure that the security-based swap clearing agency has a viable, enforceable mechanism to divest a participant and its related persons of any voting interest owned in excess of the 20% limitation, and not to give effect to the portion of any voting interest in excess of the 20% individual limitation or the 40% aggregate limitation. The Commission is also proposing to require a security-based swap clearing agency's procedures to provide a mechanism for the security-based swap clearing agency to obtain information relating to the voting interests in the security-based swap clearing agency held by its participants and their related persons.[97] The Commission believes that this requirement is essential to a security-

96 See proposed Rule 701(a)(2) under Regulation MC.

97 Id.

based swap clearing agency's ability to monitor the voting interest held by its participants and their related persons in relation to the proposed voting limitations.

5. Voting Interest Focus Alternative: Independent Directors on Board

The Commission's Voting Interest Focus Alternative would impose substantive requirements on the governance of security-based swap clearing agencies that are designed to address the concern that participants' conflicts of interest may lead them to take actions that would potentially limit fair and open access and product eligibility for central clearing, as well as potentially weaken the risk management of security-based swap clearing agencies. The proposed governance provisions, as discussed below, are intended to help mitigate potential conflicts of interest and assure the fair administration and governance of a security-based swap clearing agency by limiting the control that any one participant or group of participants may exercise over the security-based swap clearing agency.

The Commission proposes under the Voting Interest Focus Alternative to require the Board[98] of a security-based swap clearing agency to be composed of at least 35% independent directors.[99] The presence of a significant number of independent directors on the Board of a security-based swap clearing agency should provide the addition of strong and independent oversight within the security-based swap clearing agency to serve as a potential check against conflicts of interest that could pose a detriment to the security-based swap clearing agency, other firms, or the security-based swaps market generally. The Commission preliminarily believes that a level below 35% independent directors may not be sufficient to assure that independent

98 The term "Board" would be defined as the Board of Directors or Board of Governors of the SB SEF, SBS exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any equivalent body. See proposed Rule 700(c) under Regulation MC.

99 The term "director" would be defined as any member of the Board. See Proposed Rule 700(f) under Regulation MC.

directors have a significant voice.[100] A requirement lower than 35% would potentially place independent directors in a small enough minority that, relative to the remaining director slots that could potentially be filled by participant or management directors, the views of the independent directors would not be given enough consideration. While independent directors would have less than a majority representation on the Board under the Voting Interest Focus Alternative, they would have a meaningful opportunity to contribute to determinations made by the Board and the various Board committees. The Commission is proposing to require at least 35% independent directors combined with the proposal to limit participant voting interests in a security-based swap clearing agency, both on an individual and aggregate basis, as a means of effectively mitigating conflict of interest concerns while also permitting a greater proportion of participants to serve on the Board of a security-based swap clearing agency.[101] This aspect of the proposal may address potential concerns that requiring a majority independent Board would affect the Board's ability to effectively perform risk management functions.

The Commission also proposes that no director may qualify as an independent director unless the Board affirmatively determines that the director does not have a material relationship with the security-based swap clearing agency or any affiliate of the security-based swap clearing agency, or a participant in the security-based swap clearing agency, or any affiliate of a participant in the security-based swap clearing agency. The purpose of this proposal is to

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[100] Other regulators have previously chosen 35% as an appropriate level for independent representation on the Board of self-regulatory organizations. See 72 FR 6936 (February 14, 2007), which adopts final rules to address conflicts of interest at self-regulatory organizations regulated by the CFTC. Specifically, the final rules establish acceptable practices under Core Principle 15 applicable to DCMs and that provide that the Board is composed of at least 35% public directors.

[101] Proposed Rule 700(c) under Regulation MC does not prescribe the number of participant directors that are required to be on the Board. A security-based swap clearing agency may choose to have the majority of the Board be composed of independent directors.

provide assurance that an independent director candidate does not have any relationships or affiliations that would prevent the candidate from being independent of the security-based swap clearing agency. Accordingly, the Commission proposes to define the term "independent director," as it is used with respect to a security-based swap clearing agency, as a director who has no material relationship with:

(1) The security-based swap clearing agency;

(2) Any affiliate of the security-based swap clearing agency;

(3) A participant in the security-based swap clearing agency; or

(4) Any affiliate of a participant in the security-based swap clearing agency.[102]

Some relationships or affiliations would clearly exclude a director from qualifying as independent of a security-based swap clearing agency. For example, a director would not be considered independent if any of the following circumstances exists:

(i) The director, or an immediate family member, (A) is employed by or otherwise has a material relationship with the security-based swap clearing agency or any affiliate thereof, or (B) within the past three years was employed by or otherwise had a material relationship with the security-based swap clearing agency or any affiliate thereof;

(ii) (A) The director is a participant in the security-based swap clearing agency or within the past three years was employed by or affiliated with a participant or any affiliate thereof, or (B) the director has an immediate family member that is, or within the past three years was, an executive officer of a participant in the security-based swap clearing agency or any affiliate thereof;

(iii) The director, or an immediate family member, has received during any twelve-month

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[102] See proposed Rule 700(j) under Regulation MC.

period within the past three years payments that reasonably could affect the independent judgment or decision-making of the director from the security-based swap clearing agency or any affiliate thereof or from a participant in the security-based swap clearing agency or any affiliate thereof, other than the following:

(A) Compensation for Board or Board committee services;

(B) Compensation to an immediate family member who is not an executive officer of the security-based swap clearing agency or any affiliate thereof or of a participant in the security-based swap clearing agency or any affiliate thereof; or

(C) Pension and other forms of deferred compensation for prior services, not contingent on continued service.

(iv) The director, or an immediate family member, is a partner in, or controlling shareholder or executive officer of, any organization to or from which the security-based swap clearing agency or any affiliate thereof made or received payments for property or services in the current or any of the past three full fiscal years that exceed 2% of the recipient's consolidated gross revenues for that year, other than the following:

(A) Payments arising solely from investments in the securities of the security-based swap clearing agency or affiliate thereof; or

(B) Payments under non-discretionary charitable contribution matching programs.

(v) The director, or an immediate family member, is, or within the past three years was, employed as an executive officer of another entity where any executive officers of the security-based swap clearing agency serve on that entity's compensation committee;

(vi) The director, or an immediate family member, is a current partner of the outside auditor of the security-based swap clearing agency or any affiliate thereof, or was a partner or employee of the outside auditor of the security-based swap clearing agency or any affiliate thereof who worked on the audit of the security-based swap clearing agency or any affiliate thereof, at any time within the past three years; or

(vii) In the case of a director that is a member of the audit committee, such director (other than in his or her capacity as a member of the audit committee, the Board, or any other Board committee), accepts, directly or indirectly, any consulting, advisory, or other compensatory fee from the security-based swap clearing agency or any affiliate thereof or a participant in the security-based swap clearing agency or any affiliate thereof, other than fixed amounts of pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.[103]

Under the proposed rule, the term "material relationship" would be defined as a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.[104] This definition is intended to encompass all significant instances in which a director's independence is compromised.[105] In determining whether a "material relationship" exists, security-based swap clearing agencies should consider the known relationships between a director and the security-based swap clearing agency to determine whether the relationship is likely to impair the independence of the director in making decisions that affect the security-based swap clearing agency. The proposed definitions of

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103 See proposed Rule 700(j)(2) under Regulation MC.

104 See proposed Rule 700(l) under Regulation MC.

105 See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (order approving SRO rules that would find a director independent only where that director does not have a relationship with the company that would impair her independence).

"independent director" and "material relationship" should help to reduce the potential that the independent directors on the Board of the security-based swap clearing agency are subject to conflicts of interest.

Under the Voting Interest Focus Alternative, the security-based swap clearing agency would be required to establish policies and procedures to require each director, on his or her own initiative or upon request of the security-based swap clearing agency, to inform the security-based swap clearing agency of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.[106] The security-based swap clearing agency would be expected to take reasonable measures to confirm the accuracy of the information provided. This requirement should help the security-based swap clearing agency to assure that it is informed of the existence of any relationship or interest that may reasonably be considered to bear on whether a director is independent as soon as possible and without requiring the security-based swap clearing agency to investigate for such information.

6. Voting Interest Focus Alternative: Board Committees

a. Nominating Committee

The Voting Interest Focus Alternative would require security-based swap clearing agencies to create and maintain a nominating committee for the selection of Board members, and would require that such nominating committee be composed of a majority of independent directors.[107] Directors serving on the nominating committee that are not independent may be more likely to select Board candidates whose views align with such directors' interests instead of the interests of the security-based swap clearing agency or the markets generally. Having a

106 See proposed Rule 701(a)(3)(iii) under Regulation MC.

107 See proposed Rule 701(a)(4)(i) under Regulation MC.

nominating committee that is composed of majority independent directors should help to address and facilitate the selection of independent directors.

The Voting Interest Focus Proposal would also require that the nominating committee identify candidates for Board membership through a consultative process with the participants of the security-based swap clearing agency consistent with criteria approved by the Board.[108] This should help assure that the selection of directors of the Board is conducted in a prudent manner while at the same time allowing for the participants of the security-based swap clearing agency to have fair representation in the selection of the directors of the Board.[109]

b. Other Board Committees

The Voting Interest Focus Alternative would require that other Board committees of a security-based swap clearing agency that are delegated authority to act on the Board's behalf, including but not limited to the risk committee, consist of at least 35% independent directors similar to the requirement that would be imposed on the Board itself.[110] This requirement should give independent directors a meaningful voice, similar to the one they would have in the Board itself, within Board committees that essentially perform the functions of a Board. The proposed requirement would also apply to an "advisory committee" to the extent that the committee is authorized to act on behalf of the Board, including instances where the Board is required to seek approval from the committee before making a determination. However, the Commission preliminarily believes that the independence requirement should not extend to a committee that functions in a purely advisory role, because members of those committees are not in a position to

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108 See proposed Rule 701(a)(4)(ii) under Regulation MC.

109 Section 17A(a)(3)(C) of the Exchange Act requires fair representation among participants of a clearing agency by providing them with a meaningful opportunity to participate in the selection of directors. 15 U.S.C. 78q-1(a)(3)(C).

110 See proposed Rule 701(a)(5) under Regulation MC.

exercise powers of the Board or exert influence over the Board by dictating how the Board will act.

c. Disciplinary Panels

The Commission's Voting Interest Focus Alternative would impose special requirements on the composition of disciplinary panels (or their equivalents) of security-based swap clearing agencies that have not been delegated authority to act on the Board's behalf.[111] The Commission believes that participants of a security-based swap clearing agency should be appropriately disciplined for failure to comply with the rules of a security-based swap clearing agency, particularly as they relate to the ongoing risk management related requirements applicable to participants. Accordingly, the Commission is proposing that the disciplinary processes of a security-based swap clearing agency preclude any group or class of persons that are participants in the security-based swap clearing agency from exercising disproportionate influence on any disciplinary panels. In other words, to the extent that there is more than one type of group or class of persons that are participants in a security-based swap clearing agency, the composition of the disciplinary panel shall include representation of each group or class and shall not allow one group or class to have representation on the disciplinary panel that is out of proportion as compared to other groups or classes of persons that are participants in the security-based swap clearing agency. Furthermore, the disciplinary panel of the security-based swap clearing agency would include at least one person who would qualify as an independent director.

7. Voting Interest Focus Alternative: Request for Comment

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111 See proposed Rule 701(a)(6) under Regulation MC. If the security-based swap clearing agency does not have a disciplinary panel, these requirements should be interpreted as applying to the equivalent of a disciplinary panel in the security-based swap clearing agency's internal processes, unless the disciplinary panel (or its equivalent) has been delegated authority to act on the Board's behalf, in which case it would be subject to the 35% independent director requirement.

The Commission requests comment on all aspects of the voting limitations under the Voting Interest Focus Alternative, including whether the 20% limitations on individual participant voting interest and the 40% aggregate limitation on participant voting interest are sufficient to limit the ability of a participant or a group of participants to exercise undue influence or control over the governance of a security-based swap clearing agency. Should the 20% and 40% limitations be lower given the existing concentration of the industry in a small number of large dealers? If so, what limitations would be appropriate and why? Are there other conflicts of interest not discussed in this release that the Commission should consider generally and specifically with respect to voting limitations? Would the proposed restrictions have an effect on the ability to form new security-based swap clearing agencies or to effectively operate existing security-based swap clearing agencies?

The Commission also requests comment on whether there may be other ways to structure the interests in a security-based swap clearing agency to mitigate potential conflicts of interest. Are there other thresholds for voting limitations or approaches that the Commission should consider? Are there other methods for mitigating conflicts of interest the Commission should consider, such as limitations on holding non-voting interests in a security-based swap clearing agency? How would non-voting interests affect the potential for conflicts of interests?

Section 765 enumerates Specified Entities for the Commission to consider in its rulemaking. The proposed rule would apply only to Specified Entities that are participants of the security-based swap clearing agency and not to other Specified Entities, because the Commission preliminarily believes that those entities that are participants of a clearing agency are most likely to have a conflict of interest that would affect the access, product eligibility, and risk management issues discussed in this release. However, the Commission requests comment on whether all Specified Entities, regardless of participant status, should be subject to the proposed restrictions on voting interests. What are the potential conflicts of interest associated with Specified Entities that are not participants? Might Specified Entities that are not participants in a security-based swap clearing agency have an interest in limiting the number or type of security-based swaps that are accepted for clearing to the extent that they may profit from trading security-based swaps that are not centrally cleared? Are there any other classes of persons, such as participants or members of SB SEFs or SBS exchanges, that should also be subject to the proposed restrictions even though they are not participants of a security-based swap clearing agency? What effect would such restrictions have on mitigating conflicts of interest at security-based swap clearing agencies? What effect would such restrictions have on the ability to form new security-based swap clearing agencies?

The Voting Interest Focus Alternative would require that voting limitations be determined by including interests held directly by a participant in the security-based swap clearing agency, by including indirect interests of a participant in the security-based swap clearing agency, and by including interests held by related persons of a participant in the security-based swap clearing agency. The Commission requests comment on whether its formulation for calculating the aggregate and individual limits is appropriate. Specifically, the Commission requests comment on whether the scope of the definitions of "affiliate," "immediate family member," and "related person" are over-inclusive or under-inclusive and, if either, why? Is there a different methodology to reach the interest of any person with whom a security-based swap clearing agency participant may be able to act in concert with to unduly influence or control a security-based swap clearing agency that the Commission should consider?

The Commission seeks comment on whether requiring the Board of a security-based swap clearing agency to be composed of at least 35% independent directors would improve governance of the security-based swap clearing agency and mitigate potential conflicts of interest. Is 35% sufficient to give independent directors a meaningful voice within the Board, or would a higher or lower level be appropriate? Should the Commission require that a majority of the Board be composed of independent directors? How are these independent directors likely to affect the activities of the security-based swap clearing agency? What are their incentives to assure open and fair access, increased product eligibility, and sound risk management at a security-based swap clearing agency? Do independent directors have any conflicts of interest that would affect their ability to facilitate these objectives?

The Commission also requests comment on whether other measures concerning governance should be used to mitigate conflicts of interest at security-based swap clearing agencies, either in addition to or instead of the proposals outlined in this release. In particular, what other approaches would improve governance and mitigate conflicts of interest for security-based swap clearing agencies? For example, would state laws governing the fiduciary duty owed by the Board to a corporation help to mitigate conflicts of interest? Should the Commission consider any additional requirements related to fiduciary duties? The policies and charter documents of individual corporations also often impose additional responsibilities and obligations on directors. Should security-based swap clearing agencies be required to put in place specific policies or charters to address conflicts of interest by the Board? What policies or charters would be necessary to provide assurance that participant directors will act in the best interests of the security-based swap clearing agency? What other requirements, if any, should be in place with respect to the duties owed by the Board in order to mitigate conflicts of interest at security-based swap clearing agencies?

In addition, the Commission requests comment on its proposed definitions, including the definitions of "independent director" and "material relationship." Are there other ways to define "independent director" or "material relationship?" If so, what are they? Should the Commission adopt other provisions that contain particular circumstances that would preclude a finding that a director is independent or that would deem a relationship material? Should the Commission take into account a director's salary or benefits he or she receives for being a director in order to consider whether an interest in keeping the directorship could make a director more likely to act favorably toward those that control the Board? Should the Commission adopt a specific look-back period within which to determine whether a "material relationship" exists? Should additional terms used in the proposed rule be defined?

The Commission requests comment on the proposed compositional requirements of committees of the Board under the Voting Interest Focus Alternative. Is the requirement that Board committees that are delegated authority to act on behalf of the Board be composed of at least 35% independent directors appropriate? The Commission also requests comment on whether there may be other ways to structure governance restrictions for security-based swap clearing agencies to mitigate potential conflicts of interest. In particular, the Commission requests comment on the proposed compositional requirements of the nominating committee. What is the potential effect of requiring a security-based swap clearing agency to have a majority independent nominating committee? Are there other processes for the selection of independent directors and the fair representation of the participants and shareholders of a security-based swap clearing agency that the Commission should consider with respect to the nominating committee?

Should end-users or any other group be given guaranteed rights of participation in the governance of the security-based swap clearing agency? Should the Commission participate in the Board selection process, such as by requiring consultation on appointments? Should the Commission consider an alternative to a compositional requirement for a nominating committee, such as allowing a security-based swap clearing agency to have a board of trustees responsible for nominating candidates for the Board? If this were a viable alternative, should there be compositional requirements or other limits imposed on the board of trustees? How should such a board of trustees be appointed? Would the alternative of a board of trustees to nominate directors provide greater assurance that independent directors are truly independent not only at the time of their nomination but during their service on the Board as well?

With respect to governance as it relates to the risk committee, should there be special requirements relating to the risk committee, or its equivalent, of the Board? For instance, one possible alternative approach could be to provide separate requirements applicable only to the risk committee that reflect the highly specialized risk management expertise required of directors serving on that committee. For example, instead of requiring that the risk committee be composed of at least 35% independent directors (where such committee is delegated authority to act on the Board's behalf), the requirement could apply to a smaller number of independent directors, and also explicitly require that other interested persons, such as customers of participants, be represented on the risk committee. The Commission requests comment on whether a more prescriptive approach such as the one described above would be appropriate for the risk committee and what levels of participation by participants, customers of participants, or others would be appropriate. Are there factors that warrant treating the risk committee differently from other Board committees? Should the Commission require the Board to report to the Commission if the Board disagrees with a recommendation of the risk committee? Is the risk committee more or less prone to conflict of interest issues? Are there factors other than conflicts of interest that should be taken into consideration? Is it desirable to have an explicit requirement with respect to customers of participants? If so, how many customers should serve on the risk subcommittee relative to independent directors and participant directors? What definition of customer should be used for these purposes? Are there distinctions that should be made between the different types of customer firms for this purpose?

Another possible alternative approach could be to limit the applicable restrictions on the risk committee to circumstances where a specific range of topics is being addressed. For example, restrictions on participation in a risk committee could be limited to only those circumstances in which a determination about issues such as participant standards and product eligibility were being made. What are the potential advantages or disadvantages of such an approach? Would it be possible to separate activities of a committee based on topics? Are there certain issues that pose more or less of a concern with respect to conflicts of interests?

The Commission also requests comment regarding whether any requirements should be imposed on advisory committees. Would an independence requirement on a purely advisory committee mitigate potential conflicts of interest? Are there circumstances in which a purely advisory committee exercises substantial power over the Board?

The Commission requests comment on the composition of the disciplinary panel of the security-based swap clearing agency. Would the proposed rule be sufficient to address potential conflicts of interest that may interfere with the fair and effective disciplinary processes of a security-based swap clearing agency? Should different restrictions be imposed?

Although independent directors may address some of the conflicts of interest concerns that underlie Section 765 of the Dodd-Frank Act, they may not effectively eliminate all conflicts. The Commission, however, believes that effective governance via a partially independent Board is compatible with the characteristics of security-based swap clearing agencies, and the types of conflicts that may be inherent with respect to such entities.

B. Alternative II: Governance Focus Alternative

As more fully described below, under the Governance Focus Alternative, the Commission is proposing governance restrictions including requiring a majority of independent directors on the Board and voting restrictions that would be applicable only to individual participants of a security-based swap clearing agency. The Governance Focus Alternative differs from the Voting Interest Focus Alternative in that it provides greater emphasis on requirements regarding the governance arrangements of a security-based swap clearing agency as the primary means to mitigate conflicts of interest. As with the Voting Interest Focus Alternative, the Commission is proposing rules related to the governance of a security-based swap clearing agency and the voting interests held by participants because the Commission believes each contributes to conflict of interest concerns. However, the Voting Interest Focus Alternative places greater emphasis on the ability of participants to hold voting interests in the security-based swap clearing agency than it does on participants' ability to participate in the governance of the security-based swap clearing agency, while the Governance Focus Alternative, as described in more detail below, places greater emphasis on the ability of participants to participate in the governance of the security-based swap clearing agency than it does on the ability of participants on a collective basis to hold a voting interest in the security-based swap clearing agency.

1. Governance Focus Alternative: Voting Limitation

The Governance Focus Alternative would require that a security-based swap clearing agency may not permit a participant, either alone or together with its related persons, to (1) beneficially own, directly or indirectly, any interest in the security-based swap clearing agency that exceeds 5% of any class of securities, or other ownership interest, entitled to vote of such security-based swap clearing agency or (2) directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap clearing agency that exceeds 5% of the voting power of any class of securities or other ownership interest of such security-based swap clearing agency.[112] The 5% limitation on participant voting interest is intended to help mitigate conflicts of interest because each individual participant's voting interest would be substantially limited and, therefore, its ability to control the security-based swap clearing agency would also be limited.[113] As discussed previously, the Voting Interest Focus Alternative would permit a higher individual participant voting interest of 20%, but would limit the aggregate voting interests held by all participants to 40%. However, the Voting Interest Focus Alternative would allow a security-based swap clearing agency to have a Board with a majority of directors selected by participants. The

112 See proposed Rule 701(b)(1) under Regulation MC.

113 The 5% threshold level for ownership has previously been found by the Commission in other contexts to trigger reporting requirements to the Commission related to the ability to control an organization. See Rule 13d-1(a) under the Exchange Act, 17 CFR 240.13d-1(a) ("Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is specified in paragraph (i) of this section, is directly or indirectly the beneficial owner of more than 5% of the class shall, within 10 days after the acquisition, file with the Commission, a statement containing the information required by Schedule 13D"). In addition, investors acquiring more than a 5% interest in a company must file a form certifying that they acquired that interest without "the effect of changing or influencing the control of the issuer . . . ." Rule 13d-1(c)(1) under the Exchange Act, 17 CFR 240.13d-1(c)(1). See, also, Gaf Corp. v. Milstein, 453 F.2d 709 (2d Cir. N.Y. 1971), stating that "[T]he purpose of section 13(d) is to alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control. . . ." Id at 717.

Commission believes that the 5% limit per participant, in combination with the requirements related to governance arrangements described below, is sufficiently low that there is no need for the 40% aggregate cap on the voting interests held by all participants.

Furthermore, the Commission notes that the 40% aggregate cap on participant voting interests proposed in the Voting Interest Focus Alternative may restrict the potential formation of participant-owned security-based swap clearing agencies. Some clearing agencies currently registered with the Commission are user-owned or user-controlled institutions that function as quasi-utilities. This structure may provide certain benefits to the participants and the securities markets generally because such clearing agencies generally seek to match the fees charged to participants to the clearing agency's costs and not to maximize profits.[114]

In addition, potential users may have a strong incentive to form a new clearing agency if they believe an existing clearing agency is not effectively serving the security-based swaps market. Not imposing an aggregate cap on participant voting interests in a security-based swap clearing agency could help encourage the formation of new security-based swap clearing agencies and thereby increase the potential for competition among security-based swap clearing agencies. In addition, the 5% voting interest limitation may encourage open access by creating incentives for a larger number of participants to acquire a voting interest in the security-based swap clearing agency. While the Commission has not previously adopted voting limitations or governance rules for registered clearing agencies in the other securities markets, as previously discussed under the Voting Interest Focus Alternative, the security-based swaps market presents

114 See, e.g., "The US Model for Clearing and Settlement: An Overview of DTCC," available at: http://www.dtcc.com/downloads/about/US%20Model%20for%20Clearing%20and%20Settlement.pdf. ("[O]wnership and governance of [The National Securities Clearing Corporation] and [The Depository Trust Company] were from the outset those typical of market utilities.").

different concerns with respect to potential conflicts of interests that warrant additional scrutiny and efforts to mitigate such conflicts.

2. Governance Focus Alternative: Indirect or Affiliate Ownership and Ownership through Related Persons

The Commission believes that a rule that limits only direct voting interests could be circumvented by holding the interest through an affiliated party or by holding an interest in a controlling entity. Accordingly, similar to the Voting Interest Focus Alternative,[115] the Governance Focus Alternative would address conflicts of interest created by indirect voting interests of the security-based swap clearing agency and would require aggregation of a security-based swap clearing agency participant's voting interest with its related persons'[116] voting interests.[117]

3. Governance Focus Alternative: Divestiture and Voting Restriction Requirement

Similar to the Voting Interest Focus Alternative,[118] the Governance Focus Alternative would require security-based swap clearing agencies to have rules in place for the divestiture of voting interests that exceed the 5% limitation and a mechanism to not give effect to the portion of any voting interest held by a participant in excess of the 5% voting limitation.[119] The Commission believes that this requirement is essential to a security-based swap clearing agency's ability to monitor voting interests by its participants in relation to the proposed voting limitations.

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115 See supra Section I.A.3.

116 See supra note 92 and accompanying text.

117 See proposed Rule 701(b)(1) under Regulation MC.

118 See supra Section I.A.4.

119 See proposed Rule 701(b)(2) under Regulation MC.

4. Governance Focus Alternative: Majority Independent Board

As discussed previously, the Governance Focus Alternative differs from the Voting Interest Focus Alternative by placing greater emphasis on the governance arrangements of the security-based swap clearing agency. Each alternative approach seeks to strike a balance between the appropriate restrictions imposed on a security-based swap clearing agency relating to governance and voting rights held by participants. Under the Governance Focus Alternative, participants on a collective basis could potentially own all voting interests in a security-based swap clearing agency. While this option allows for potential benefits in terms of participants' ability to form new clearing agencies, it also allows participants' to control 100% of the voting interest in a security-based swap clearing agency, in contrast to the Voting Interest Focus Alternative, which would limit participants to holding no more than 40% of the voting interest. Accordingly, in order to balance the increased voting interest that may be held by participants collectively, the Commission proposes that a greater proportion of the Board be composed of independent directors under the Governance Focus Alternative.

The Governance Focus Alternative is intended to mitigate conflicts of interest by limiting the influence participants may have in the determinations of the Board or in the administration of a security-based swap clearing agency. Specifically, the Governance Focus Alternative would require the Board[120] of a security-based swap clearing agency to be composed of a majority of independent directors.[121] The presence of a majority of independent directors on the Board of a security-based swap clearing agency is intended to reduce the ability of non-independent directors to influence the operation of the security-based swap clearing agency in favor of their

120 See supra note 98.

121 See proposed Rule 701(b)(3)(i) under Regulation MC. See supra note 99 for the definition of "director."

own self-interests and to promote open and fair access, product eligibility, and sufficient risk management standards. This should in turn benefit non-participant firms that enter into correspondent clearing arrangements with participants, and SBS exchanges and SB SEFs who will rely on the availability of a security-based swap clearing agency. A majority independent Board requirement is consistent with accepted corporate governance "best practices."[122] Furthermore, requiring a majority of the Board of a security-based swap clearing agency to be independent would still permit the security-based swap clearing agency to provide participants with fair representation in the selection of directors and the administration of the affairs of the security-based swap clearing agency as required under the Exchange Act.[123]

The Commission also proposes that no director may qualify as an independent director unless the Board affirmatively determines that the director does not have a material relationship with the security-based swap clearing agency or any affiliate of the security-based swap clearing agency,[124] or a participant in the security-based swap clearing agency, or any affiliate of a participant in the security-based swap clearing agency.[125] The proposed definitions of "independent director" and "material relationship" are designed to reduce the potential that the Board of the security-based swap clearing agency is controlled by persons who are subject to conflicts of interest.

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122 See, e.g., James H. Cheek III, et al., Report of the American Bar Association Task Force on Corporate Responsibility (2003); and The Business Roundtable, Principles of Corporate Governance (May 2010).

123 Section 17A(b)(3)(C) of the Exchange Act requires that the rules of a registered clearing agency assure a fair representation of its shareholders (or members) and participants in the selection of its directors and administration of its affairs. 15 U.S.C. 78q-1(b)(3)(C).

124 See supra note 102 and accompanying text.

125 See proposed Rule 701(b)(3)(ii) under Regulation MC.

While the proposal that a majority of the Board be composed of independent directors should help to mitigate certain conflicts of interest, and particularly those conflicts that are most likely to result in an adverse effect on the security-based swap clearing agency, the Commission recognizes that it would not completely eliminate conflicts of interest. Participant directors would still be permitted to serve on the Board. The Commission believes that participants may have operational, risk management, and market expertise that may be useful for effective oversight of a security-based swap clearing agency.

In addition, independent directors themselves may not be free of conflicts of interest. Although the independent directors would not have a material relationship with the clearing agency or any of its participants, they could still be influenced by other sources such as non-participant shareholders of the security-based swap clearing agency. The presence of independent directors may be an effective mechanism to address certain types of conflicts in certain types of institutions but not necessarily in all instances nor for all institutions. The Commission, however, believes that effective governance via a majority independent Board is compatible with the characteristics of security-based swap clearing agencies, and the types of conflicts that may be inherent with respect to such entities.

To help address these concerns, the proposed rules would require each security-based swap clearing agency to establish policies and procedures to require each director, on his or her own initiative or upon request of the security-based swap clearing agency, to inform the security-based swap clearing agency of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.[126] This requirement should keep the security-based swap clearing agency informed of the existence of any

[126] See proposed Rule 701(b)(3)(iii) under Regulation MC.

relationship or interest that may reasonably be considered to bear on whether a director is independent as soon as possible without requiring the security-based swap clearing agency to investigate for such relationships or interest.

5. Governance Focus Alternative: Board Committees

a. Nominating Committee

The Governance Focus Alternative would require security-based swap clearing agencies to create and maintain a nominating committee composed entirely of independent directors.[127] This is consistent with the purpose of the Governance Focus Alternative to place enhanced requirements on the governance arrangements of a security-based swap clearing agency, including the composition of the Board and Board committees, with less emphasis on the requirements with respect to the voting interests held by participants. Non-independent directors on the nominating committee could circumvent the majority independence requirement by nominating a candidate that is subject to their influence. Specifically, directors serving on the nominating committee that are not independent may be more likely to select Board candidates whose views align with such directors' interests instead of the interests of the security-based swap clearing agency or the markets generally. A requirement that all directors serving on the nominating committee be independent of participants would address these concerns by limiting participants' control over the nomination process. A fully independent nominating committee may be warranted under the Governance Focus Alternative because the lack of an aggregate cap in this proposal means that participants may collectively hold greater voting interests in selecting the independent directors.

[127] See proposed Rule 701(b)(4)(i) under Regulation MC.

The Governance Focus Alternative would also require that the nominating committee identify candidates for Board membership through a consultative process with the participants of the security-based swap clearing agency consistent with criteria approved by the Board.[128] This should assure that the selection of the independent directors of the Board is conducted in a prudent manner while at the same time allowing participants of the security-based swap clearing agency to have a fair voice in the selection of the directors of the Board.[129]

b. Other Board Committees

The Governance Focus Alternative would require that other Board committees of a security-based swap clearing agency that are delegated authority to act on the Board's behalf, including but not limited to the risk committee, consist of a majority of independent directors similar to the requirement that would be imposed on the Board itself.[130] This requirement should prevent the dilution of the majority Board independence requirement that may result if Board committees that essentially perform the functions of a Board are not themselves subject to a similar requirement. The proposed requirement would also apply to an "advisory committee" to the extent that such a committee is authorized to act on behalf of the Board, including instances where the Board is required to seek approval from the committee before making a determination. However, the Commission preliminarily believes that this majority independence requirement should not extend to a committee that functions in a purely advisory role, because members of those committees are not in a position to exercise powers of the Board or exert influence over the Board by dictating the actions of the Board.

c. Disciplinary Panels

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128 See proposed Rule 701(b)(4)(ii) under Regulation MC.

129 See supra note 123.

130 See proposed Rule 701(b)(5) under Regulation MC.

Similar to the Voting Interest Focus Alternative,[131] the Governance Focus Alternative would impose special requirements on the composition of disciplinary panels (or their equivalents) of security-based swap clearing agencies that have not been delegated authority to act on the Board's behalf.[132]

6. Governance Focus Alternative: Request for Comment

The Commission requests comment on all aspects of the 5% participant voting interest limitation. Is the 5% voting limitation appropriate, or should the Commission consider a higher or lower limitation? How does the relative concentration of the security-based swaps market among a small number of large dealers affect whether a 5% limitation is appropriate? Would 5% still allow a relatively small number of participants to effectively dominate the Board of a clearing agency? Should the Commission consider any form of an aggregate cap under this alternative? How likely is it that a security-based swap clearing agency would adopt a utility model, given the status of the security-based swaps market? Would the 5% limit impede the ability of a clearing agency to adopt a utility model? What advantages or disadvantages would such a model have? Are there other conflicts of interest, not discussed in this release, that the Commission should consider generally and specifically with respect to voting interest limitations? Would the proposed restrictions have an effect on the ability to form new security-based swap clearing agencies?

Are there other ways to more narrowly target voting limitations? Should the Commission impose voting restrictions on only the largest participants because those participants control the majority of the security-based swaps market (based on either the volume of transactions cleared at the security-based swap clearing agency or the notional value of the participant's outstanding

131 See supra Section I.A.8.d. and accompanying text.

132 See proposed Rule 701(b)(6) under Regulation MC.

security-based swap positions)? If such an approach is preferable, what should the threshold be for determining whether a participant is "large"? Should the Commission require the security-based swap clearing agency to consider the participant's volume of cleared transactions at the security-based swap clearing agency, the notional value of the participant's outstanding security-based swap positions at the security-based swap clearing agency, or both? Should the Commission require the security-based swap clearing agency to consider either volume or outstanding notional value of a participant's positions held outside of a security-based swap clearing agency? How often should the Commission require the security-based swap clearing agency to reevaluate its standard? How effectively would such an approach address conflict of interest concerns? What would be the advantages and disadvantages of this approach compared to the approach proposed above? Are there administrative complexities associated with determining and monitoring the point at which a firm reaches large participant status? Are the conflicts of interest concerns regarding all large participants similar or should there be differences in the voting limitations among large participants?

Should the restrictions on voting interests apply to other large entities, such as the Specified Entities listed in Section 765, even if they are not participants in a security-based swap clearing agency? What potential conflicts of interest could result if Specified Entities that are not large participants controlled the voting interest in a security-based swap clearing agency? How should such potential conflicts of interest be addressed?

Should the Commission consider a limitation on the non-voting interests owned by participants? Should the Commission consider a limitation on the voting and non-voting interests held by Specified Entities?

The Commission seeks comment on whether requiring the Board of a security-based swap clearing agency to be composed of a majority of independent directors would improve governance of the security-based swap clearing agency and mitigate potential conflicts of interest. Would a majority independent Board be helpful in mitigating conflicts of interest if the voting interest of a security-based swap clearing agency is owned by participants? If a majority independent Board is not appropriate to mitigate conflicts, what percentage of the Board should be independent? What are the costs and benefits of requiring the Board's of security-based swap clearing agencies to be composed of a majority of independent directors? How do these costs and benefits differ from the proposal that 35% of the Board be composed of independent directors? Would independent directors be likely to have the necessary experience and expertise to serve on the Board? Could less experience or expertise negatively affect risk management practices or the efficiency of the clearing agency and, if so, how? If any such experience or efficiency issues exist, how could they be overcome? What are the independent directors' incentives regarding fair and open access, product eligibility, and sound risk management? How are these incentives different from those of participants? Do they result in conflicts of interest? If so, how are the conflicts of interest different from those of participants? How should they be addressed by the Commission?

Should the Commission consider alternative limits, or alternative combinations of limits, on voting interests or independent directors? For example, should the voting interest restrictions of 20% on individual interests and 40% in the aggregate be combined with the requirements for a majority independent Board and a 100% independent nominating committee? Would an alternative combination of requirements related to voting interests and independent directors be more effective? For example, would a higher requirement in each case (e.g., a 10% limit on individual voting interests and a requirement for 60% independent directors) be more effective? Or would other combinations be more effective? Should the Commission reduce the restrictions over time if conflict of interest concerns are lessened as the security-based swaps market develops? For example, if participation in the security-based swaps market becomes more open and includes a broader range of participants, the interests of the participants may become more aligned with those of the clearing agency and the markets generally. Would restrictions on voting interests and governance still be needed in this circumstance? Are there other circumstances where the voting interest and governance restrictions may be reduced or eliminated altogether? If, over time, the security-based swaps market does not become more competitive, should the Commission consider additional governance and voting measures to promote open access and competition? What measures would be appropriate? What standards should the Commission use to determine whether additional restrictions should or should not be imposed?

Could restrictions regarding the governance structure of a security-based swap clearing agency alone be sufficient to address conflict of interest concerns or are both restrictions on governance and voting interests needed? Would participants of a security-based swap clearing agency be able to exercise undue influence over a security-based swap clearing agency through a voting interest even if a majority of the Board is independent? Are requirements related to the governance structure of a security-based swap clearing agency more or less effective than voting limitations at addressing conflicts of interest?

The Commission requests comment on the proposed compositional requirements of the nominating committee. What is the potential effect of requiring a security-based swap clearing agency to have an entirely independent nominating committee? Would requiring an entirely independent nominating committee, which is required to consult with participants of the security-based swap clearing agency, be consistent with the fair representation requirement under the Exchange Act? Should end-users or any other group be given guaranteed rights of participation in the governance of the security-based swap clearing agency? Should the Commission have some oversight of the Board selection process? Should the Commission consider an alternative to a compositional requirement for a nominating committee, such as allowing a security-based swap clearing agency to have a board of trustees responsible for nominating candidates for the Board? If this were a viable alternative, should there be compositional requirements or other limits imposed on the board of trustees? How should such a board of trustees be appointed? Would the alternative of a board of trustees to nominate directors provide greater assurance that independent directors are truly independent not only at the time of their nomination but during their service on the Board as well?

The Commission requests comment on the proposed compositional requirements of committees of the Board under the Governance Focus Alternative. Is the requirement that Board committees that are delegated authority by the Board be composed of a majority of independent directors appropriate? Should there be special requirements relating to the risk committee, or its equivalent, of the Board? The Commission requests comment on the possible alternatives for risk committee governance as discussed in Section IV.A.7. Would the possible alternatives for the risk committee be more or less desirable with respect to the Governance Focus Alternative? Under the Governance Focus Alternative, should the percentage of directors on the risk committee be higher or lower than what is proposed? The Commission also requests comment on whether there are other ways to structure governance arrangements for security-based swap clearing agencies to mitigate potential conflicts of interest.

The Commission requests comment on the composition of the disciplinary panel of the security-based swap clearing agency. Would the proposed rule be sufficient to address potential conflicts of interest that may interfere with the fair and effective disciplinary processes of a security-based swap clearing agency? Should different restrictions be imposed?

C. Existing Standards for Registered Clearing Agencies

In addition to any new rules adopted by the Commission with respect to conflicts of interest at security-based swap clearing agencies, the standards in the Exchange Act that apply to all securities clearing agencies registered with the Commission will apply to security-based swap clearing agencies. The Dodd-Frank Act requires security-based swap clearing agencies to be registered as clearing agencies with the Commission under Section 17A of the Exchange Act.[133] Thus, security-based swap clearing agencies will be required to comply with the standards in Section 17A of the Exchange Act. Some of these standards may be used to address concerns related to conflicts of interest, regardless of whether a security-based swap clearing agency elects the Voting Interest Focus Alternative or the Governance Focus Alternative. As a result, the standards in Section 17A would be used in addition to specific conflict of interest rules adopted under Section 765 of the Dodd-Frank Act.[134]

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133 Depository institutions or derivatives clearing organizations that have previously cleared swaps pursuant to an exemption from registration as a clearing agency will be deemed to be registered with the Commission under Section 17A of the Exchange Act. See Pub. L. No. 111-203, Section 763(l).

134 See Section 17A(b)(3) of the Exchange Act, which sets forth the standards for registered clearing agencies. 15 U.S.C. 78q-1(b)(3). See also Securities Exchange Act Release No. 16900 ("Standards Release") (June 17, 1980), 20 FR 416 (July 1, 1980). The Standards Release provides guidance on the standards to be used by the Commission's Division of Trading and Markets in connection with the registration of clearing agencies. The standards also serve as staff guidelines to assist clearing agencies in modifying their organizations, capacities, and rules to comply with the clearing agency registration provisions of the Exchange Act.

The Section 17A standards may be used to mitigate conflicts of interest or the effects of conflicts of interest in a number of ways. As part of the initial registration process, the Commission approves the organizational structure of a clearing agency.[135] The Commission also reviews and approves significant changes to a clearing agency's governance structure after it is registered.[136] In addition, a clearing agency must admit persons such as banks and broker-dealers, and other entities that the Commission may designate by rule, as participants,[137] subject to the participation standards of the clearing agency.[138]

The Commission is also considering matters related to conflicts of interests as part of broader standards that would be applicable to clearing agencies in association with requirements under Sections 763(b) and 805(a) of the Dodd-Frank Act.

135 Section 17A(b)(3)(A) provides in full a clearing agency shall not be registered unless the Commission determines that the "clearing agency is so organized and has the capacity to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible, to safeguard securities and funds in its custody or control or for which it is responsible, to comply with the provisions of [the Exchange Act] and the rules and regulations thereunder, to enforce (subject to any rule or order of the Commission pursuant to section 17(d) or 19(g)(2) of [the Exchange Act]) compliance by its participants with the rules of the clearing agency, and to carry out the purposes of [Section 17A of the Exchange Act]." 15 U.S.C. 78q-1(a)(3)(C).

136 See Securities Exchange Act Release Nos. 612194 (December 22, 2009), 74 FR 68883 (December 22, 2009) (File No. SR-FICC-2009-10); 61215 (December 22, 2009), 74 FR 68888 (December 29, 2009) (File No. SR-NSCC-2009-10); and 61216 (December 22, 2009), 74 FR 68877 (December 29, 2009) (File No. SR-DTC-2009-16), notice and order granting accelerated approval of proposed rule changes filed by the clearing agency subsidiaries of the Depository Trust and Clearing Corporation (DTC, NSCC, and FICC) to permit DTCC to nominate non-participant candidates for election to its Board.

137 15 U.S.C. 78q-1(b)(3)(B).

138 Id. See also Section 17A(b)(4)(B), which provides that a registered clearing agency may deny participation to, or condition the participation of, any person if such person does not meet such standards of financial responsibility, operational capability, experience, and competence as are prescribed by the rules of the clearing agency. A registered clearing agency may examine and verify the qualifications of an applicant to be a participant in accordance with procedures established by the rules of the clearing agency. 15 U.S.C. 78q-1(b)(4)(B).

Clearing agencies also may not permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency.[139] These standards in Section 17A help to mitigate concerns related to conflicts of interest by promoting access to and use of a clearing agency by all qualified persons on an equivalent basis.[140] The Section 17A standards also help to prevent a participant from using its influence to amend the rules of the clearing agency in a manner that favors its own institution to the disadvantage of other participants because the rules of a clearing agency may not be applied on a discriminatory basis.[141]

Finally, the Section 17A standards help to mitigate conflict of interest concerns by providing that the rules of a registered clearing agency may not impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. This helps assure that the clearing agency operates in a manner that is consistent with the public interest and is not used by participants or other interested parties to gain an unfair competitive advantage.[142] The Commission staff has previously interpreted these standards as requiring that

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139 15 U.S.C. 78q-1(b)(3)(F).

140 See Standards Release, supra note 134, at 419. All participants utilizing similar clearing agency services, with the exception of participants that are registered clearing agencies for which specialized requirements apply, should be required to comply fully with the clearing agency's internal financial and operational rules such as clearing fund deposits, mark-to-market payments, and margin deposits related to the services used.

141 Id at 418. The provisions in Section 17A recognize that a clearing agency may discriminate among persons in the admission to, or the use of, the clearing agency, by requiring that participants meet certain financial, operational, and other fitness standards. However, Section 17A also requires that sanctioned discriminations must not be unfair. In addition, the Commission must find that clearing agency rules embodying any discriminations are in the public interest and are consistent with the requirements of the Exchange Act.

142 The standard does not prohibit all burdens on competition. However, if a proposed rule of a clearing agency would impose a burden on competition, the burden must be weighed against the benefits of the rule in achieving the purposes of the Exchange Act. For

a clearing agency must justify any anticompetitive effect of membership criteria and that it will evaluate an anticompetitive effect in light of the following factors: (1) the essential nature of the service; (2) the number and type of potential participants denied access to clearance and settlement services; (3) the number of entities providing comparable clearance and settlement services; and (4) the availability of correspondent clearing arrangements to provide indirect access to a clearing agency's services.[143] The Commission believes these factors should also be used to evaluate the anticompetitive effect of the membership standards of security-based swap clearing agencies once they are registered clearing agencies under Section 17A of the Exchange Act.

The Commission requests comment on the application of the standards under Section 17A to security-based swap clearing agencies in conjunction with the proposed rules to address conflicts of interest. Will the proposed rules effectively build on the Section 17A standards? Should the Commission take a more targeted approach by focusing new requirements under Section 765 of the Dodd-Frank Act on Section 17A standards alone, such as by having requirements addressing only membership standards and determinations whether to clear products? Would such an approach sufficiently address conflicts of interests? If not, are the proposed rules sufficient to address potential gaps in the way Section 17A alone would address conflicts of interest with respect to security-based swap clearing agencies? Should additional rules be proposed under Section 17A to further address conflict of interest concerns? Should the Commission extend the application of the proposed rules for security-based swap clearing agencies to all registered clearing agencies? To what extent would competitive pressures in the

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example, a clearing agency may impose participation standards that have an anticompetitive effect as long as any such anticompetitive effect is justified.

143 See Standards Release, supra note 134, at 419.

security-based swaps market, particularly as it continues to develop, help to mitigate conflicts of interest? Would the standards under Section 17A help to promote competition in a way that would help to mitigate conflicts of interest? To what extent does the Commission's oversight of clearing agencies pursuant to the standards under Section 17A alleviate the need for ownership limitations and governance requirements?

V. Discussion of Proposed Rule 702 under Regulation MC for Security-Based Swap Execution Facilities and National Securities Exchanges That Post or Make Available for Trading Security-Based Swaps

A. Ownership and Voting Limitations

Section 765 requires the Commission to adopt rules to mitigate conflicts of interest, which may include numerical limits on control of, or the voting rights with respect to, any clearing agency that clears security-based swaps, or on the control of any SB SEFs or SBS exchanges. Pursuant to this directive, the Commission is proposing ownership and voting limits for a SB SEF that would apply to any SB SEF participant and for a SBS exchange or facility of a national securities exchange that posts or makes available for trading security-based swaps ("SBS exchange facility") that would apply to any SBS exchange member. Specifically, the Commission proposes that a SB SEF, SBS exchange, or SBS exchange facility shall not permit any SB SEF participant or SBS exchange member, as applicable, either alone or together with its related persons, to: (1) beneficially own, directly or indirectly, any interest in the SB SEF, SBS exchange, or SBS exchange facility, as applicable, that exceeds 20% of any class of securities, or other ownership interest, entitled to vote of such SB SEF, SBS exchange, or SBS exchange facility; or (2) directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the SB SEF, SBS exchange, or SBS exchange facility, as applicable, that exceeds 20% of the voting power of any class of securities or other ownership interest of such SB SEF, SBS exchange, or SBS exchange facility.[144]

The Commission is concerned that if a SB SEF participant or SBS exchange member, either alone or together with its related persons, were to own a significant stake in the SB SEF, SBS exchange, or SBS exchange facility, respectively, the SB SEF participant or SBS exchange member could use its significant ownership interest to influence the operations of the SB SEF, SBS exchange, or SBS exchange facility to unduly derive benefits at the expense of other owners and market participants. The Commission is particularly concerned that a SB SEF participant or SBS exchange member may have financial incentives to limit the level of access to, and the scope of products traded on, these trading venues as a means to impede competition from other market participants. For example, the Commission understands that many of the electronic multi-dealer trading platforms that exist today for OTC derivatives or fixed income products limit the number of dealers from which a customer can request a quote. The Commission believes that a fewer number of dealers participating on a platform or exchange could result in less competition on pricing. The Commission believes that imposing ownership and voting limits, as described above, could mitigate potential conflicts of interest with respect to the level of access to the market and determinations as to which products are traded by limiting the ability of a small group of persons (such as dealers) to control the Board[145] and thus the governance of the SB SEF, SBS exchange, or SBS exchange facility.[146]

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144 See proposed Rule 702(b) under Regulation MC.

145 See supra note 98 for the proposed definition of "Board."

146 The Commission also believes that such limits would further the ability of the SB SEF and SBS exchange to effectively carry out its obligations Section 763(c) of the Dodd-Frank Act and Section 6 of the Exchange Act, respectively, and, in particular, provide market participants with impartial access to SB SEFs. See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c), and 15 U.S.C. 78f.

Unlike the Voting Interest Focus Alternative or the Governance Focus Alternative for security-based swap clearing agencies, the Commission is not proposing an aggregate 40% voting interest limit collectively on all SB SEF participants (with respect to SB SEFs) and SBS exchange members (with respect to SBS exchanges) or a 5% individual voting interest limit, respectively. The Commission recognizes that, as with security-based swap clearing agencies, the proposed rule would limit, but not eliminate, the ability of a small group of SB SEF participants or SBS exchange members, as applicable, to own a SB SEF, SBS exchange, or SBS exchange facility. Specifically, as few as five entities could own SB SEFs, SBS exchanges, and SBS exchange facilities under this proposal. However, the Commission's concerns with respect to concentration of ownership in security-based swap clearing agencies and SB SEFs, SBS exchanges, and SBS exchange facilities are informed by the differences in the structure for clearing and trading of security-based swaps. The Commission's experience has been that the central clearing model in the securities markets historically has tended toward convergence to a single clearing agency for each type of cleared product, while the market structure for securities trading historically has not necessarily tended toward a similar model.[147] The Commission also notes that security-based swap clearing agencies perform a critical function in mitigating financial risk for security-based swaps market participants. Although SB SEFs, SBS exchanges, and SBS exchange facilities are critical to promoting price transparency and therefore market efficiency, the Commission does not believe that the operation of SB SEFs, SBS exchanges, and SBS exchange facilities would pose the same level of systemic risk as security-based swap clearing agencies. There generally will be a lower barrier to entry with respect to trading

147 The Commission has not made any determinations about whether security-based swap clearing agencies will also tend to converge to a single clearing agency or even a small number of clearing agencies, as the central clearing of security-based swaps is still a developing area.

platforms because participants of a SB SEF or members of an SBS exchange would not incur the margin, guaranty fund, or other obligations that members of a clearing agency would incur, and thus multiple venues for the trading of security-based swaps are more likely to emerge. Thus, the Commission is not proposing identical ownership requirements for security-based swap clearing agencies and SB SEFs, SBS exchanges, and SBS exchange facilities.

For purposes of calculating a SB SEF participant's or SBS exchange member's ownership and voting interests, the proposed rule would aggregate such person's ownership and voting interests with those of its related persons. When used with respect to a SB SEF, proposed Rule 700(u) under Regulation MC would define the term "related person" to mean: (1) any affiliate of a security-based swap execution facility participant; (2) any person associated with a security-based swap execution facility participant; (3) any immediate family member of a security-based swap execution facility participant or any immediate family member of the spouse of such person, who, in each case, has the same home as the security-based swap execution facility participant or who is a director or officer of the security-based swap execution facility or any of its parents or subsidiaries; or (4) any immediate family member of a person associated with a security-based swap execution facility participant or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the security-based swap execution facility participant or who is a director or officer of the security-based swap execution facility or any of its parents or subsidiaries.

Further, when used with respect to a SBS exchange or SBS exchange facility, proposed Rule 700(u) under Regulation MC would define the term "related person" to mean: (1) any affiliate of a member of the national securities exchange that posts or makes available for trading security-based swaps; (2) any person associated with a member of the national securities exchange that posts or makes available for trading security-based swaps; (3) any immediate family member of a member of the national securities exchange that posts or makes available for trading security-based swaps or any immediate family member of the spouse of such person, who, in each case, has the same home as the member of the national securities exchange that posts or makes available for trading security-based swaps or who is a director or officer of the national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or any of its parents or subsidiaries; or (4) any immediate family member of a person associated with a member of the national securities exchange that posts or makes available for trading security-based swaps or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the national securities exchange that posts or makes available for trading security-based swaps or who is a director or officer of the national securities exchange or facility thereof that posts or makes available for trading security-based swaps or any of its parents or subsidiaries. To further the purpose of the proposed limits, the Commission preliminarily believes that it would be important to aggregate the SB SEF participant's or SBS exchange member's ownership and voting interests with the interest of any person with whom such person may be able to act together to influence or control the SB SEF, SBS exchange, or SBS exchange facility.

The proposed rule would restrict indirect as well as direct ownership and voting of a SB SEF, SBS exchange, or SBS exchange facility. Because the proposed rule could be easily circumvented if the Commission were to limit solely direct ownership and voting, the Commission preliminarily believes it would be important to further the purpose of imposing ownership and voting limits to also restrict the indirect ownership and voting interests of SB SEF participants and SBS exchange members. For example, if the Commission simply proposed to prohibit a SB SEF participant from directly owning or voting shares, the participant could hold its ownership interests in the SB SEF through a holding company, thus easily circumventing the intent of the proposed rule. Accordingly, the ownership and voting limits would apply to ownership and voting of interests in a parent company of the SB SEF, SBS exchange, or SBS exchange facility. For example, if the SB SEF were wholly-owned by a holding company, a SB SEF participant would be prohibited from owning or voting more than 20% of the voting interest in the parent company. Finally, the proposed limits also would apply to a SB SEF participant or SBS exchange member that beneficially owns more than 25% of an entity that itself owns more than 20% of a SB SEF, SBS exchange, or SBS exchange facility.[148]

To assure that SB SEFs, SBS exchanges, and SBS exchange facilities maintain an ownership structure consistent with the proposed ownership and voting limits, the Commission proposes that these entities have rules that (1) provide an effective mechanism to divest a SB SEF participant's or SBS exchange member's ownership that, alone or together with its related persons, exceeds 20% and (2) are reasonably designed not to give effect to a SB SEF participant's or SBS exchange member's voting interest that, alone or together with its related persons, exceeds 20%.[149] The Commission believes that in order for the ownership and voting limits to be effective, each SB SEF, SBS exchange, and SBS exchange facility must take measures to reduce a SB SEF participant's or member's ownership interest or not give effect to any voting interest that exceeds the proposed limits. The Commission intends to provide SB SEFs, SBS exchanges, and SBS exchange facilities flexibility in determining how to implement these requirements. Any rules adopted by these trading venues, however, must assure that they have a viable, enforceable mechanism to divest a SB SEF participant or SBS exchange member

148 See supra note 93 for the proposed definition of "control."

149 See proposed Rules 702(c)(1) and (2) under Regulation MC.

of any interest held in excess of the 20% limit and to not give effect to the portion of voting interest held in excess of the 20% limit. The Commission also proposes to require each SB SEF, SBS exchange, or SBS exchange facility to have rules to provide a mechanism to obtain information relating to its ownership and voting interests.[150] The Commission believes that a requirement to collect information regarding ownership and voting interests of SB SEF participants and SBS exchange members is essential for registered trading venues to monitor and comply with the proposed ownership and voting limits.[151]

The Commission believes that an ownership and voting limit of 20% is an appropriate threshold. On the one hand, the restriction would limit the ability of a SB SEF participant or SBS exchange member to exert undue influence over the governance of a SB SEF, SBS exchange, or SBS exchange facility, respectively. On the other hand, such an ownership and voting limit should not overly interfere in such an entity's organizational structure or the ability of a SB SEF participant or SBS exchange member to acquire a substantial equity interest in a SB SEF, SBS exchange, or SBS exchange facility, as applicable.[152] Thus, the proposed ownership and voting limits should strike an appropriate balance between the objectives of mitigating conflicts of interest and refraining from unnecessarily hindering the ability of entities to form new trading venues. In addition, there may be incentives to create a new SBS exchange or SB SEF because a SBS exchange or SB SEF may draw significant new business by making

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150 See proposed Rule 702(c)(3) under Regulation MC.

151 See supra Section IV.A.4.

152 National securities exchanges that may trade security-based swaps currently prohibit a member from owning or voting more than 20% of the exchange, although an exchange's method of calculating the 20% interest, aggregated with any person with whom such person may be able to act together to influence or control an exchange, may vary from the Commission's proposal. See, e.g., Amended and Restated Certificate of Incorporation of BATS Global Markets, Inc., Article FIFTH; Amended and Restated Certificate of Incorporation of NYSE Euronext, Article V.

available to trade a security-based swap that is required to be cleared under Section 763(a).[153] Furthermore, the risk management and economies of scale issues that may create a barrier to entry with respect to new security-based swap clearing agencies generally would not affect the creation of SBS exchanges or SB SEFs.

While the Commission believes that the proposed 20% ownership and voting limits are appropriate, it also understands that the movement of trading of security-based swaps onto SB SEFs, SBS exchanges, or SBS exchange facilities will foster enhanced transparency and market efficiency. The Commission does not intend to unnecessarily impede the emergence of what could be vital sources of, among other things, liquidity and pricing transparency for security-based swaps. However, imposing on SB SEFs and SBS exchanges ownership and voting limits similar to those that shareholder-owned cash equities and options exchanges have in place could have the unintended consequence of deterring new, competitive trading venues at a time when organized markets for security-based swaps are just beginning to develop. A trading platform that currently trades security-based swaps in the OTC market but would not meet the proposed ownership and voting limits would need to revise its ownership structure if it chooses to become a SB SEF. There could be costs and delays as the potential SB SEF seeks to find one or more additional owners to satisfy the proposed limits, with a possible diminution in the value of the original owner(s)' investment. Moreover, it is possible that imposing these limits may affect the security-based swaps market differently than the cash equities and listed options markets.

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153 The counterparties to a transaction in a security-based swap that is required to be cleared under Section 763(a)(2) of the Dodd-Frank Act will be required to execute the transaction on a SBS exchange or on a SB SEF. There is an exception from the execution requirement if no SBS exchange or SB SEF makes the security-based swap available to trade. See Pub. L. No. 111-203, Section 763(h). The exception from trade execution is also available if the exception from mandatory clearing under Section 763(g) applies. See Pub. L. No. 111-203, Section 763(g).

Ownership and voting limits were implemented at national securities exchanges at a time when the trading of exchange-listed securities was fairly well established and competitive. Consequently, a 20% ownership and voting limit may not negatively affect the ability of cash equity and options exchanges to promote competing trading venues but, if applied to the security based-swaps market that is in its infancy, could retard market development.

The Commission is sensitive to arguments against imposing ownership and voting limits for SB SEFs, SBS exchanges, and SBS exchange facilities, some of which were articulated at the Conflicts Roundtable. However, it also understands that the OTC derivatives market is highly concentrated and dealer dominated. Although ownership and voting limits arguably may have a less negative effect on new entrants to the cash equities and options markets and their ability to compete, there may also be less need for such limitations in those markets. In contrast, although ownership and voting limits may more directly affect the ability of SB SEFs and SBS exchanges to start up, the lack of market characteristics to promote competing trading venues for security-based swaps may emphasize the greater need for ownership and voting limits. If the market characteristics for security-based swaps naturally promote dealer domination without robust competing trading venues, there is more need to mitigate the types of concerns that underlie Section 765, such as by imposing ownership and voting limits.[154]

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154 In the equities market a small group of broker-dealers or single-dealer proprietary firms can and do own alternative trading systems ("ATSs") and thus it can be argued that SB SEFs and SBS exchanges should be permitted to operate similarly. See Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 61208 (November 23, 2009) (as of November 2009, there were approximately 73 ATSs that are subject to Regulation ATS). However, ATSs exist in the context of a marketplace with robust competition among numerous trading venues. Therefore, ATSs that are owned by one broker-dealer or a small group of broker-dealers, by virtue of their ownership structure alone, generally do not present a concern that they could lessen price competition or market efficiency.

The Commission must weigh the potential implications of imposing ownership and voting limits against imposing other requirements that would allow a dealer-dominated security-based swaps market to continue. As part of the balance between mitigating conflicts of interest without unduly restricting the ability of a competitive market for trading of security-based swaps to emerge, the Commission proposes to limit ownership in SB SEFs, SBS exchanges, and SBS exchange facilities specifically to those interests entitled to vote.[155] Consequently, a SB SEF participant or SBS exchange member would not be prohibited from owning any percentage of a nonvoting interest in a SB SEF, SBS exchange, or SBS exchange facility. In contrast, national securities exchanges generally limit their members from owning more than 20% of any interest, voting or otherwise. However, as discussed above, trading venues for exchange-listed securities are well established and highly competitive. In this regard, the Commission does not believe that it is necessary to propose the same ownership limits as those currently in place at national securities exchanges. Further, the proposed 20% limit on ownership and voting would still allow as few as five entities to own a SB SEF, SBS exchange, or SBS exchange facility. Thus, the proposed limit by itself would not completely prohibit a small number of entities from potentially exerting undue influence over SB SEFs, SBS exchanges, or SBS exchange facilities in a way that could benefit the few to the detriment of others.

The Commission requests comment on all aspects of the proposed ownership and voting limits, including whether it is necessary and appropriate to have ownership and voting limits at all. If commenters believe that it is necessary and appropriate to impose ownership and voting limits to mitigate conflicts of interest, the Commission requests comment on whether the proposed limits are appropriate, or whether they would unduly hinder the development of SB

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155 See supra note 64.

SEFs without serving to mitigate any conflicts.[156] Should the Commission require a voting limit, but not an ownership limit or a different limit for ownership versus voting? Even with the prohibition against owning more than 20% of any interest entitled to vote, a SB SEF participant or SBS exchange member could have sufficient ownership of nonvoting interest, either alone or in addition to voting interest, to exert influence on these trading venues. Should the Commission require the ownership limit to apply to any class of equity securities or other ownership interest rather than any class of securities, or ownership interest, entitled to vote?[157] Would the proposed limits impede the number or types of SB SEFs from being established? Should the proposed

156 In the SRO Governance Proposing Release, the Commission proposed a similar 20% ownership and voting limit for members of a national securities exchange. A number of commenters favored this proposal, including several commenters that were national securities exchanges or a facility of a registered securities association. See, e.g., letter from Michael J. Simon, Secretary, ISE, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("ISE Comment Letter") ("[The ownership limitation] provides SROs with flexibility, yet recognizes the unique conflicts that could arise if a member were to own a controlling interest in an SRO with regulatory responsibility for the member."); letter from Meyer S. Frucher, Chairman and Chief Executive Officer, Phlx, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("Phlx Comment Letter") ("The Exchange unequivocally agrees with the Commission that a significant shareholder could use its voting power to influence the operations of an exchange in a way that adversely affects the mission, integrity or regulatory capacity of the exchange, or otherwise is detrimental to the public interest."); letter from Philip D. DeFeo, Chairman and Chief Executive Officer, Pacific Exchange, Inc. ("PSX"), to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("PSX Comment Letter"); letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq Stock Market, Inc., to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("Nasdaq Comment Letter"). The Commission notes, however, that the SRO Governance Proposing Release related to national securities exchanges that trade equity securities and listed options and registered securities associations, and the comments received did not address potential conflicts in other contexts.

157 The CFTC has proposed similar ownership and voting limits for DCMs and registered SEFs, and applies the ownership limit only to any class of equity securities entitled to vote. See http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister_governance.pdf.

ownership and voting limits be phased in for SB SEFs to provide a grace period for those entities that would not meet the requirements under Regulation MC?

The Commission also seeks comment on whether the proposed ownership and voting limits would continue to be important as the market for security-based swaps evolves. If multiple SB SEFs emerge as this market develops, would competitive pressures alleviate any of the conflicts of interest that are the basis for the Commission's proposals? In that case, would it be appropriate for the Commission to impose different limits? Should the Commission reduce the restrictions over time, if conflict of interest concerns are lessened as the security-based swaps market develops? For example, if participation in the trading of security-based swaps becomes more open and includes a broader range of participants, and multiple SB SEFs or SBS exchanges evolve to trade the same security-based swaps, would there still be a need to retain ownership and voting limits or are there factors that would allow such limits to be revised? What factors should the Commission consider in assessing whether any ownership and voting limits it may impose on SB SEFs should be revisited?

As mentioned above, each national securities exchange currently prohibits its members from owning an interest, voting or otherwise, or voting more than 20% (or less) of the exchange or a facility of the exchange.[158] Therefore, the Commission preliminarily does not believe that the proposed rules would have a material effect on an exchange's ability to post or make available for trading security-based swaps. Nevertheless, the Commission requests comment on

158 A member has in the past been permitted on a pilot basis to own more than 20% of a facility of an exchange subject to certain terms and conditions. See Securities Exchange Act Release Nos. 59281 (January 22, 2009), 74 FR 5014 (January 28, 2009) (order approving on a pilot basis 50% ownership of the New York Block Exchange, a trading facility of NYSE, by BIDS ATS, a member of NYSE). This pilot has since been extended for an additional year and will expire on January 22, 2011 unless further extended or permanently approved. See Securities Exchange Act Release No. 61409 (January 22, 2010), 75 FR 4889 (January 29, 2010).

whether the proposed limits in this rulemaking could affect a national securities exchange's ability or decision to post or make available for trading security-based swaps. Also, given that national securities exchanges currently have limits on ownership and voting by members, would codifying the proposed limits help to further mitigate the types of conflicts of interest that underlie the Dodd-Frank Act for SBS exchanges? Would there be any effect on the willingness of entities to register to become a national securities exchange and trade security-based swaps? What would be the implication, if any, on an exchange that chose to trade security-based swaps through a facility that is a separate legal entity? More generally, for SB SEFs and SBS exchanges or SBS exchange facilities, should ownership and voting be limited to the same threshold or should they be different? If the Commission should take a different approach for ownership and voting, what should that approach be?

As described above, Section 765 enumerates Specified Entities that the Commission should consider in its rulemaking. The Commission understands that, depending on who may be permitted to directly effect transactions on a SB SEF (or is a SBS exchange member), limits on ownership and voting that apply only to SB SEF participants or SBS exchange members could be either over-inclusive or under-inclusive or both, with respect to the Specified Entities. For example, restricting control of a SB SEF based on an entity's direct participation on the SB SEF could capture a person who is not one of the Specified Entities or, conversely, fail to take into consideration a Specified Entity. Accordingly, the Commission requests comment on whether the scope of the proposed ownership and voting limits is appropriate. Should the limits on ownership and voting extend to all or some of the Specified Entities, regardless of their direct participation on the SB SEF or SBS exchange? If so, why? What are the potential conflicts concerns that such Specified Entities may pose? How are conflicts concerns posed by such

Specified Entities different from those posed by SB SEF participants or SBS exchange members who are not also Specified Entities? In this regard, the Commission notes that the definition of "related person" would encompass any such entity that is affiliated with such a SB SEF participant or SBS exchange member, although it may not itself be a SB SEF participant or SBS exchange member.

In addition, national securities exchanges generally limit ownership and voting by non-members, as well as members.[159] Specifically, exchanges generally limit each non-member to no more than 40% ownership of the exchange. The limit on ownership by non-members of an exchange is designed in part to provide the Commission and the exchange with the proper tools (such as access to books and records) necessary to carry out the Commission's and the exchange's respective regulatory oversight responsibilities, as well as to mitigate more general conflict concerns between owners' commercial interests and the exchange's regulatory obligations. The Commission requests comment on whether it should impose, as part of this rulemaking, similar limits on ownership and voting. Such an ownership limit would apply to the Specified Entities, to the extent they are not subject to the proposed ownership limit described above. In addition to the requirements of Section 765, the Dodd-Frank Act more generally requires a SB SEF to establish and enforce rules to minimize conflicts of interest in its decision-making process and establish a process for resolving the conflicts of interest. What are the types of conflicts that a person who is not a SB SEF participant or SBS exchange member may pose?

The Commission also requests comment on whether its formulation for calculating the 20% threshold is appropriate. Specifically, the Commission requests comment on all prongs of the definition of "related person," including whether the definition is over-inclusive or under-

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159 See supra Section III.B.

inclusive. What other method could the Commission use to reach the interest of any person with whom a SB SEF participant or SBS exchange member may be able to act together to influence or control a SB SEF or SBS exchange? Finally, the Commission expects a SB SEF, SBS exchange, and SBS exchange facility to have in place an effective mechanism for enforcing the ownership and voting limits. The Commission requests comment on whether the proposed rules related to divesture of ownership and voting limits are appropriate. Should the Commission explicitly require in the proposed rules specific ways to divest ownership and voting interest of SB SEF participants and SBS exchange members who violate the ownership and voting limits? Is the proposed rule pertaining to obtaining information on ownership and voting interest of SB SEFs, SBS exchanges, and SBS exchange facilities appropriate? Should the Commission require that trading venues collect information pertaining to certain ownership or voting thresholds?

B. Governance Requirements

The Commission is proposing substantive requirements with respect to the governance of SB SEFs, SBS exchanges, and SBS exchange facilities that are designed to address the conflict of interest concerns identified above, including the concern that dealer-owners could unduly influence the governance and operation of a SB SEF or SBS exchange. These governance provisions, as discussed below, should help mitigate conflicts of interest as directed by Section 765 of the Dodd-Frank Act.

1. Board

The Commission proposes that the Board of a SB SEF, SBS exchange, or SBS exchange facility be composed of a majority of independent directors.[160] The presence of a majority of independent directors on the Board should reduce the ability of owner-directors of a SB SEF,

[160] See proposed Rule 702(d)(1) under Regulation MC. See also supra note 102 and accompanying text for the proposed definition "independent director."

SBS exchange, or SBS exchange facility to improperly influence the operation of such entity to their own advantage and to the detriment of other users or potential users of the facility or exchange. A majority independent director requirement should help foster a greater degree of independent decision-making consistent with the objectives of the Dodd-Frank Act and the Exchange Act and should reduce the ability of owners that are participants or members to control key decisions regarding the operation of the SB SEF or SBS exchange and thereby potentially limit access to, or limit the products made available for trading on, the SB SEF or SBS exchange, which could adversely affect the trading of security-based swaps in regulated markets. Further, the definition of independent director is designed to assure that the independent director would not have a direct economic stake in the SB SEF or SBS exchange, or other relationship that would call into question the impartiality of the director, and thus would not be subject to the conflicts of interest identified above.

SB SEFs and SBS exchanges are intended to serve important roles in providing centralized, transparent trading of security-based swaps and, under Section 763(c) of the Dodd-Frank Act or existing Section 6 of the Exchange Act, as applicable, will have a number of responsibilities.[161] Requiring a majority independent Board should help assure that SB SEFs and SBS exchanges would operate in an impartial manner with respect to these (and other) mandated duties. Moreover, requiring a majority independent Board for SB SEFs and SBS exchanges would be commensurate with the manner in which national securities exchanges generally are

161 For SB SEFs, these responsibilities include establishing and enforcing rules with respect to the terms and conditions of the security-based swaps traded or processed on or through the facility and any limitation on access to the facility; trading procedures to be used in entering and executing orders traded on SB SEFs; and monitoring trading in SB SEFs to prevent manipulation, price distortion, and disruptions of the settlement process through surveillance, compliance and disciplinary practices and procedures. See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c).

governed today[162] and comports with the listing rules of exchanges, which are approved by the Commission.[163]

One of the alternatives the Commission proposes for security-based swap clearing agencies is to require the Board of any security-based swap clearing agency be composed of 35% independent directors. The Commission proposes this 35% independence alternative to address potential concerns that requiring a majority independent Board for security-based swap clearing agencies would affect the Board's ability to effectively perform risk management functions. Security-based swap clearing agencies perform a critical function in mitigating financial risk for security-based swaps market participants. Although critical to promoting price transparency and therefore market efficiency, as noted above, the Commission does not believe that the operation of SB SEFs, SBS exchanges, and SBS exchange facilities would pose the same level of systemic risk as security-based swap clearing agencies because they do not assume the risk of managing open positions or of guaranteeing the settlement of transactions. Thus, the Commission is not making the same proposal with respect to SB SEFs, SBS exchanges, and SBS exchange facilities.

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162 See supra Section III.B. Currently, the governance structure of a facility of an exchange that is a separate legal entity from the exchange and that is not a wholly-owned subsidiary of the exchange is not subject to any specific board or committee compositional requirements. Given the nature of the conflict concerns for the trading of security-based swaps and the structure of the security-based swaps market – namely, the dominance by a small group of dealers and the concern with respect to undue influence in the operation of the SB SEF or SBS exchange - the Commission believes that it is necessary and appropriate to impose the same board and committee compositional requirements on a facility of an exchange if that facility posts or makes available for trading security-based swaps.

163 See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (order approving File Nos. SR-NYSE-2002-33, SR-NASD-2002-77, SR-NASD-2002-80, SR-NASD-2002-138, SR-NASD-2002-139, and SR-NASD-2002-141).

Although a majority independent Board may address conflicts of interest concerns that underlie Section 765 of the Dodd-Frank Act, it may not effectively eliminate all conflicts. The presence of independent directors may be an effective mechanism to address certain types of conflicts in certain types of institutions but not necessarily in all instances nor for all institutions. The Commission, however, does not believe that the characteristics of SB SEFs and SBS exchanges, and the types of conflicts that may be inherent with respect to such entities, pose a set of circumstances that are incompatible with an effective governance via a majority independent Board.

Taking into account these and other concerns, the Commission has considered a less prescriptive governance rule to address conflicts of interest for venues that trade security-based swaps. However, especially because SB SEFs are not SROs and thus their rules are not subject to Commission approval pursuant to Section 19 of the Exchange Act,[164] a principles-based approach to governance may not give the Commission sufficient ability to address potential conflicts in the operation of SB SEFs. Although the Commission, through its authority to approve applications to register as a SB SEF, may be able to ascertain that a SB SEF at the time of its registration has a governance structure that sufficiently would mitigate conflicts of interest, a less prescriptive approach could make it more difficult for the Commission to assure that the SB SEF's governance structure continues to meet the proposed requirements over time.

The Commission welcomes commenters' insights to inform its understanding of the governance of trading venues for security-based swaps. As discussed above, a majority independent Board may not effectively address all conflicts. The Commission therefore seeks comment on all aspects of its proposal for a majority independent Board. Should the

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164 15 U.S.C. 78s.

Commission adopt a less prescriptive approach to mitigating conflicts of interest in the governance of SB SEFs and SBS exchanges? Are there other approaches that would improve governance and mitigate conflicts of interest? For example, would state laws governing the fiduciary duty owed by corporate board members help to mitigate conflicts of interest or, as noted above, would such laws potentially aggravate the types of conflicts of interest that the Commission is trying to address? Should the Commission consider any additional requirements related to fiduciary duties to either enhance mitigation of conflicts or address deficiencies?

Further, the Commission requests comment on whether requiring the Board of a SB SEF, SBS exchange, or SBS exchange facility to be composed of a majority of independent directors would improve the governance of the SB SEF, SBS exchange, or SBS exchange facility, as applicable, and mitigate conflicts of interest that could arise. The Commission specifically requests comment on whether there are other Board structures that could help mitigate conflicts of interest. If having a majority independent Board is not necessary to mitigate conflicts, but some lesser percentage of independent directors would help address such concerns, what percentage of Board members should be required to be independent? What are the benefits and costs of requiring Boards of SB SEFs, SBS exchanges, and SBS exchange facilities to be composed of a majority of independent directors? Would a majority independent Board help to mitigate conflicts of interest if the ownership of a SB SEF, SBS exchange, or SBS exchange facility is concentrated in a small group of owners (e.g., five owners) rather than a larger group (e.g., greater than ten owners)? Would a majority independent Board help to mitigate conflicts of interest that could arise between the commercial interests of a SB SEF, SBS exchange, or SBS exchange facility or the owners of the SB SEF, SBS exchange or SBS exchange facility and the regulatory responsibilities of the SB SEF or SBS exchange? Are there experience or efficiency issues if a majority of the Board must be composed of independent directors? Are there remedies for overcoming any such experience or efficiency issues?[165]

The Commission also notes that currently, for national securities exchanges, at a minimum, the number of non-industry directors should equal or exceed the number of industry directors.[166] The Commission requests comment on whether requiring a majority independent Board could further mitigate conflicts for SBS exchanges or whether the current standards exchanges have in place would sufficiently address the conflict concerns with respect to exchanges that would post or make available for trading security-based swaps. Further, the Commission requests comment as to whether the requirement for Board composition should be different for SB SEFs and SBS exchanges and, if so, why and how?

The Commission also requests comment on the proposed definitions of "independent director" and "material relationship."[167] Are the definitions of "independent director" and

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165 The SRO Governance Proposing Release proposed that the board of a national securities exchange or national securities association be composed of a majority of independent directors. See SRO Governance Proposing Release, supra note 59. A number of commenters, particularly national securities exchanges, favored this proposal. See, e.g., PSX Comment Letter, supra note 156; Letter from Anthony K. Stankiewicz, Esq., Vice President, Legal and Governance, BSE, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 (supporting the majority independent board requirement but objecting to the definition of independence) ("BSE Comment Letter"); Letter from Mary Yeager, Assistant Secretary, NYSE, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("NYSE Comment Letter"). A few commenters objected to it as being an unnecessary requirement to mandate for all exchanges. See, e.g., ISE Comment Letter, supra note 156; Letter from William J. Brodsky, Chairman and Chief Executive Officer, Chicago Board Options Exchange, Incorporated, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("CBOE Comment Letter"). The Commission notes, however, that the SRO Governance Proposing Release related to national securities exchanges that trade equity securities and listed options and registered securities associations, and the comments received did not address potential conflicts in other contexts.

166 See supra Section III.B.

167 See proposed Rules 700(j) and (l) under Regulation MC.

"material relationship" appropriate? If not, how should they be defined? The proposed rule provides circumstances that would preclude a finding that a director is independent.[168] The Commission requests comment on whether this approach is appropriate or whether the Commission should take a less prescriptive approach. The Commission also notes that the proposed rule precludes a director from being deemed independent if he or she has received from the SB SEF, SBS exchange, or SBS exchange facility within the past three years payments that reasonably could affect his or her independent judgment or decision-making, excluding remunerations for Board or Board committee services. The Commission requests comment on whether it is appropriate to exclude compensation for Board or Board committee service from disqualifying a director as an independent director. Are there circumstances or levels of compensation that should disqualify a candidate from being deemed independent? The Commission also requests comment on whether, instead of independence requirements, it should require that the number of "non-industry" directors equal or exceed the number of "industry" directors, as such terms are generally defined by the exchanges.[169] Are there other types of affiliations that the Commission should be concerned about that are not addressed by the proposed definitions of "independent director" or "material relationship"?

The Commission is not proposing that the Board composition requirement apply to parent companies of a SB SEF, SBS exchange, or SBS exchange facility.[170] In other words, the Commission is not proposing to require a holding company that wholly owns, or entities that

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168 See Section 303A.02 of the NYSE Listed Company Manual and Nasdaq Rule 5605(a)(2), both of which contain specific circumstances that, if satisfied, would preclude a determination that the director is independent.

169 See supra note 66.

170 If the parent company of a SB SEF, SBS exchange or SBS exchange facility was itself a regulated entity that is subject to the Exchange Act and rules and regulations thereunder, then it would comply with any requirements that it is subject to in that capacity.

control, a SB SEF, SBS exchange, or SBS exchange facility to have a majority independent Board.[171] The Commission preliminarily believes that the composition of the Board of a parent that wholly owns or controls a SB SEF, SBS exchange, or SBS exchange facility does not raise conflicts concerns that require Commission rulemaking. The Commission, however, requests comment on whether the majority independent Board requirement should apply to an entity that owns and controls a SB SEF, SBS exchange, or SBS exchange facility.

2. Regulatory Oversight Committee

In addition to a majority independent Board, the Commission proposes that a SB SEF or SBS exchange establish a ROC that is composed solely of independent directors to oversee the SB SEF's obligations under Section 763(c) of the Dodd-Frank Act or the SBS exchange's regulatory oversight responsibilities under Section 6 of the Exchange Act, respectively.[172] This requirement also would apply to a national securities exchange that posts or makes available for trading security-based swaps through a facility of the exchange.[173] The ROC would oversee the regulatory program on behalf of the Board. Specifically, the Commission expects that a ROC, among other things, would monitor a SB SEF's or SBS exchange's regulatory program for sufficiency, effectiveness, and independence; oversee all facets of the regulatory program;

171 The CFTC has proposed to apply a "public director" requirement to parent companies that operate DCMs and SEFs. See http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister_governance.pdf.

172 See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c), and 15 U.S.C. 78(f). See also proposed Rule 702(e)(1) under Regulation MC.

173 Proposed Rule 702(e) under Regulation MC does not explicitly include a SBS exchange facility. A facility that posts or makes available for trading a security-based swap would do so under the registration of an exchange of which it is a facility. Therefore, the exchange is deemed the statutory entity posting or making available for trading the security based swap and is responsible for the regulatory oversight of the facility. Accordingly, the exchange whose facility posts or makes available for trading a security-based swap must itself establish the requisite ROC.

review the size and allocation of the regulatory budget and resources; and review regulatory proposals and advise the Board as to whether and how such changes may affect regulation. The proposed rule also would require that any recommendation of the ROC that is not adopted or implemented by the Board be reported promptly to the Commission.[174]

The proposed provisions relating to the ROC should help limit the ability of owners of the SB SEF and SBS exchange to unduly influence the operation of these entities, and thus would further the objectives of good governance and mitigation of conflicts of interest that underlie Section 765 of the Dodd-Frank Act. A ROC is intended to have an important role in assuring that a SB SEF or SBS exchange carries out its obligations in an even-handed and effective manner and that its oversight functions are adequately funded.

Although the Commission encourages national securities exchanges to have a wholly independent ROC, it has not in the past required them to do so.[175] As mentioned above,

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174 See proposed Rule 702(e)(2) under Regulation MC.

175 In the SRO Governance Proposing Release, the Commission proposed to require SROs to have a ROC and to require that all members of such committee be independent. See SRO Governance Proposing Release, supra note 59. Some commenters generally favored the requirement of a ROC. See, e.g., PSX Comment Letter, supra note 156; CBOE Comment Letter, supra note 165. However, a number of commenters objected to the requirement that certain board committees, including the ROC, be composed solely of independent directors. See, e.g., Phlx Comment Letter, supra note 156 ("To impose this requirement on all Standing Committees would potentially exclude persons with the most experience and knowledge from serving on these committees."); CBOE Comment Letter, supra note 165; letter from Neal Wolkoff, Acting Chief Executive Officer, the American Stock Exchange LLC, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("[A] number of the exchanges may find it difficult to find enough qualified independent directors with sufficient expertise to satisfy all of these committees."); letter from the Archipelago Exchange, BSE, the Chicago Stock Exchange, ISE, the Nasdaq Stock Market, and Phlx, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2005 ("[As] a result of the potential loss of flexibility, we disagree with the mandated requirement for specific committees composed exclusively of directors that meet the [Commission's] proposed definition of independence."). The Commission notes, however, that the SRO Governance Proposing Release related to national securities exchanges that trade equity securities and listed options and registered securities

however, the conflict concerns that Section 765 is intended to address are not entirely analogous to those posed by national securities exchanges. Rather, there is a heightened concern regarding conflicts of interest for trading venues of security-based swaps because a small group of dealers may exert undue influence to control the level of access to, and the scope of products traded on such venues. Further, while SB SEFs do not possess the full range of self-regulatory obligations that exchanges have, they nonetheless have a number of regulatory duties that are set forth in the core principles for SB SEFs contained in Section 763(c) of the Dodd-Frank Act.[176] Thus, it appears that a need for a wholly independent ROC may be greater for SB SEFs and SBS exchanges than for other registered national securities exchanges.[177]

The Commission also recognizes that, as mentioned above, an independent director, who by definition would be outside the management of a SB SEF or SBS exchange and not a SB SEF participant or SBS exchange member may not have access to the same amount or types of information as non-independent directors. Therefore, a ROC composed solely of independent directors may need to rely on management or non-independent directors for information, with attendant biases of information from such sources. If directors on a ROC, moreover, lack necessary information or are otherwise not sufficiently knowledgeable, the committee's effectiveness as a whole may be compromised. Such ROC may defer to management's expertise or the expertise of non-independent directors on the Board. Further, as mentioned above,

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associations, and the comments received did not address potential conflicts in other contexts.

176 See supra note 54.

177 Some exchanges have voluntarily created ROCs. See, e.g., Securities Exchange Act Release Nos. 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (order approving demutualization of the Chicago Stock Exchange ("CHX")) (at the time of the demutualization, CHX proposed to have, and currently has, majority public directors on its ROC) and 62158 (May 24, 2010), 75 FR 30082 (May 28, 2010) (order approving the demutualization of CBOE) (CBOE's ROC is composed solely of non-industry directors).

independent directors may have their own biases that could compromise the structural protections intended by a wholly independent ROC. Therefore, the Commission seeks comment on the proposal relating to the composition and duties of the ROC. Would the establishment of a fully independent ROC help mitigate the identified conflicts of interest? Are there particular circumstances under which a ROC should be permitted to have non-independent directors? If so, please identify them.

Separately, the Commission requests comment on whether it should specify in the proposed rule the duties of the ROC. If so, what should be the scope of the ROC's duties? For example, should a ROC be required to oversee decisions as to which entities have access to the trading facility and under what circumstances, or which products are made available for trading? Is it appropriate to require that the Board submit to the Commission any recommendation of the ROC that it does not adopt or implement? Would this requirement help assure good governance that may mitigate conflicts? Should such reports be required to be submitted promptly to the Commission? Would a different time period be more appropriate? For instance, should such reports instead be required to be submitted semi-annually or, for SB SEFs, should they be incorporated as part of the annual report of the Chief Compliance Officer, which is required pursuant to core principle 14 under Section 763(c) of the Dodd-Frank Act? Are there reasons, consistent with mitigation of conflicts, why SB SEFs and SBS exchanges should be treated differently with respect to the proposal to require a fully independent ROC? Are there other ways in which material information pertaining to the ROC's ability to carry out its duties effectively can be brought to the Commission's attention?

3. Other Board Committees

The Commission is proposing compositional and other requirements with respect to various other Board committees. In this regard, proposed Rule 702(f)(1) under Regulation MC would require that the nominating committee of a SB SEF, SBS exchange, or SBS exchange facility be composed solely of independent directors. The proposed requirement for the Board of the SB SEF, SBS exchange, or SBS exchange facility to be composed of a majority of independent directors could be undercut if the nominating committee were dominated by persons that had an ownership interest in these entities, were affiliated with such owners, or were selected by the owner-directors or their affiliates. Further, the proposed rule would require that any committee of the Board that is delegated the authority to act on the Board's behalf, such as any executive committee, also must be composed of a majority of independent directors.[178] This proposed provision extends to Board committees that are authorized to act on behalf of the Board the compositional requirement proposed for the full Board and is designed to assure that the SB SEF, SBS exchange or SBS exchange facility would not subvert the proposed majority Board independence standard by delegating the Board's duties to a committee that does not have the same majority independence standard.

With respect to a wholly independent nominating committee, the Commission recognizes that the proposal may not sufficiently mitigate concerns that certain shareholders may be able to influence or control the director nominating process and thus undermine the intent of a majority independent Board. As discussed above, an independent director may not truly be independent from the influence of, or bias toward, a large shareholder or group of shareholders, other non-independent directors, or even from management. Consequently, if the nominating committee is

[178] See proposed Rule 702(f) under Regulation MC. This proposed provision would not apply to the ROC or the nominating committee since the proposals would require the ROC and the nominating committee to be composed solely of independent directors.

composed of enough directors who are subject to such influence or bias, the palliative purpose of requiring a wholly independent nominating committee could be compromised. Accordingly, the Commission requests comment on whether it should prescribe or limit the manner in which a SB SEF, SBS exchange, or SBS exchange facility could appoint the nominating committee. Should the Commission consider an alternative to a compositional requirement for a nominating committee, such as allowing a SB SEF, SBS exchange, or SBS exchange facility to have a board of trustees responsible for nominating candidates for the Board? If this were a viable alternative, should there be compositional requirements or other limits imposed on the board of trustees? How should such a board of trustees be appointed? Would the alternative of a board of trustees to nominate directors provide greater assurance that independent directors are truly independent not only at the time of their nomination but during their service on the Board as well?

Conversely, the Commission also notes that dealer-owners that are Board members would not be able to serve on a wholly independent nominating committee and thus would not have a voice in the process of nominating candidates for Board seats. This would mean that the nominating committee would not have access to the dealer-owners' potentially valuable insights with respect to qualified candidates for either independent or non-independent director positions. Accordingly, the Commission invites commenters to suggest the appropriate compositional requirements for the nominating committee and explain their views. Should the Commission instead require a majority independent nominating committee? Would a majority independent nominating committee be consistent with the proposal's goal to mitigate conflicts for SB SEFs and SBS exchanges?[179]

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[179] The SRO Governance Proposing Release proposed that certain committees, including the nominating committee, be composed solely of independent directors. See SRO Governance Proposing Release, supra note 59. Some commenters favored this

SB SEFs are not subject to "fair representation" requirements, like national securities exchanges, which must assure their members "fair representation" in the selection of directors and the administration of the exchange's affairs.[180] Should the Commission adopt additional compositional requirements to provide SB SEF participants a guaranteed voice in the selection of the SB SEF's directors and the administration of its affairs?[181] For example, should the Commission require that the nominating committee consult with participants in the SB SEFs or SBS exchanges, as applicable? Or, should the Commission require that the participants in the SB SEFs or SBS exchanges select a certain percentage of directors? If so, should the Commission also limit the ability of owner participants (such as dealers) to participate in this process? If that is the case, should any such limitation depend on whether ownership is concentrated in a small number of dealers? Should end users also be given guaranteed rights of participation in the governance of the SB SEF?

The Commission also seeks comment on whether the proposed compositional requirements relating to any committee that is delegated the authority to act on behalf of the Board are appropriate and whether there are any other areas in which the Commission should propose compositional requirements for SB SEF and SBS exchange committees. For example,

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requirement. See, e.g., PSX Comment Letter, supra note 156. A number of commenters, particularly national securities exchanges, objected to the requirement that certain board committees be composed solely of independent directors. See supra note 175.

180 See Section 6(b)(3) of the Exchange Act, 15 U.S.C. 78f(b)(3).

181 As discussed above, Section 763(c) of the Dodd-Frank Act sets forth 14 core principles that SB SEFs must satisfy, including one relating to conflicts of interest, and provides the Commission with rulemaking authority with respect to implementation of these core principles. As the Commission has not yet proposed rules regarding the requirements and operation of a SB SEF, including the scope of trading on and which entities would be allowed to directly access a SB SEF, the Commission may determine that it is more appropriate to propose participant representation requirements, if any, in its broader rulemaking relating to SB SEFs.

the Commission requests comment on whether it should require any SB SEF, SBS exchange, or SBS exchange facility committee that determines which security-based swaps will trade on the SB SEF or SBS exchange, respectively, be composed of majority independent directors, or require participation by other groups on such committee. Should the ROC be required to oversee decisions regarding access to the SB SEF and regarding which security-based swaps are made available to trade on the SB SEF?

4. Disciplinary Process

As noted above, the Commission historically has required that national securities exchanges' disciplinary panels be balanced and include industry member representation.[182] Proposed Rule 702(g) under Regulation MC would require that any disciplinary process of a SB SEF and SBS exchange shall preclude any group or class of persons that is a SB SEF participant or SBS exchange member from dominating or exercising disproportionate influence. In other words, to the extent that there is more than one type of group or class of persons that are participants or members in a SB SEF or SBS exchange, as applicable, the composition of any disciplinary panel should not allow one group or class to have representation on the disciplinary panel that is out of proportion as compared to other groups or classes of persons that are participants in the SB SEF or SBS exchange. In addition, any panel that is responsible for disciplinary decisions, and any appeals body, must include at least one independent director.[183] These proposed provisions should help mitigate conflicts of interest in the SB SEF's and SBS

[182] See supra Section III.B.

[183] See proposed Rule 702(h) under Regulation MC.

exchange's disciplinary process. This requirement also would apply to a national securities exchange that posts or makes available for trading a security-based swap through its facility.[184]

The Commission seeks comment on the proposal relating to requirements of the disciplinary process, including the compositional requirements. Should any disciplinary panel also be required to include representatives selected by SB SEF participants or SBS exchange members, as applicable? Would the proposed provisions help to mitigate the identified conflicts of interest? Should any other persons be precluded from dominating the disciplinary process? Are there any additional provisions that should be proposed to mitigate conflicts of interest in the disciplinary process?[185] The Commission also requests comment on whether the Commission's proposal would meaningfully supplement or enhance the requirements that SBS exchanges, as national securities exchange, already have in place with respect to the disciplinary process.

VI. Discussion of Exemptive Authority Pursuant to Section 36 of the Exchange Act

The Commission pursuant to Section 36 of the Exchange Act may grant an exemption from any rule or any provision of any rule under Regulation MC. Any such exemption could be subject to conditions and could be revoked by the Commission at any time. Generally, the Commission would consider granting an exemption where the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. For example, the SBS exchange, SB SEF, or security-based swap clearing agency might be unable, on a temporary basis and for reasons beyond its control, to comply with one of the rules under

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184 See supra note 173. Similar to the requirement pertaining to the ROC, the exchange, not the facility, bears the responsibility of disciplining its members. See Section 6 of the Exchange Act. Consequently, proposed Rule 702(h) does not explicitly mention SBS exchange facility. However, a national securities exchange that posts or makes available for trading a security-based swap through its facility must also comply with the requirements of proposed Rule 702(h) under Regulation MC.

185 See supra note 181.

Regulation MC. The Commission could also grant an exemption where the SBS exchange, SB SEF, or security-based swap clearing agency demonstrated that it established alternative means to effectively mitigate conflicts of interest as contemplated under Regulation MC and that it would otherwise be unable to comply with the requirements under Regulation MC, including as a start-up SB SEF, SBS exchange, or security-based swap clearing agency. The Commission in its sole discretion would determine whether to grant or deny a request for an exemption. In addition, the Commission could revoke an exemption at any time, including if the SBS exchange, SB SEF, or security-based swap clearing agency could no longer demonstrate that such exemption is necessary or appropriate in the public interest, or is consistent with the protection of investors.

The Commission requests comment on all aspects of the exemptive authority. Would such exemptive authority be useful to facilitate the purposes of Section 765? If so, in what circumstances should the Commission grant exemptions? Should exemptions only be granted in limited circumstances? Should the Commission potentially consider granting exemptions from all rules under Regulation MC or are exemptions only warranted for specific rules or specific entities? For example, should exemptions only be available with respect to the voting interest restrictions applicable to security-based swap clearing agencies? What specific factors should the Commission consider in determining whether to grant an exemption? Are there cases where exemptions may not be appropriate and should not be considered?

VII. Effective and Compliance Date

The Commission is required to adopt rules under Section 765 within 180 days of enactment of Title VII. However, certain of the rules the Commission is proposing today would apply to SB SEFs, which will be the subject of new definitional rules that are required under the

Dodd-Frank Act to be completed by July 15, 2011. Accordingly, the Commission is proposing that provisions of Regulation MC as applicable to SB SEFs would become effective sixty (60) days after July 15, 2011. All other provisions of the rules under Regulation MC would become effective sixty (60) days after the final rules are published in the Federal Register.

The Commission recognizes that existing entities may need a transitional period to implement any final rules. Accordingly, the Commission is proposing to permit the phase-in implementation of the rules under Regulation MC over two (2) years or two regularly-scheduled Board elections. The phase-in implementation would apply to existing exchanges, clearing agencies, or other institutions that apply to register as a SBS exchange, SB SEF, or security-based swap clearing agency. However, the Commission expects that entities that are newly created in order to establish a SBS exchange, SB SEF, or security-based swap clearing agency would fully comply with the final rules.

The Commission requests comment on (i) the timing of effectiveness for the final rules, and (ii) the length and applicability of the implementation period.

VIII. General Request for Comments

The Commission seeks comment on the proposed rules that are intended to mitigate conflicts of interest with respect to security-based swap clearing agencies, SB SEFs, SBS exchanges, and SBS exchange facilities, on any additional or different provisions that would mitigate conflicts of interest for these entities, and on any other matters that might have an implication on the proposals. The Commission particularly requests comment from the point of view of entities that plan to register as security-based swap clearing agencies or SB SEFs and from national securities exchanges that plan to become SBS exchanges or create SBS exchange facilities; entities operating platforms that currently trade or clear security-based swaps; broker-dealers, financial institutions, major security-based swap participants, and other persons that trade security-based swaps; and end-users generally.

The Commission invites commenters to address whether the proposed rules are appropriately tailored to achieve the goal of mitigating conflicts of interest in the ownership and governance of security-based swap clearing agencies, SB SEFs, SBS exchanges, and SBS exchange facilities, including with respect to the administration of these entities' regulatory activities. The Commission also requests comment on the necessity and appropriateness of mandating ownership and voting limitations for security-based swap clearing agencies, SB SEFs, SBS exchanges, and SBS exchange facilities and on whether there are other means to achieve the statutory mandate of Section 765 of the Dodd-Frank Act.

The Commission is proposing governance requirements for security-based swap clearing agencies, SB SEFs, SBS exchanges, and SBS exchange facilities that are designed to mitigate conflicts of interest. The Commission requests comment on whether the governance requirements, by themselves, would be enough to mitigate conflicts.

The Commission requests comment on the two alternative proposals for security-based swap clearing agencies. Are there other alternatives that would more effectively mitigate conflicts of interest? Should security-based swap clearing agencies be permitted to choose between alternatives at all? The Commission may determine to adopt only one of the proposed alternatives as a final rule. If only one alternative were to be adopted as a final rule, which one should it be? Should any of the provisions of the proposed alternatives be revised? The Commission may combine aspects of each proposed alternative rule (with or without modifications) and adopt them as a single final rule. If that approach is taken, which aspects of each alternative should be combined? For example, should the voting interest restrictions in

Rule 701(a) be combined with the governance restrictions in Rule 701(b) to create a stronger rule to mitigate conflicts of interest at security-based swap clearing agencies? As compared to each other, how is each alternative likely to affect access and risk management at security-based swap clearing agencies? How will each alternative affect and be affected by developments in the market, including the prospect of future competition?

The Commission also requests comment on the impact on competition the two alternative proposals might have. The Voting Interest Focus Alternative and the Governance Focus Alternative are designed to address the unique conflict of interest issues at security-based swap clearing agencies. The Commission requests comment on whether imposing voting interest and governance limitations could have the unintended consequence of deterring new, competitive security-based swap clearing agencies at a time when central clearing for security-based swaps is still developing. A security-based swap clearing agency that currently clears security-based swaps but would not meet the proposed voting interest limits would need to revise its ownership structure. There could be costs and delays as the security-based swap clearing agency seeks to find one or more additional owners to satisfy the proposed limits, with a possible diminution in the value of the original owner(s)' investment.

The Commission is sensitive to arguments against imposing ownership and voting limits for security-based swap clearing agencies, some of which were articulated at the Conflicts Roundtable. However, it also understands that the OTC derivatives market is highly concentrated and dealer dominated. As a result, voting interest and governance restrictions may be necessary at security-based swap clearing agencies where they have not been necessary at other securities clearing agencies. Access to central clearing services will be crucial for most firms that will actively trade in security-based swaps that are required to be cleared. Although the proposed restrictions may have the effect of creating barriers to potential security-based swap clearing agencies (and thus market participants could have fewer clearing agencies to choose from) the incentives of independent directors will likely promote increased access to central clearing for market participants. In contrast, although ownership and voting limits may more directly affect the ability of SB SEFs and SBS exchanges to start up, the lack of market characteristics to promote competing trading venues for security-based swaps may emphasize the greater need for ownership and voting limits. If the market characteristics for security-based swaps naturally promote dealer domination without robust competing trading venues, there is more need to mitigate the types of concerns that underlie Section 765, such as by imposing ownership and voting limits.[186]

The CFTC is adopting rules to mitigate conflicts of interest for derivatives clearing organizations that clear swaps, swap execution facilities and boards of trade designated as a contract markets that post swaps or make swaps available for trading as required under Section 726 of the Dodd-Frank Act. Understanding that the Commission and the CFTC regulate different products and markets and, as such, appropriately may be proposing alternative regulatory requirements, the Commission requests comments on the impact of any differences between the Commission and CFTC approaches to the mitigation of conflicts of interest. Specifically, would the regulatory approaches under the Commission's proposed rulemaking

186 In the equities market a small group of broker-dealers or single-dealer proprietary firms can and do own alternative trading systems ("ATSs") and thus it can be argued that SB SEFs and SBS exchanges should be permitted to operate similarly. See Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 61208 (November 23, 2009) (as of November 2009, there were approximately 73 ATSs that are subject to Regulation ATS). However, ATSs exist in the context of a marketplace with robust competition among numerous trading venues. Therefore, ATSs that are owned by one broker-dealer or a small group of broker-dealers, by virtue of their ownership structure alone, generally do not present a concern that they could lessen price competition or market efficiency.

pursuant to Section 765 of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Section 726 of the Dodd-Frank Act result in duplicative or inconsistent efforts on the part of market participants subject to both regulatory regimes or result in gaps between those regimes? If so, in what ways do commenters believe that such duplication, inconsistencies, or gaps should be minimized? Do commenters believe the approaches proposed by the Commission and the CFTC to mitigate conflicts of interest are comparable? If not, why? Do commenters believe there are approaches that would make the mitigation of conflicts of interest more comparable? If so, what? Do commenters believe that it would be appropriate for the Commission to adopt an approach proposed by the CFTC that differs from the Commission's proposal? Is so, which one? The Commission requests commenters to provide data, to the extent possible, supporting any such suggested approaches.

In addition, the Commission seeks comment regarding any potential implication of the proposals on users of any security-based swap clearing agencies, SB SEFs, and SBS exchanges, other market participants, and the public generally. The Commission seeks comment on the proposals as a whole, including their interaction with the other provisions of the Dodd-Frank Act. The Commission seeks comment on whether the proposals would help achieve the broader goals of increasing transparency and accountability in the OTC derivatives market.

Commenters should, when possible, provide the Commission with empirical data to support their views. Commenters suggesting alternative approaches should provide comprehensive proposals, including any conditions or limitations that they believe should apply, the reasons for their suggested approaches, and their analysis regarding why their suggested approaches would satisfy the statutory mandate contained in Section 765 of the Dodd-Frank Act regarding mitigation of conflicts of interest.

IX. Paperwork Reduction Act

The proposed rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[187] The titles for these collections are Rule 701 of Regulation MC, both in the Voting Interest Focus Alternative and the Governance Focus Alternative, and Rule 702 of Regulation MC.

The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11.

A. Summary of Collection of Information

1. Security-Based Swap Clearing Agencies

Proposed alternative Rule 701(a)(2) under Regulation MC would require security-based swap clearing agencies to have rules that would: (1) provide for an effective mechanism to divest any participant of any interest owned in excess of the proposed 20% ownership limit; (2) not give effect to the portion of any voting interest held by one participant in excess of the proposed 20% voting limit; (3) not give effect to the portion of any voting interest among all security-based swap clearing agency participants owned in the aggregate in excess of the proposed 40% ownership limit; and (4) provide an effective mechanism for the security-based swap clearing agency to obtain information relating to the voting interests in such entity. Alternative Rule 701(b)(2) under Regulation MC would require security-based swap clearing agencies to have rules that would: (1) provide for an effective mechanism to divest any participant of any interest owned in excess of the proposed 5% ownership limit; (2) not give effect to the portion of any voting interest held by one participant in excess of the proposed 5% voting limit; and (3) provide an effective mechanism for the security-based swap clearing agency to obtain information

187 44 U.S.C. 3501 et seq.

relating to the voting interests in such entity. Each security-based swap clearing agency must comply with one of the alternatives. Establishing such rules would result in a paperwork burden for a security-based swap clearing agency. In addition, if the security-based swap clearing agency was to request to receive ownership and voting information from participants pursuant to Rule 701(a) or (b), the request would be a collection of information.

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

Proposed Rule 702(c) under Regulation MC would require SB SEFs, SBS exchanges, and SBS exchange facilities to have rules that would: (1) provide for an effective mechanism to divest any participant or member, as applicable, of any interest owned in excess of the proposed 20% ownership limit; (2) not to give effect to the portion of any voting interest help by one or more participants or members, as applicable, in excess of the proposed 20% voting limit; and (3) provide an effective mechanism for the SB SEF, SBS exchange or SBS exchange facility to obtain information relating to ownership and voting interests in such entity. Establishing such rules would result in a paperwork burden for a SB SEF, SBS exchange, or SBS exchange facility, as applicable. In addition, if a SB SEF, SBS exchange, or SBS exchange facility were to request to receive ownership and voting information from participants or members pursuant to Rule 702(c) that would be a collection of information.

Proposed Rule 702(e) under Regulation MC would require SB SEFs and SBS exchanges to establish a ROC that is composed solely of independent directors,[188] to oversee the SB SEF's and SBS exchange's obligations under Section 763(c) of the Dodd-Frank Act and Section 6 of

[188] Proposed Rule 702(e) under Regulation MC does not explicitly include SBS exchange facilities because the exchange whose facility posts or makes available for trading a security-based swap must itself establish the requisite ROC. See supra note 173.

the Exchange Act, respectively.[189] The proposed rule would require that any recommendation of the ROC that is not adopted or implemented by the SB SEF's or SBS exchange's Board be reported promptly to the Commission.

B. Proposed Use of Information

1. Security-Based Swap Clearing Agencies

The purpose of the collection of information in proposed Rule 701(a) or (b) under Regulation MC is to enable a security-based swap clearing agency to monitor voting interests with respect to the security-based swap clearing agency, and enable the security-based swap clearing agency to take necessary action if the voting interests by a participant or group of participants in the security-based swap clearing agency exceed those allowed under proposed Rule 701(a) or (b).

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

The purpose of the collection of information in proposed Rule 702(c) under Regulation MC is to enable a SB SEF, SBS exchange, or SBS exchange facility to monitor voting interests with respect to such entity, and enable the SB SEF, SBS exchange, or SBS exchange facility, as applicable, to take necessary action if the ownership or voting rights by a participant or member or group of participants or members, as applicable, exceed those allowed under proposed Rule 702(b).

The purpose of the collection of information in proposed Rule 702(e) under Regulation MC is to provide the Commission with information regarding the instances in which the SB SEF

189 See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c). Specifically, the ROC would oversee the SBS exchange's and SB SEF's regulatory program on behalf of the Board and the Board would be required to delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to fulfill its mandate.

or SBS exchange does not adopt or implement a recommendation of the ROC, which would help the Commission in its oversight of SB SEFs and SBS exchanges. The information collection also should promote sound regulatory policies and foster the effectiveness of the ROC by putting the SB SEF or SBS exchange on notice that the Commission must be apprised promptly of any recommendation that is made by the ROC that is not adopted or implemented.

C. Respondents

1. Security-Based Swap Clearing Agencies

The collection of information associated with the proposed Rule 701(a) and (b) under Regulation MC would apply to security-based swap clearing agencies. Currently, four clearing agencies are authorized to clear credit default swaps, including security-based swaps,[190] pursuant to temporary conditional exemptions under Section 36 of the Exchange Act.[191] The obligation to centrally clear security-based swap transactions is a new requirement under Title VII of the Dodd-Frank Act. Based on the fact that there are currently four clearing agencies authorized to clear security-based swaps and that there could conceivably be one or two more in the future,[192] the Commission preliminarily estimates that four to six clearing agencies may seek to clear security-based swaps and be subject to the information collection requirements in proposed Rule 701(a) or (b). The Commission is using the higher estimate of six for the PRA analysis.

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

The collection of information associated with the proposed Rule 702(c) under Regulation

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190 Of the four clearing agencies granted temporary exemptions from registration, only three have cleared products that are classified as security-based swaps under Title VII of the Dodd-Frank Act.

191 15 U.S.C. 78mm.

192 The Commission does not expect there to be a large number of clearing agencies that clear security-based swaps, based on the significant level of capital and other financial resources necessary for the formation of a clearing agency.

MC would apply to SB SEFs, SBS exchanges, and SBS exchange facilities. In the Dodd-Frank Act, Congress defined for the first time a SB SEF and mandated the registration of these new facilities.[193] Based on conversations with the CFTC and industry sources, the Commission preliminarily believes that approximately 10-20 entities could seek to become SB SEFs and thus be subject to the collection of information requirement of proposed Rule 702(c). The Commission is using the higher estimate of 20 SB SEFs for this PRA analysis. In addition, there are currently 15 national securities exchanges that could be subject to the collection of information requirement of Rule 702(c).[194] To provide an estimate that is not under-inclusive, the Commission preliminarily estimates that all 15 of the currently registered national securities exchanges could become SBS exchanges or could create a separate legal entity that would be a facility of the exchange to trade security-based swaps.

The collection of information associated with the proposed Rule 702(e) under Regulation MC would apply to SB SEFs and SBS exchanges. Based on the estimates noted above, to provide an estimate that is not under-inclusive, the Commission preliminarily believes that 20 SB SEFs and 15 SBS exchanges or SBS exchange facilities would be subject to the collection of information requirement of Rule 702(e).

D. Total Annual Reporting and Recordkeeping Burdens

1. Security-Based Swap Clearing Agencies

193 See Sections 763(a) and 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(a) and (c).

194 The 15 national securities exchanges are: BATS Exchange, Inc.; BATS Y-Exchange, Inc.; Chicago Board Options Exchange, Incorporated; Chicago Stock Exchange, Inc.; C2 Options Exchange, Incorporated, EDGA Exchange, Inc., EDGX Exchange, Inc., International Securities Exchange, LLC; The NASDAQ Stock Market LLC; NASDAQ OMX BX, Inc.; NASDAQ OMX PHLX, Inc.; National Stock Exchange Inc.; New York Stock Exchange LLC; NYSE Amex LLC; and NYSE Arca, Inc.

Proposed Rule 701(a) would require security-based swap clearing agencies to have rules that would: (1) provide for an effective mechanism to divest any participant of any interest owned in excess of the proposed 20% ownership limit; (2) not give effect to the portion of any voting interest held by one participant in excess of the proposed 20% voting limit; (3) not give effect to the portion of any voting interest among all security-based swap clearing agency participants owned in the aggregate in excess of the proposed 40% ownership limit; and (4) provide an effective mechanism for the security-based swap clearing agency to obtain information relating to the voting interests in such entity. Proposed Rule 701(b) would require security-based swap clearing agencies to have rules that would: (1) provide for an effective mechanism to divest any participant of any interest owned in excess of the proposed 5% ownership limit; (2) not give effect to the portion of any voting interest held by one participant in excess of the proposed 5% voting limit; and (3) provide an effective mechanism for the security-based swap clearing agency to obtain information relating to the voting interests in such entity. Each security-based swap clearing agency must comply with one of the alternatives.

Establishing such rules would result in a paperwork burden for a security-based swap clearing agency. The Commission preliminary believes that there would be a one-time paperwork burden of 15 hours per entity associated with the drafting and implementation of any such rules by the security-based swap clearing agency for a total of 90 hours (15 hours X 6 respondents).

Any collection of information by a security-based swap clearing agency from a participant that has a voting interest in the security-based swap clearing agency would differ depending upon the number of shareholders or other owners of voting interests that are participants in the security-based swap clearing agency. Accordingly, the number of responses per year that would be generated by proposed Rule 701(a) or (b) under Regulation MC would vary by security-based swap clearing agency. At this point, however, currently only the largest fourteen dealer firms are participants that clear security-based swaps at such clearing agencies. The Commission believes that it would be reasonable for security-based swap clearing agencies to collect information related to the voting interests held by participants on a quarterly basis. This would provide the security-based swap clearing agency with sufficiently current information regarding participants' voting interests in the security-based swap clearing agency and allows the security-based swap clearing agency to review the information at a single point in time. Accordingly, the Commission preliminarily estimates that each security-based swap clearing agency would request information approximately 4 times per year from approximately 14 participants.

The Commission also estimates that the preparation and sending of each of the 4 requests for information would require approximately 4 hours and reviewing the responses to each of the 4 requests for information would require 10 hours. This would result in a total annual reporting and recordkeeping burden of 56 hours ((4 requests X 4 hours) + (4 requests X 10 hours)) for each security-based swap clearing agency, and a total annual burden for all security-based swap clearing agencies of 336 hours (56 hours X 6 clearing agencies). The Commission preliminarily estimates that each participant would require 1 hour to prepare and send the security-based swap clearing agency its response to the request, for a total annual reporting and recordkeeping burden for each participant of each security-based swap clearing agency of 4 hours (4 requests X 1 hour) and a total annual burden for all participants in all 6 security-based swap clearing agencies of 336 hours (14 participants X 4 hours X 6 security-based swap clearing agencies) thereby resulting in a total estimated annual burden for all security-based swap clearing agencies and participants of 672 hours (336 hours for all participants + 336 hours for all security-based swap clearing agencies). The Commission requests comment on these estimates.

The Commission estimates that the total paperwork burden resulting from the proposals relating to security-based swap clearing agencies is 762 hours for an initial paperwork burden and 672 hours thereafter.[195]

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

Proposed Rule 702(c) would require SB SEFs, SBS exchanges, and SBS exchange facilities to have rules that would provide for an effective mechanism to divest any participant or member, as applicable, of any interest owned in excess of the proposed 20% ownership limit; that would not give effect to the portion of any voting interest held by one or more participants or members, as applicable, in excess of the proposed 20% voting limit; and that would provide an effective mechanism for the SB SEF, SBS exchange, or SBS exchange facility to obtain information relating to ownership and voting interests in such entity. Establishing such rules or policies and procedures, as applicable, would result in a paperwork burden for a SB SEF, SBS exchange, or SBS exchange facility, as applicable. The Commission preliminary believes that there would be a one-time paperwork burden of 15 hours per entity associated with the drafting and implementation of any such rules by the SB SEF, SBS exchange, or SBS exchange facility, as applicable, for a total of 525 hours (15 hours X 35 respondents).

195 The aggregate initial paperwork burden is calculated as follows: 90 hours (one time paperwork burden for security-based swap clearing agencies to establish rules to divest any ownership interest in excess of the limit and not to give effect to any portion of the voting interests in excess of the limit) + 336 hours (annual burden for security-based swap clearing agencies to prepare and send requests for voting information) + 336 hours (annual burden for participants of security-based swap clearing agencies to prepare and send responses to requests for voting information) = 762 hours. After the initial year, the paperwork burden is calculated as follows: 762 hours (total paperwork burden resulting from the proposals relating to security-based swap clearing agencies) – 90 hours (one-time paperwork burden for security-based swap clearing agencies) = 672 hours.

The number of responses per year that would be generated by requests by a SB SEF, SBS exchange, or SBS exchange facility, as applicable, for ownership or voting information from participants or members that are owners of securities entitled to vote or otherwise have a voting interest in the SB SEF, SBS exchange, or SBS exchange facility would depend upon the number of owners of voting securities that are participants or members. Assuming that all classes of securities entitled to vote are owned or otherwise controlled by participants or members, the minimum number per SB SEF, SBS exchange, or SBS exchange facility would be 5. Based on the Commission's understanding of the ownership structures and voting rights of existing entities that may register as SB SEFs, and its understanding of the ownership structures and voting rights of existing national securities exchanges, the Commission preliminarily estimates that each SB SEF, SBS exchange, or SBS exchange facility on average would request information from approximately 20 participants or members, as applicable. The Commission believes that it would be reasonable for a SB SEF, SBS exchange, or SBS exchange facility to collect information on ownership and voting rights on a quarterly basis. Accordingly, the Commission preliminarily estimates that each SB SEF, SBS exchange, or SBS exchange facility would request information approximately 4 times per year from approximately 20 participants or members.

The Commission estimates that the preparation and sending of each of the 4 requests for information would require approximately 4 hours, and reviewing the responses to each of the 4 requests for information would require 10 hours. This would result in a total annual reporting and recordkeeping burden of 56 hours ((4 requests X 4 hours) + (4 requests X 10 hours)) for each SB SEF, SBS exchange, or SBS exchange facility, as applicable, and a total annual burden for all SB SEFs, SBS exchanges, and SBS exchange facilities of 1,960 hours (56 hours X 35 respondents). The Commission preliminarily estimates that each participant or member would require 1 hour to prepare and send the response to the request, for a total annual reporting and recordkeeping burden for each participant or member of 4 hours (4 requests X 1 hour) and a total annual burden for all participants or members of 2,800 hours (700 participants or members X 4 hours). The Commission requests comment on these estimates.

The Commission preliminarily believes that the collection of information burden imposed by proposed Rule 702(e) under Regulation MC would be minimal. The Commission estimates that a representative of the Board of a SB SEF or SBS exchange would spend no more than one hour to complete the required notice to the Commission. This figure includes the time to prepare, review, and electronically submit such notice to the Commission. The Commission expects to establish an electronic mailbox for these notices and would identify the address if the Commission were to adopt this specific proposal. Although the Commission preliminarily believes that the Board of a SB SEF or SBS exchange often would adopt or implement the recommendations of its ROC, the Commission preliminarily believes that the Board of a SB SEF or SBS exchange could occasionally decide not to adopt such recommendations. Although the Commission expects that this would be an infrequent occurrence, the Commission preliminarily estimates that a Board could decide not to adopt a ROC recommendation up to 12 times per year. This estimate assumes that the Board of a SB SEF or SBS exchange would meet at least once per month and would decide each time that it meets not to adopt a ROC recommendation. Therefore, the Commission estimates that the total reporting burden under the proposed Rule 702(e) for all SB SEFs and SBS exchanges combined would be 420 hours.[196]

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196 (20 (estimated number of SB SEFs subject to the collection of information under the proposed Rule 702(e)) + 15 (estimated number of SBS exchanges subject to the collection of information under the proposed Rule 702(e))) x 12 (estimated number of

The Commission estimates that the total paperwork burden resulting from the proposals relating to SB SEFs, SBS exchanges or SBS exchange facilities is 5,705 for an initial paperwork burden and 5,180 thereafter.[197]

E. Retention Period of Recordkeeping Requirements

1. Security-Based Swap Clearing Agencies

Security-based swap clearing agencies will be required to be registered with the Commission following the effective date of Title VII of the Dodd-Frank Act.[198] Accordingly, once registered with the Commission, security-based swap clearing agencies would be required to retain any collection of information pursuant to proposed Rules 701(a) or (b) under Regulation MC as applicable, in accordance with, and for the periods specified in Rule 17a-1 under the Exchange Act.[199] Retention and recordkeeping requirements have not been established for security-based swap clearing agencies before the effective date of Title VII; however, security-

notices prepared annually by each SB SEFs pursuant to the proposed Rule 702(e)) x 1 hour (estimate of total time to complete, review, and prepare required notice) = 420 hours.

197 The aggregate initial paperwork burden is calculated as follows: 525 hours (one-time paperwork burden for SB SEFs, SBS exchanges and SBS exchange facilities to establish rules to divest any ownership interest in excess of, and to not give effect to any portion of voting interests in excess of, the proposed 20% limit) + 1,960 hours (annual burden for SB SEFs, SBS exchanges and SBS exchange facilities to prepare and send requests for ownership and voting information) + 2,800 hours (annual burden for participants to prepare and send responses to requests for ownership and voting information) + 420 hours (annual burden for SB SEFs and SBS exchanges to prepare and submit notices pursuant to proposed Rule 702(e)(2)) = 5,705 hours. After the initial year, the paperwork burden is calculated as follows: 5,705 hours (total paperwork burden resulting from the proposals relating to SB SEFs, SBS exchanges and SBS exchange facilities) – 525 hours (one-time paperwork burdens for SB SEFs, SBS exchanges and SBS exchange facilities) =5,180 hours.

198 New Exchange Act Section 17A(g) provides that it shall be unlawful for a clearing agency, unless registered with the Commission, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to a security-based swap. 15 U.S.C. 78q-1(g).

199 17 CFR 240.17a-1.

based swap clearing agencies may be required to retain records and information collected pursuant to proposed Rules 701(a) or (b) similar to the current recordkeeping requirements in Rule 17a-1.

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

Although recordkeeping and retention requirements have not yet been established for SB SEFs under new Exchange Act provisions added by the Dodd-Frank Act, the Commission is authorized to adopt such rules.[200] In addition, the recordkeeping and reporting core principle applicable to SB SEFs, as set forth in Section 763(c) of the Dodd-Frank Act, requires a SB SEF to maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of five years.[201] Therefore, for purposes of this PRA, the Commission assumes that a SB SEF would be required to retain any collection of information pursuant to proposed Rules 702(c) and 702(e) under Regulation MC, as applicable, for a period of not less than five years. Should the Commission propose rules to implement the recordkeeping and reporting core principle for SB SEFs, it would include any collection of information burden with respect to any proposed recordkeeping and retention rules for SB SEFs in such rulemaking.

All registered national securities exchanges must currently comply with the recordkeeping and reporting requirements in Rule 17a-1 under the Exchange Act.[202] Therefore, SBS exchanges would be required to retain any collection of information pursuant to proposed

200 As discussed above, Section 763(c) of the Dodd-Frank Act sets forth 14 core principles that SB SEFs must satisfy, including one relating to recordkeeping and reporting, and provides the Commission with rulemaking authority with respect to implementation of these core principles. See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c).

201 See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c).

202 17 CFR 240.17a-1.

Rules 702(c) and 702(e), as applicable, in accordance with, and for the periods specified in, Rule 17a-1 under the Exchange Act.

F. Collection of Information is Mandatory

1. Security-Based Swap Clearing Agencies

The collection of information under proposed alternative Rules 701(a) and (b) under Regulation MC would be mandatory. The collection of information under proposed Rules 701(a) and (b) would be required from participants in a security-based swap clearing agency upon request from the security-based swap clearing agency. The collection of information would allow the security-based swap clearing agency and the Commission to determine whether the requirements in proposed Rules 701(a) and (b) regarding limitations on voting interests are met.

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

The collection of information under proposed Rule 702(c) under Regulation MC would be mandatory. The collection of information would allow the SB SEF, SBS exchange, or SBS exchange facility as applicable, and the Commission to determine whether the requirements in proposed Rule 702(c) regarding limitations on ownership and voting rights are met and enable the SB SEF, SBS exchange, or SBS exchange facility, as applicable, to take necessary action if the ownership or voting rights by a participant or group of participants exceed those allowed under proposed Rule 702(b).

The collection of information under proposed Rule 702(e) under Regulation MC would be mandatory and permit the Commission to collect accurate information about the regulatory program of SB SEFs and SBS exchanges. Specifically, the collection of information would allow the Commission to stay informed about the recommendations of the ROC that are not followed by the SB SEF or SBS exchange and the SB SEF's or SBS exchange's reasons for not adopting such recommendations.

G. Responses to Collection of Information Will Not Be Kept Confidential

1. Security-Based Swap Clearing Agencies

Other than information for which a security-based swap clearing agency requests confidential treatment and which may be withheld from the public in accordance with the provisions of 5 U.S.C. 522, the collection of information pursuant to the proposed Rules 701(a) and (b) would not be confidential and would be publicly available.

2. SB SEFs, SBS Exchanges, and SBS Exchange Facilities

Other than information for which a SB SEF, SBS exchange or SBS exchange facility requests confidential treatment and which may be withheld from the public in accordance with the provisions of 5 U.S.C. 522, the collection of information pursuant to the proposed Rules 702(c) and (e) would not be confidential and would be publicly available.

H. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;

2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

3. Enhance the quality, utility, and clarity of the information to be collected; and

4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, OMB, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-27-10. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-27-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, Station Place, 100 F Street, NE, Washington, DC 20549-0213.

X. Cost-Benefit Analysis

Congress has required the Commission to implement rules under Section 765 of the Dodd-Frank Act to mitigate conflicts of interest in the security-based swaps market. The proposed rules under Regulation MC are designed to enhance, through mitigation of conflicts of interest, the benefits of having security-based swaps cleared through a security-based swap clearing agency and traded on a SB SEF or SBS exchange. The proposed rules, however, are also likely to impose costs on security-based swap clearing agencies, SB SEFs, and SBS exchanges. The Commission is sensitive to the costs and benefits that would result from the proposed rules and has identified certain costs and benefits of these proposals, as described below.

A. Background

The proposed governance and ownership and voting rules are intended to reduce conflicts of interest in security-based swap clearing agencies, SB SEFs, and SBS exchanges. Ownership and voting limitations and other governance rules are designed to limit the influence of any single market participant or a group of participants in the operation of security-based swap clearing agencies, SB SEFs, and SBS exchanges and thus reduce the risk that conflicts of interest would negatively affect the operation of these entities and the security-based swaps market.[203] However, since the OTC swaps marketplace regulated under Title VII likely would change significantly after the effective date of the Dodd-Frank Act and the Commission's rules promulgated thereunder, it is difficult to quantify the costs and benefits that the proposed rules may create. These issues are discussed more fully below.

B. Security-Based Swap Clearing Agencies

The Commission has granted exemptions from Section 17A of the Exchange Act to five entities to act as clearing agencies for security-based swaps.[204] The first cleared CDS transaction pursuant to the exemptive orders was cleared on March 9, 2009. Security-based swap clearing is, therefore, in an emergent stage and empirical evidence on how the security-based swaps market will develop following the effective date of the Dodd-Frank Act and rules thereunder is

203 The Commission pursuant to Section 36 of the Exchange Act may grant an exemption from any rule or any provision of any rule under Regulation MC. Any such exemption could be subject to conditions and could be revoked by the Commission at any time. See supra Section VI for a discussion of the Commission's exemptive authority under Section 36 of the Exchange Act.

204 See CDS Clearing Exemption Orders, supra note 17.

scarce. However, the number of security-based swap clearing agencies may converge in the long run to a very small number or even a single security-based swap clearing agency.[205] This is because of the potential for efficiency gains through convergence given that central clearing of securities is characterized by large fixed costs and benefits to participants associated with consolidating portfolios. Alternatively, competitive forces may result in use of a larger number of security-based swap clearing agencies, particularly if the security-based swap clearing agencies specialize in clearing particular types of security-based swaps or if they clear security-based swaps only in certain jurisdictions.[206]

1. <u>Costs and Benefits Related to Ownership Restrictions in Security-Based Swap Clearing Agencies</u>

Restrictions on the voting interests held by clearing participants may affect the number of potential clearing participants and may also affect the level of their participation in clearing security-based swaps. The 20% individual voting limitation on security-based swap clearing agencies and the 40% aggregate voting limitation on security-based swap clearing agencies, under the proposed Voting Interest Focus Alternative, and the 5% individual voting limitation under the Governance Focus Alternative, are intended to keep participants from exercising undue influence over the security-based swap clearing agency and to lessen the likelihood of anti-competitive behavior. One particular concern is that without a limitation on voting interests,

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[205] <u>See</u>, <u>e.g.</u>, Darrell Duffie and Haoxiang Zhu, "Does a Central Clearing Counterparty Reduce Counterparty Risk?" Stanford University Working Paper, March 2010; Craig Pirrong, 2009, "The Economics of Clearing in Derivatives Markets: Netting, Asymmetric Information, and the Sharing of Default Risks Through a Central Counterparty," Working paper, University of Houston.

[206] The central clearing of security-based swaps is still developing and the Commission has not made any determinations about the number of security-based swap clearing agencies that may be used by market participants. However, it is important that emerging security-based swap clearing agencies have the opportunity to compete with existing security-based swap clearing agencies.

large dealers may control a security-based swap clearing agency and set standards – such as a heightened capital threshold for participation or a requirement that participants have execution capabilities– to limit participation by non-owner dealers or brokers and increase or protect their market share and potentially influence market prices. Hence, a potential benefit of voting limitations may be the preservation of non-owner dealers' access to central clearing and promotion of competition that results in lower costs to market participants. The proposed limitations in both the Voting Interest Focus Alternative and the Governance Focus Alternative are designed to achieve this result.

Another potential benefit of the imposition of a limitation on voting interests is the chance that a broader group of participants would have the ability to reduce their risk exposure as greater levels of central clearing is encouraged if the risks at the clearing agency are managed appropriately. Clearing agencies decrease systemic risk by mutualizing losses[207] and netting otherwise bilateral obligations. There may, however, at times be a trade-off between a clearing agency's risk management and its participation standards. It likely would be beneficial if the voting restrictions proposed by Rules 701(a) and (b) under Regulation MC in each of the Voting Interest Focus Alternative and the Governance Focus Alternative lead to increased market participation. Conversely though, to the extent that such market participation goes beyond prudent levels, it may create more systemic risk at the security-based swap clearing agency. For example, lessening capital requirements to increase participation beyond a prudent level may increase the overall risk of clearing operations, while increasing capital requirements for clearing

207 See, e.g., Ice Trust Overview, p. 7 (available at https://www.theice.com/publicdocs/clear_us/ICE_Trust_Overview.pdf).

members without an adequate basis may needlessly exclude some smaller dealers or other firms from participation and thereby create market inefficiencies.[208]

Non-participant shareholders may also have an incentive to permit more clearing agency participation than clearing agency participant shareholders would. Non-participant shareholders benefit from increased membership to the extent that additional revenues are generated and therefore have an incentive to promote increased use of central clearing both in terms of number of participants and the scope of products cleared. This could potentially reduce systemic risk by making more OTC products eligible for central clearing. In addition, non-shareholder participants have an incentive to promote appropriate risk management because a financial loss to the clearing agency would devalue their investment. For example, security-based swap clearing agencies may put their own capital or surplus funds at risk in the event of a default. In addition, clearing agencies face reputational risk associated with a member default that would likely negatively affect the value of shareholders' shares. This aligns the interests of shareholders with appropriate risk management of a clearing agency. However, non-participant shareholders may not face the same potential of downside risk as clearing agency participants. For example, non-participant shareholders do not bear certain costs associated with increased risk since the clearing agency losses are shared by the clearing agency participants. To the extent that non-participant shareholders use their control to maximize revenues of the clearing agency without full consideration of the total clearing agency risks, the potential cost is that suboptimal clearing agency participation standards will be developed. All directors have a fiduciary duty to the security-based swap clearing agency and its shareholders, however, they also have a duty to oversee the security-based swap clearing agency's compliance with the

208 See supra Section II.A.2.a.

requirements in the Exchange Act and the rules and regulations thereunder. In certain circumstances, independent directors could give greater emphasis to profit-maximizing initiatives and fail to give sufficient consideration to the related risk management issues.

Another potential cost of ownership and voting limitations, notwithstanding the fact that the market structure may converge in the long-run to a single security-based swap clearing agency, is the potential effect on competition among alternative security-based swap clearing agency venues. Under the Voting Interest Focus Alternative, a 20% individual participant voting limit and a 40% aggregate participant voting limit restricts the ability of any single dealer or small group of dealers to own a security-based swap clearing agency, but it may also reduce the potential number of investors that would be willing to devote resources to form a security-based swap clearing agency. This potentially diminishes the likelihood for a long-term market structure with multiple clearing agencies. Conversely, the Governance Focus Alternative would not impose an aggregate cap and would allow the voting interests in a security-based swap clearing agency to be owned entirely by participants. This would facilitate the formation of security-based swap clearing agencies by potential users and promote greater competition among security-based swap clearing agencies.

In addition, if a participant is subject to restrictions regarding the amount of voting interest it may own in a security-based swap clearing agency, then it may forgo a potential investment opportunity, unless it is willing to invest in non-voting shares of the security-based swap clearing agency. The effect of these restrictions is different with respect to individual participants under the Governance Focus Alternative, which limits any one participant's voting interest in a security-based swap clearing agency to 5%, than it is under the Voting Interest Focus Alternative, which limits any one participant's voting interests to 20% and has an aggregate voting interest limit of 40%. In the case of an ownership position in excess of regulator's restrictions, the owner would have to divest a portion of its voting shares in order to meet the regulatory requirement. The potential foregone benefits include profits generated from clearing activities that are distributed to owners as well as any private ownership benefits from directing the clearing operations, which include activities discussed above with respect to conflicts of interest. While it is difficult to assess the value of these investment opportunities, the 2010 six-month data from consolidated reports of condition and income from the Federal Financial Institutions Examinations Council of the largest security-based swap clearing agency provides a snapshot of the magnitude of current profits being generated.[209]

Moreover, as previously discussed in the PRA section, proposed Rules 701(a) and (b) under Regulation MC would require a security-based swap clearing agency to have an effective mechanism to obtain information relating to voting interests in the security-based swap clearing agency by any participant in the security-based swap clearing agency. It was estimated that these obligations would result in a total annual burden for all security-based swap clearing agencies of 336 hours plus a total annual reporting and recordkeeping burden for all participants of 336 hours. It was also estimated that there would be a 90 hour one-time paperwork burden for security-based swap clearing agencies to establish rules to divest any ownership interest in excess of the limit and not to give effect to any portion of the voting interests in excess of the limit. Assuming an hourly cost of $291 for a compliance attorney[210] to meet these requirements,

209 ICE Trust's profits for the first six months of 2010 were $1,325,000, which would represent an annual profit of $2,650,000. FFIEC Central Data Repository's Public Data Distribution, https://cdr.ffiec.gov/public/Default.aspx.

210 The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

this would result in an overall estimated initial annual cost of $221,742 and an annual cost thereafter of $195,552 for participants and security-based swap clearing agencies collectively.[211]

Under the Voting Interest Focus Alternative, proposed Rule 701(a) in Regulation MC would require the security-based swap clearing agency to have rules requiring a participant to divest voting interest greater than the 20% threshold and rules reasonably designed not to give effect to a voting interest of a participant greater than the 20% threshold or voting interests of participants considered in the aggregate with any other participants greater than the 40% threshold. This proposed rule would impose a cost on the security-based swap clearing agency to initiate the divestiture or not give effect to the voting rights that surpass the stated threshold. Particularly in the case of the aggregate participant voting limitation, the security-based swap clearing agency would have to develop standards regarding how to allocate the voting interest for which it will give effect if the aggregate voting interest is above the 40 percent threshold.

Similarly, under the Governance Focus Alternative, proposed Rule 701(b) in Regulation MC would impose a cost on the security-based swap clearing agency to require the divestiture or not give effect to the voting rights that surpass the stated threshold of 5 percent. However, because there is not a proposed limit on participants' aggregate voting interests under the Governance Focus Alternative, the security-based swap clearing agency would not have to adopt rules for allocating voting interests in the case of a divestiture.

2. <u>Costs and Benefits Related to Independence Requirements for Security-Based Swap Clearing Agencies</u>

211 Overall initial annual cost for participants and clearing agencies information requirements = (336 hours + 336 hours + 90 hours) X $291 = $221,742. Overall subsequent annual cost for participants and clearing agencies information requirements = (336 hours +336 hours) X $291 = $195,552.

Potential conflicts of interest also exist between participants of a security-based swap clearing agency and the public interest. Even when the influence of any single dealer is limited through voting restrictions, economic incentives could align several dealer participants in a way that may be costly to investors. For instance, in order for a product to be required to trade through an SB SEF or SBS exchange, it must be deemed eligible for clearing at a clearing agency. A dealer-controlled security-based swap clearing agency may have an incentive to limit the products deemed eligible for clearing because then such a product would remain viable in the OTC markets, in which the dealers have a significant financial stake.[212] Products that are eligible for clearing that are not cleared do not have the price transparency or investor accessibility that they would otherwise have, increasing market participant costs paid by investors. As a result, there are potential incentives for security-based swap clearing agency participants to coordinate in ways that voting restrictions cannot address. Representation by independent directors would provide views and influence that by design are not subject to these conflicts.

Proposed Rule 701(b)(3) in Regulation MC of the Governance Focus Alternative would require that a majority of directors must be independent. As a result, participants could not directly control the Board regardless of their voting interests. To further the goal of majority independence on the Board, proposed Rule 701(b)(4) under Regulation MC in the Governance Focus Alternative would require a security-based swap clearing agency to establish a nominating committee composed solely of independent directors. Since many of the Board decisions come from committees and conflicts may be prevalent or even more pronounced in these situations, proposed Rule 701(b)(5) under Regulation MC in the Governance Focus Alternative would

212 See, generally, Darrell Duffie, "How Should We Regulate Derivatives Markets?" Pew Financial Reform Project, Briefing Paper #5, 2009.

require that if any committee, including but not limited to a risk committee, has authority to act on behalf of the Board, that committee must also be composed of a majority of independent directors. This would help prevent important decisions from escaping the view of a majority of independent directors. To the extent that independent directors reduce the likelihood that one group of participants coordinate decision-making in such a way that is detrimental to the security-based swap clearing agency as a whole, it would serve to benefit the security-based swap clearing agency and the market generally.

The Voting Interest Focus Alternative would require 35%, rather than a majority, of the Board be composed of independent directors. While director independence is widely believed to be a catalyst for improved governance, there is no conclusive empirical evidence to support the view that a majority of independent directors benefits shareholder profits.[213] It also is often argued that the presence of inside affiliated board members is important in facilitating the flow of material information to independent directors so that they may come to informed decisions.[214] This may be especially important for a security-based swap clearing agency because it provides highly specialized and technical services. The imposition of a Board structure that precludes the likely owners of a security-based swap clearing agency – dealers – from gaining a majority may have a negative effect on the operations of the security-based swap clearing agency if independent directors do not have commensurate qualifications or skills as participant directors. There could be significant costs associated with educating independent directors about the clearance and settlement process and the complex risk management issues that must be

213 However, the Commission recognizes that the industry widely accepts a majority of independent directors as "best practices." See supra note 122.

214 See M. Harris and A. Raviv, 2007, "A Theory of Board Control and Size," The Journal of Finance; R. Adams and D. Fererria, 2008, "A Theory of Friendly Boards," The Journal of Finance, vol. 62(1) pp. 217-250.

considered by the Board. This could slow the Board or committee processes, at least initially. Clearing and settlement is a highly specialized area and it may be difficult to find independent directors with relevant experience. As a result, independent directors may defer to industry directors or to the officials of the clearing agency, who have more knowledge and experience, thereby undermining the benefits of requiring independence.

In the context of wholly independent committees, such as a nominating committee, the independent directors may become reliant on executive directors and other employees of the security-based swap clearing agency to inform their decision-making due to their lack of expertise in clearing and settlement. If management fails to keep the directors on wholly independent committees fully informed, the independent directors on such committees fail to seek sufficient information from management to make informed decisions, or management fails to give independent directors adequate resources to make effective decisions, there could be costs to the security-based swap clearing agency. On the other hand, if management fully apprises the directors on wholly independent committees of necessary information and the independent directors have sufficient resources and are fully engaged with respect to their duties, there would be benefits to the security-based swap clearing agency.

In addition, the effectiveness of the Board can depend on the personalities and personal traits, as well as the qualifications, of the persons serving on the Board. Independent directors that take the time to understand the operations and programs of a security-based swap clearing agency and to ask probing questions of management are more likely to be effective independent directors. However, independent directors would unlikely be able to acquire the specific risk management expertise related to clearance and settlement if they do not have relevant experience prior to serving on the Board. In addition, because independent directors would not be employed by or participants in the security-based swap clearing agency, they may often need to rely on management or other directors to keep fully informed. There could be costs to the security-based swap clearing agency if one or more independent directors is ineffectual because he or she did not fully understand the operations or risk management procedures of the security-based swap clearing agency. Thus, imperfect decisions by independent directors could result in costs to the security-based swap clearing agency. This may potentially be more likely where the majority of the Board is required to be independent. On the other hand, independent directors who have relevant expertise, are engaged in carrying out their director duties, and who grasp the issues confronting the security-based swap clearing agency could be very beneficial to the security-based swap clearing agency because they could bring an outside perspective and fresh insights and ideas to the security-based swap clearing agency.

The proposed governance requirements under both the Voting Interest Focus Alternative and the Governance Focus Alternative could impose other costs on security-based swap clearing agencies. An entity that plans to register as a security-based swap clearing agency may need to revise the composition of its Board if the Board currently is not composed of 35% or a majority of independent directors. Moreover, security-based swap clearing agencies may have to restructure their nominating committees as well as other committees that are authorized to act for the Board. In this regard, security-based swap clearing agencies could face difficulties locating qualified individuals to serve as independent directors, particularly because security-based swaps trading is complex and the pool of qualified candidates may be limited. There also may be costs in educating independent directors to become familiar with the manner in which these security-based swaps are traded and the new regulatory structure governing security-based swaps, which could slow Board processes at least initially. These costs would be greater under the Governance

Focus Alternative, which requires a higher percentage of independent directors on the Board and on the committees.

The proposed governance requirements could impose other costs on security-based swap clearing agencies. A security-based swap clearing agency may incur costs as a result of the requirement to include 35% or a majority of independent directors on its Board and a similar or heightened requirement with respect to committees authorized to act on behalf of the Board. Any such costs are likely to be incurred in connection with conducting a search for independent directors with the necessary qualifications and expertise to serve on the Board of a security-based swap clearing agency. The actual cost for each security-based swap clearing agency may vary based on the current governance arrangements and practices of the security-based swap clearing agencies. In addition, if a security-based swap clearing agency is required to conduct a search for independent directors, the costs incurred by the security-based swap clearing agency may vary based on whether it has the resources to conduct its own search or has to retain an outside consultant. The Commission preliminarily estimates that those security-based swap clearing agencies that must rely on a recruitment specialist to secure an independent director could incur a cost of approximately $68,000 per director.[215]

C. SB SEFs and SBS Exchanges

Currently, there are no trading venues that are registered with the Commission as SB SEFs, and no national securities exchanges that currently post or make available for trading security-based swaps. Based on the Dodd-Frank Act's definition, a SB SEF could include a

215 The Commission is basing this estimate on a recent study noting that the retainer fee for outside directors is on average $67,624. See http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/2010/2010_Outside_Director_Compensation.pdf. The Commission believes that this amount could serve as a proxy for the amount of any fee to be charged by a recruitment firm that would conduct a national search for an independent director.

trading platform with participating dealers.[216] SB SEFs are conceptually similar to alternative trading systems and national securities exchanges in the equity and options markets and designated contract markets in the futures markets in that they will provide a centralized trading facility for the trading of security-based swaps. To the extent that SB SEFs would organize and form in a similar manner to these structures, the Commission preliminarily anticipates that SB SEFs and SBS exchanges would be significantly more competitive than security-based swap clearing agencies. In particular, barriers to entry in terms of capital are likely to be lower, and many existing dealers, national securities exchanges and other entities of various sizes currently have electronic trading capabilities that could allow them to enter this market readily.

1. Costs and Benefits Related to Ownership Requirements of SB SEFs and SBS Exchanges

The 20% ownership and voting limits contained in proposed Rule 702(b) under Regulation MC would prohibit any SB SEF participant or SBS exchange member or small group thereof from owning or otherwise controlling any class of voting securities or other interests of a SB SEF, SBS exchange or SBS exchange facility, as applicable. The intent of this requirement, as with security-based swap clearing agencies, is to limit the influence of any single dealer or a small group of dealers in a single SB SEF, SBS exchange or SBS exchange facility and thus reduce the likelihood that smaller non-owner dealers would be unfavorably treated and the ability of dealer-owners to influence market prices of security-based swaps. It is hard to predict, however, what entities will be SB SEFs or SBS exchanges or whether there will be any market power from owning or controlling a SB SEF or SBS exchange as discussed above. If the

216 Section 763(c) of the Dodd-Frank Act sets forth 14 core principles that SB SEFs must satisfy and provides the Commission with rulemaking authority with respect to implementation of these core principles. The Commission expects to address the issue of what is a SB SEF in a separate rulemaking under Section 763(c) of the Dodd-Frank Act. See Section 763(c) of the Dodd-Frank Act, Pub. L. No. 111-203, Section 763(c).

concern, as with central clearing, is that a single SB SEF or SBS exchange emerges as the dominant trading platform, then ownership and voting restrictions may be an important consideration. For example, the NYSE was the dominant exchange for trading equity securities for a long period, and even today U.S. futures markets are characterized by a dominant exchange connected to a single clearing agency.

However, evidence from the current cash equity and options markets shows that several trading platforms with different business models and clienteles often emerge.[217] Hence, SB SEFs, SBS exchanges, and SBS exchange facilities that are controlled by a single dealer may not necessarily result in unfair trading practices if market participants have alternative comparable venues to execute the same security-based swaps and those venues are able to compete effectively with single dealer platforms. Allowing SB SEFs, SBS exchanges and SBS exchange facilities that are controlled by a single dealer may in fact increase the level of competition, which would benefit investors. A 20% restriction on ownership of voting securities could require a dealer to partner with either other dealers or a non-dealer majority owner, or to hold a non-voting ownership interest, which could reduce incentives to start up a new venue, potentially limiting innovative alternatives to security-based swap execution and security-based swap products.[218]

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217 For example, there are currently 15 registered national securities exchanges with varying platforms and business models that compete for clients and order flow in the equities and/or options markets.

218 As noted above, Section 763(c) of the Dodd-Frank Act sets forth 14 core principles that SB SEFs must satisfy, including one relating to conflicts of interest, and provides the Commission with rulemaking authority with respect to implementation of these core principles. The Commission may determine that it is appropriate to propose additional rules to mitigate conflicts of interest with respect to SB SEFs, including incorporating ownership and/or voting limits and other requirements with respect to ownership of a SB SEF by persons other than SB SEF participants. The Commission also may consider proposals such as providing for the fair representation of SB SEF participants in the

The Commission anticipates that the proposed ownership and voting limitations may impose costs on SB SEFs, SBS exchanges and SBS exchange facilities. Entities planning to register as SB SEFs and SBS exchanges would have to ensure that they are in compliance with the proposed ownership and voting limitations and thus would need to spend time and incur costs to design or modify their ownership structure and internal processes, as well as take the necessary steps to draft or amend their governing documents and rules to comply with such ownership and voting limitations. Designing or modifying internal processes and drafting or revising governing documents and rules would impose costs on SB SEFs, SBS exchanges and SBS exchange facilities. The Commission estimates that it would take a compliance attorney approximately 15 hours to revise the relevant governing documents and to file them with the appropriate authorities. Assuming an hourly cost of $291 for a compliance attorney,[219] these requirements would result in an overall annual cost per SB SEF, SBS exchange or SBS exchange facility of $4,365, or $152,775 in the aggregate for all SB SEFs, SBS exchanges, and SBS exchange facilities.[220]

As previously discussed in the PRA section, proposed Rule 702(c) would require SB SEFs, SBS exchanges, or SBS exchange facilities, as applicable, to have an effective mechanism to obtain information relating to ownership and voting interest in the SB SEF, SBS exchange, or SBS exchange facility, by any participant or member of the SB SEF, SBS exchange or SBS

selection of the SB SEF's directors and the administration of its affairs as part of its broader rulemaking relating to SB SEFs.

219 See supra note 210.

220 Overall annual cost per SB SEF, SBS exchange, or SBS exchange facility = 15 hours X $291 = $4,365; aggregate annual cost for all SB SEFs, SBS exchanges, and SBS exchange facilities = $$4,365 X 35 = $152,775.

exchange facility.[221] It was estimated that these obligations would result in a total annual burden for all SB SEFs, SBS exchanges, and SBS exchange facilities of 1,960 hours. It was also estimated that there would be a total annual reporting and recordkeeping burden for all participants or members of 2,800 hours. Assuming an hourly cost of $291 for a compliance attorney[222] to meet these requirements, this would result in an overall annual cost of $1,385,160 for participants or members and SB SEFs, SBS exchanges, and SBS exchange facilities collectively.[223] To the extent that certain participants or members may be required to file ownership or voting information with a domestic or international government authority pursuant to securities laws, and such information is made available to the SB SEF, SBS exchange, or SBS exchange facility, this cost would be reduced.

Proposed Rule 702(c) under Regulation MC also would require a SB SEF, SBS exchange or SBS exchange facility to have rules to divest a participant or member of an ownership interest that violates the proposed ownership limits, and to not give effect to a voting interest of a participant or member that violates the proposed voting limits. As previously discussed in the PRA section, this requirement is estimated to result in an initial paperwork burden for all SB SEFs, SBS exchanges, or SBS exchange facilities of 525 hours. Assuming an hourly cost of $291 for a compliance attorney[224] to meet these requirements, this would result in an initial cost of $152,775 for all SB SEFs, SBS exchanges, and SBS exchange facilities.[225]

221 See supra Section IX.

222 See supra note 210.

223 Overall annual cost for participants or members and SB SEFs, SBS exchanges and SBS exchange facilities = (1960 hours +2800 hours) X $291 = $1,385,160.

224 See supra note 210.

225 This initial cost is estimated as follows: 15 hours X 35 respondents X $291 per hour = $152,775.

This proposed rule also would impose costs on SB SEFs, SBS exchanges, or SBS exchange facilities to initiate the divestiture or not give effect to the voting rights that surpass the stated threshold. For example, a SB SEF, SBS exchange, or SBS exchange facility could incur costs involved with redeeming shares held in excess of the proposed limits if such entity chooses to provide in its rules that any such excess shares would be purchased by the entity. A SB SEF, SBS exchange, or SBS exchange facility also could adopt rules to limit voting by any participant or member that owns more than 20% of outstanding interests. Thus, a SB SEF, SBS exchange, or SBS exchange facility also could incur costs associated with monitoring votes cast at any shareholder meeting to determine that no SB SEF participant or SBS exchange member and its related persons subject to the voting limits exceeds those limits.

The Commission recognizes that entities that are currently in existence and plan to become SB SEFs, SBS exchanges or SBS exchange facilities could incur costs if they do not meet the proposed ownership and voting limitations. For example, if a single or small group of market participants that would be direct participant(s) in a SB SEF plans to register a platform as a SB SEF, it or they potentially would need to secure additional owners to meet the 20% limitation on ownership of voting securities of a SB SEF. This could impose costs on an entity that has a single owner-participant or a small number of owner-participants and that plans to register a platform as a SB SEF, from the costs of finding other owners or the sharing of potential profits with a larger group of owners. As noted above, currently there are no trading venues that are registered with the Commission as SB SEFs. Based on initial discussions with market participants that have indicated an interest in registering as a SB SEF, the Commission preliminarily believes that few entities that may register as a SB SEF currently have ownership structures that would conflict with the proposed ownership and voting limitations for SB SEFs.

In addition, as discussed above, national securities exchanges that may potentially register as SBS exchanges or create a facility that will be a SBS exchange facility should already be in compliance with the proposed ownership and voting limitations. Based on these factors, the Commission preliminarily believes that the aggregate costs imposed by the ownership and voting limitations on entities initially seeking to register as SB SEFs, SBS exchanges or SBS exchange facilities would not be significant.

2. Costs and Benefits Related to Independence Requirements in SB SEFs and SBS Exchanges

Proposed Rule 702(d) under Regulation MC would require the Boards of SB SEFs and SBS exchanges or SBS exchange facilities to be composed of at least a majority of independent directors to mitigate conflicts of interest and help ensure that the entity does not advance the interests of its owners, some of which may be dealer-participants or their affiliates. By mandating a structure that would require a majority of Board members to be independent, the governance of SB SEFs, SBS exchanges and SBS exchange facilities should be less susceptible to promoting the self-interests of such participants. The majority independent directors should help foster a greater degree of independent decision-making consistent with the objectives of the Dodd-Frank Act and the Exchange Act. Further, a Board whose independent directors constitute at least a majority of the Board should help ensure that the views of independent directors are taken into account and should help strengthen the hand of independent directors when dealing with management. In the Commission's preliminary view, requiring the Boards of SB SEFs, SBS exchanges and SBS exchange facilities to have a majority of independent directors should help reduce the possibility of damaging conflicts of interest that otherwise might arise when persons who do not meet the definition of independent director at the SB SEF, SBS exchange or SBS exchange facility are involved in key decisions, such as which products will be made available for trading and the access levels of potential market participants. To the extent that independent directors would reduce the likelihood that one group of participants could coordinate decision-making in such a way that would be detrimental to the SB SEF, SBS exchange or SBS exchange facility as a whole, this would be a benefit.

In addition, proposed Rule 702(f) under Regulation MC would require that the nominating committee of a SB SEF, SBS exchange or SBS exchange facility be composed solely of independent directors. This proposed requirement should foster a process for nominating independent directors that would help to assure that such directors are independent and not likely to be unduly influenced by an owner of the SB SEF, SBS exchange or SBS exchange facility who is possibly a SB SEF participant-dealer or SBS exchange member or affiliate thereof. In addition, the requirement in proposed Rule 702(g) under Regulation MC that any committee that would have the authority to act on behalf of the Board be composed of a majority of independent directors is designed to prevent important decisions from escaping the view of a majority of independent directors. Many Board decisions come from committees and conflicts may be similarly prevalent or even more pronounced in these situations.

Proposed Rule 702(e) under Regulation MC also would require the Board of any SB SEF and SBS exchange to establish a ROC consisting solely of independent directors to oversee the entity's regulatory obligations.[226] The Commission preliminarily believes that this requirement should be effective in managing the conflicts of interest inherent in the Board's oversight of whether a SB SEF or SBS exchange satisfies its regulatory obligations. The proposed provision relating to the establishment of an independent ROC should help promote greater accountability

226 Proposed Rule 702(e) under Regulation MC does not explicitly include SBS exchange facilities because the exchange whose facility posts or makes available for trading a security-based swap must itself establish the requisite ROC. See supra note 173.

on the part of SB SEFs and SBS exchanges with respect to the obligations placed on them by the Exchange Act, including as amended by the Dodd-Frank Act, and strengthen their ability to meet those obligations. A ROC composed solely of independent directors should result in a greater degree of objective decision-making with respect to the SB SEF's or SBS exchange's regulatory obligations. Vigilant and informed oversight by a strong, effective and independent ROC may increase investor confidence in the operation of SB SEFs and SBS exchanges, and the security-based swaps market generally. National securities exchanges that currently have a ROC composed of independent directors have noted the benefits of such a governance mechanism.[227] In addition, requiring the Board to report promptly to the Commission any recommendation of the ROC that the Board does not implement should provide the Commission with information on a timely basis regarding the Board's decision not to take certain actions.

The governance proposals for SB SEFs, SBS exchanges and SBS exchange facilities would complement the proposed ownership and voting limits for these entities. Five or more dealer-participants or members could still own 100% of the voting securities of a SB SEF, SBS exchange or SBS exchange facility, as applicable, under the proposed voting and ownership limits. In addition, even when the influence of any single dealer is limited through ownership

227 See CBOE Comment Letter, supra note 165 ("CBOE also implemented other changes that are similar to the proposals contained in the Release, for example establishing a Regulatory Oversight Committee, composed solely of public directors.... As a result, CBOE believes that its existing governance structure and practices serve not only to protect investors and the public interest and assure the integrity of CBOE's regulatory activities, but also to enhance the ability of CBOE to develop and implement sound business strategies"); NYSE Comment Letter, supra note 165 ("As an important part of the reform process of 2003, the NYSE formalized the effective functional separation of regulatory programs from the competitive business functions, under a Chief Regulatory Officer ("CRO") reporting to a Regulatory Oversight Committee ("ROC") of the Board of Directors consisting of all independent directors.... We agree with the Commission that this structure, with a separate regulatory executive reporting to an empowered, qualified and independent board, amply funded and professionally staffed, assures the integrity of the regulatory process.")

and voting restrictions, economic incentives can align several dealer participants in a way that may be costly to investors. As a result, there are potential incentives for SB SEF participant-dealers and SBS exchange member-dealers to coordinate in ways that ownership and voting restrictions could not address. Requiring independence on the Board and certain key Board committees should further reduce the ability of the participant-owners of the SB SEF or member-owners of the SBS exchange or SBS exchange facility to unduly influence decision-making at the Board level in a way that advances their interests. Representation by independent directors would provide views and influence that by design are not subject to these conflicts.

As noted in the discussion relating to security-based swap clearing agencies, while director independence is widely believed to be a catalyst for improved governance and the Commission recognizes that the industry widely accepts a majority of independent directors as "best practices,"[228] there is no conclusive empirical evidence to support the view that a majority of independent directors benefits shareholder profits. However, the Model Business Corporation Act recognizes the important role of independent directors.[229]

The proposed governance requirements could impose costs on SB SEFs, SBS exchanges and SBS exchange facilities. Entities planning to register as SB SEFs and SBS exchanges may need to draft or amend their governing documents and design or modify their governance processes to comply with the proposed governance requirements, which would impose costs on SB SEFs, SBS exchanges and SBS exchange facilities. The Commission estimates that it would take a compliance attorney approximately 15 hours to revise the relevant governing documents and to file them with the appropriate authorities, for a total estimated cost per SB SEF, SBS

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228 See supra note 122.

229 MODEL BUS. CORP. ACT § 8.01(c) (4th ed. 2008).

exchange or SBS exchange facility of $4,365, or $152,775 in the aggregate for all SB SEFs or SBS exchanges, and SBS exchange facilities.[230]

An entity that plans to register as a SB SEF or a SBS exchange may need to revise the composition of its Board (or that of its SBS exchange facility, in the case of an exchange that posts or makes available for trading security-based swaps through a facility with a separate governance structure), if the Board currently is not composed of a majority of independent directors. SB SEFs and SBS exchanges or SBS exchange facilities also would need to establish wholly independent nominating committees, and SB SEFs and SBS exchanges would need to establish wholly independent ROCs. In this regard, SB SEFs, SBS exchanges and SBS exchange facilities could face difficulties in locating qualified individuals to serve as independent directors, particularly because security-based swaps trading is complex and some potential candidates may decline to serve as a director if they believe that they lack sufficient expertise.

The Commission preliminarily believes that the cost of securing independent directors to serve on the Board of the SB SEF, SBS exchange or SBS exchange facility could range from a relatively low cost for those entities that have the contacts and resources to be able to search for one or more independent directors on their own; to a moderate cost for those entities that can undertake the search on their own but would incur some expenditures, such as placing advertisements in national media; to a higher cost for those entities that must secure the services of a recruitment firm that specializes in the placement of independent directors. The Commission preliminarily estimates that those SB SEFs, SBS exchanges or SBS exchange

[230] Assuming an hourly cost of $291 for a compliance attorney, the overall annual cost per SB SEF, SBS exchange or SBS exchange facility and aggregate cost for all SB SEFs, SBS exchanges, and SBS exchange facilities was calculated as follows: per entity annual cost = 15 hours X $291 = $4,365; aggregate annual cost = $4,365 X 35 = $152,775. See supra note 210.

facilities that must rely on a recruitment specialist to secure an independent director could incur a cost of approximately $68,000 per director.[231] The Commission preliminarily estimates that 10-20 entities could seek to register as SB SEFs and notes that there are 15 national securities exchanges; however, the number of Board members could vary widely among SB SEFs, SBS exchanges and SBS exchange facilities. Therefore, the Commission provides an estimate of a maximum recruitment cost of $68,000 per independent director.[232]

The imposition of a Board structure that precludes the likely participants in SB SEFs, SBS exchanges or SBS exchange facilities – dealers – from gaining a majority or having representation on certain Board committees may have a negative effect on the operations of the SB SEF, SBS exchange or SBS exchange facility if independent directors do not have commensurate qualifications or skills as affiliated directors or do not engage actively in their Board or committee duties. There could be costs in educating independent directors to become familiar with the manner in which security-based swaps are traded and in the new regulatory structure that would govern them, which could slow Board or committee processes at least initially. In addition, independent directors may yield to industry directors who have more knowledge and experience, thereby undermining the benefits of requiring independence. In the context of wholly independent committees, such as a nominating committee or ROC, the

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231 The Commission is basing this estimate on a recent study noting that the retainer fee for outside directors is on average $67,624. See http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/2010/2010_Outside_Director_Compensation.pdf. The Commission believes that this amount could serve as a proxy for the amount of any fee to be charged by a recruitment firm that would conduct a national search for an independent director.

232 As discussed above, since 2004 when the Commission proposed rules to promote the fair administration and governance of, and to impose ownership and voting limitations on, national securities exchanges, a number of exchanges have adopted governance structures which meet many of the requirements of proposed Rule 702. Thus, the costs for complying with the proposed governance rules would be decreased for some SBS exchanges.

independent directors may become reliant on executive officers and other employees of the SB SEF or SBS exchange to inform their decision-making due to their lack of expertise in the industry. If management fails to keep the directors on wholly independent committees fully-informed, if the independent directors on such committees fail to seek sufficient information from management to make informed decisions or if management fails to give independent directors adequate resources to make effective decisions, there could be costs to the SB SEF, SBS exchange or SBS exchange facility. On the other hand, if management fully apprises the directors on wholly independent committees of necessary information and the independent directors have sufficient resources and are fully engaged with respect to their duties, there would be benefits to the SB SEF, SBS exchange or SBS exchange facility.

In addition, the effectiveness of majority independent Boards can depend on the personalities and personal traits, as well as the qualifications, of the persons serving on the Board. Independent directors that take the time to understand the operations and programs of a SB SEF, SBS exchange or SBS exchange facility and to ask probing questions of management are more likely to be effective independent directors. However, because independent directors would not be employed by the SB SEF, SBS exchange, or SBS exchange facility or be participants or members of such entity, they often may need to rely on management or other directors to keep them fully informed. There could be costs to the SB SEF, SBS exchange, or SBS exchange facility if one or more independent directors is ineffectual because he or she did not fully understand the operations of the SB SEF or SBS exchange, either because the independent directors did not take the necessary initiative or management failed to keep the independent directors fully apprised of information that would lead to their effective decision-making. Thus, imperfect decisions by independent directors could result in costs to the SB SEF, SBS exchange, or SBS exchange facility. On the other hand, independent directors who have expertise in areas that could be helpful to the SB SEF, SBS exchange or SBS exchange facility, who are engaged in carrying out their director duties, and who grasp the issues confronting the SB SEF, SBS exchange or SBS exchange facility could be very beneficial to the SB SEF, SBS exchange or SBS exchange facility because they could bring fresh insights and ideas to these entities.

Finally, under the proposed Rule 702(e)(2) under Regulation MC, SB SEFs and SBS exchanges would need to report promptly to the Commission any recommendation of the ROC that the Board does not adopt or implement, which would result in costs to SB SEFs and SBS exchanges. As discussed above, the Commission preliminarily estimates that the annual information collection burden for each SB SEF or SBS exchange under this provision of the proposed rules would be 12 hours.[233] Accordingly, the Commission's staff estimates that it would cost each SB SEF or SBS exchange $3,492 annually to comply with this provision of the proposed rules.[234]

D. Request for Comments

The Commission requests that commenters provide views and supporting information regarding the costs and benefits associated with the proposals. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not already identified. The Commission also requests comment regarding the relative costs and benefits of pursuing

233 See supra Section IX.D.

234 12 hours (estimated annual information collection burden for each SB SEF and SBS exchange) x $291 (hourly cost for a compliance attorney) = $3,492. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

alternative regulatory approaches that are consistent with Section 765 of the Dodd-Frank Act. In addition, the Commission requests comment on whether other provisions of the Dodd-Frank Act for which Commission rulemaking is required are likely to have an effect on the costs and benefits of the proposed rules.

XI. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act[235] 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. In addition, Section 23(a)(2) of the Exchange Act[236] requires the Commission, when adopting rules under the Exchange Act, to consider the effect such rules would have on competition. Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Security-based swaps are currently executed and traded in the OTC market, with five large commercial banks representing 97% of the total U.S. banking industry notional amounts outstanding of derivatives.[237] The gross notional amount of CDS as of the end of 2009 was approximately $30 trillion.[238]

[235] 15 U.S.C. 78c(f).

[236] 15 U.S.C. 78w(a)(2).

[237] See Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2010.

[238] Data available at http://www.isda.org/statistics/pdf/ISDA-Market-Survey-results1987-present.xls.

As discussed above, the Commission has granted exemptions to five entities to act as security-based swap clearing agencies for CDS.[239] Four of the exemptions are currently active. SB SEFs and SBS exchanges are expected to register to trade security-based swaps in connection with the implementation of rules under Title VII of the Dodd-Frank Act.

As discussed above, the intent of the ownership and voting limitations and governance proposed rules is to mitigate potential conflicts of interests of market participants in the clearing and trading of security-based swaps. These proposed rules may have a significant effect on the level of competition within the marketplace.

The voting restrictions on security-based swap clearing agencies that limit the influence of any single participant or group of participants could increase the level of competition at the participant level if they preserve access to central clearing and trading by other participants. Without these voting restrictions, it may be possible for a dominant participant owner to use its voting interest to set rules, fees, or capital requirements that engender an uncompetitive environment. For instance, a heightened capital threshold for participation might prevent some firms from qualifying as participants and thus deny them access to clearing. However, the proposed voting limitations among participants may also impede competition at the security-based swap clearing agency level, since there are likely a limited number of firms with the expertise, resources and desire to have an ownership interest in a security-based swap clearing agency.[240]

As previously noted, evidence from the securities markets suggests that clearing agencies over the long-run tend to converge to a small number of entities or even a single entity. Clearing

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239 See CDS Clearing Exemption Orders, supra note 17.

240 The Commission pursuant to Section 36 of the Exchange Act may grant an exemption from any rule or any provision of any rule under Regulation MC. See supra Section VI.

activities are characterized by high start-up costs and low marginal costs such that there are large economies of scale. For example, all trades executed on the eight U.S. based options exchanges are cleared at the Options Clearing Corporation, and trades executed on the U.S. equity markets, composed of exchanges, alternative trading platforms, and OTC trading, are cleared at the National Securities Clearing Corporation, a wholly-owned subsidiary of the Depository Trust and Clearing Corporation.[241] A single security-based swap clearing agency may also be more efficient in that it would facilitate the fungibility of contracts across multiple execution facilities and exchanges.

Whether the differences in the Voting Interest Focus Alternative and the Governance Focus Alternative would result in substantially different effects on efficiency, capital formation, and competition remains uncertain. Preliminarily, the Commission believes that the aggregate cap on participant voting interests may limit the formation of new clearing agencies and, consequently, limit the opportunity for competition among security-based swap clearing agencies. However, the aggregate cap under the Voting Interest Focus Alternative may also be more effective at mitigating conflicts of interest than the rules proposed under the Governance Focus Alternative, and could result in greater access to central clearing and a higher volume of security-based swap products made eligible for clearing. As discussed previously, central clearing would facilitate improved transparency, risk management, and competition in the security-based swaps market. This in turn should have a positive effect on efficiency, capital formation, and competition.

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241 The central clearing of security-based swaps is still developing and the Commission has not made any determinations about the number of security-based swap clearing agencies that may be used by market participants.

The Commission preliminarily believes that the start-up costs for a SB SEF, SBS exchange or SBS exchange facility, or for an existing national securities exchange to post or make available for trading security-based swaps, will be low. If a SB SEF, SBS exchange or SBS exchange facility would not provide the desired level of access to a market participant, and the start-up costs of setting up a competing SB SEF, SBS exchange or SBS exchange facility are low, then this would encourage the entrance of alternate trading venues for market participants and allow competition to discipline harmful practices by any single SB SEF, SBS exchange, or SBS exchange facility. However, if ownership restrictions are such that dealers must coordinate ownership among a group, then there may be fewer potential owners available, and thus there could be less incentive to form competing SB SEFs, SBS exchanges, or SBS exchange facilities. In this case, ownership limitations would impede competition[242]

The proposed rules under Regulation MC relating to Board and committee independence may also increase the level of participant competition by making it more difficult for a small group of dealer-owners to influence a security-based swap clearing agency, SB SEF or SBS exchange even in light of the proposed ownership and voting restrictions. This is necessary because economic incentives could align the interests of participants against the interest of the security-based swap clearing agency, SB SEF or SBS exchange as a whole irrespective of whether those participants are owners. For example, if the Board of a dealer-controlled security-based swap clearing agency determines to refuse to clear a proposed security-based swap product, then such a product would not be required to be traded on a SB SEF or SBS exchange and would likely trade OTC, reducing price transparency and likely resulting in higher revenue for the dealers in the OTC market than if the product was available through a SB SEF, SBS

[242] See supra note 240.

exchange or SBS exchange facility. Majority independence requirements for the Board and committees that have the authority to act on behalf of the Board are an additional tool to address this potential conflict of interest. Given the size of the security-based swaps market and its non-competitive tendencies, the benefits with respect to efficiency and competition that ownership, voting, and director representation requirements would provide are likely to be substantial.

The Commission requests comment on the possible effects of the proposed rules under Regulation MC on efficiency, competition, and capital formation. The Commission requests that commenters provide views and supporting information regarding any such effects. The Commission notes that such effects are difficult to quantify. The Commission seeks comment on possible anti-competitive effects of the proposed rules under Regulation MC not already identified. The Commission also requests comment regarding the competitive effects of pursuing alternative regulatory approaches that are consistent with Section 765 of the Dodd-Frank Act. In addition, the Commission requests comment on how the other provisions of the Dodd-Frank Act for which Commission rulemaking is required will interact with and influence the competitive effects of the proposed rules under Regulation MC.

XII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[243] the Commission must advise the OMB as to whether proposed Regulation MC and the rules proposed thereunder constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (2) a

243 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation.

The Commission requests comment on the potential impact of proposed Regulation MC and the rules proposed thereunder on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

XIII. Regulatory Flexibility Act Certification

Section 603(a) of the Regulatory Flexibility Act[244] ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis of the proposed rules under Regulation MC on small entities, unless the Commission certifies that the proposed rules, if adopted, would not have a significant economic impact on a substantial number of small entities.[245]

A. Security-Based Swap Clearing Agencies

Proposed Rule 701 under Regulation MC would apply to all security-based swap clearing agencies. Four entities are currently exempt from registration as a clearing agency under section 17A of the Exchange Act to provide central clearing services for CDS, a class of security-based swaps.[246] The Commission believes, based on its understanding of the market, that likely no more than six security-based swap clearing agencies could be subject to the requirements of proposed Rule 701.

For purposes of Commission rulemaking in connection with the RFA, an issuer or person, other than an investment company, is a small business if its total assets on the last day of its most recent fiscal year were $5 million or less.[247] The Commission believes that the entities

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244 5 U.S.C. 603(a).

245 5 U.S.C. 605(b).

246 See CDS Clearing Exemptions, supra note 17.

247 17 CFR 230.157. See also 17 CFR 240.0-10(a).

likely to register as security-based swap clearing agencies will not be small entities, but rather part of large business entities that have assets in excess of $5 million and total capital in excess of $500,000.[248]

B. SB SEFs

Proposed Rule 702 under Regulation MC would apply to all SB SEFs. In the Dodd-Frank Act, Congress defined for the first time what activity would constitute a SB SEF and mandated the registration of these new facilities. The Commission preliminarily believes that approximately 10 to 20 SB SEFs could be subject to the requirements of proposed Rule 702.

For purposes of Commission rulemaking in connection with the RFA, an issuer or person, other than an investment company, is a small business if its total assets on the last day of its most recent fiscal year were $5 million or less.[249] The Commission preliminarily believes that the entities likely to register as SB SEFs will not be considered small entities because most, if not all, of the SB SEFs will be part of large business entities, and that all SB SEFs will have assets in excess of $5 million.[250]

C. SBS Exchanges

Proposed Rule 702 under Regulation MC would apply to all SBS exchanges. All of the 15 currently registered national securities exchanges could become SBS exchanges, and therefore, subject to the requirements of Rule 702.[251]

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248 Commission staff based this determination on its review of various public sources of financial information about the current registered clearing agencies and entities currently exempt from clearing agency registration under Section 17A of the Exchange Act.

249 17 CFR 230.157. See also 17 CFR 240.0-10(a).

250 Commission staff based this determination on its review of various public sources of financial information about the entities likely to register as SB SEFs.

251 See supra note 194.

For purposes of Commission rulemaking in connection with the RFA, a national securities exchange is a small business if it has been exempted from the reporting requirements of Rule 601 of Regulation NMS[252] (Dissemination of Transaction Reports and Last Sale Data with Respect to Transactions in NMS Stocks) and is not affiliated with any person (other than a natural person) that is not a "small business."[253] None of the currently registered national securities exchanges is a small entity. Therefore, the Commission preliminarily believes that none of the SBS exchanges will be considered small entities.

D. Certification

For the reasons stated above, the Commission certifies that the proposed rules under Regulation MC would not have a significant economic impact on a substantial number of small entities. The Commission requests comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, including national securities exchanges, clearing agencies or other small businesses or small organizations that may register as SB SEFs, SBS exchanges or security-based swap clearing agencies, and provide empirical data to support the extent of the impact.

XIV. Statutory Basis and Rule Text

Pursuant to the Exchange Act, 15 U.S.C. 78a et seq., and particularly, Sections 3, 3D, 6, 11A, 17A, 19, and 23(a) thereof, and Section 765 of the Dodd-Frank Act, the Commission is proposing to adopt Regulation MC under the Exchange Act.

Text of Proposed Rule Amendments

List of Subjects in 17 CFR Part 242

Reporting and recordkeeping requirements, Securities.

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252 17 CFR 242.601.

253 17 CFR 240.0-10(e).

For the reasons stated in the preamble, the Commission is proposing to amend Title 17, Chapter II of the Code of the Federal Regulations as follows:

PART 242—REGULATIONS M, SHO, ATS, AC, NMS, AND MC AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

1. The authority citation for part 242 is amended by adding authorities for Sections 242.700, 242.701 and 242.702 to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78f, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q-1, 78q(a), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

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Section 242.700 is also issued under sec. 943, PUB. L. NO. 111-203, Section 765.

Section 242.701 is also issued under sec. 943, PUB. L. NO. 111-203, Section 765.

Section 242.702 is also issued under sec. 943, PUB. L. NO. 111-203, Sections 763 and 765.

2. The part heading for part 242 is revised to read as set forth above.

3. Sections 242.700, 242.701 and 242.702 are added to read as follows:

§ 242.700 Definitions.

(a) The term affiliate means any person that, directly or indirectly, controls, is controlled by, or is under common control with, the person.

(b) The terms beneficial ownership, beneficially owns or any derivative thereof shall have the same meaning, with respect to any security or other ownership interest, as set forth in §240.13d-3, as if (and whether or not) such security or other ownership interest were a voting equity security registered under section 12 of the Exchange Act (15 U.S.C. 78l); provided that to the extent any person beneficially owns any security or other ownership interest solely because such person is a member of a group within the meaning of section 13(d)(3) of the Exchange Act (15 U.S.C. 78m(d)(3)), such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person has the power to direct the vote of such security or other ownership interest.

(c) The term Board means the Board of Directors or Board of Governors of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any equivalent body.

(d) The term clearing agency has the same meaning as set forth in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(e) The term control means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(1) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(2) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(3) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(f) The term director means any member of the Board.

(g) The term Exchange Act means the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(h) The term facility has the same meaning as set forth in section 3(a)(2) of the Exchange Act (15 U.S.C. 78c(a)(2)).

(i) The term immediate family member means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

(j) The term independent director means (1) a director who has no material relationship with:

(i) The security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable;

(ii) Any affiliate of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable;

(iii) A security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable; or

(iv) Any affiliate of a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable.

(2) A director is not an independent director if any of the following circumstances exists:

(i) The director, or an immediate family member, is employed by or otherwise has a material relationship with the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof, or within the past three years was employed by or otherwise had a material relationship with the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof;

(ii) (A) The director is a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable, or within the past three years was employed by or affiliated with such participant or member or any affiliate thereof; or

(B) The director has an immediate family member that is, or within the past three years was, an executive officer of a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable, or any affiliate thereof;

(iii) The director, or an immediate family member, has received during any twelve month period within the past three years payments that reasonably could affect the independent judgment or decision-making of the director from the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof or from a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable, or any affiliate thereof, other than the following:

(A) Compensation for Board or Board committee services;

(B) Compensation to an immediate family member who is not an executive officer of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof or of a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable, or any affiliate thereof; or

(C) Pension and other forms of deferred compensation for prior services, not contingent on continued service.

(iv) The director, or an immediate family member, is a partner in, or controlling shareholder or executive officer of, any organization to or from which the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof made or received payments for property or services in the current or any of the past three full fiscal years that exceed two percent of the recipient's consolidated gross revenues for that year, other than the following:

(A) Payments arising solely from investments in the securities of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or affiliate thereof; or

(B) Payments under non-discretionary charitable contribution matching programs.

(v) The director, or an immediate family member, is, or within the past three years was, employed as an executive officer of another entity where any executive officers of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, serve on that entity's compensation committee;

(vi) The director, or an immediate family member, is a current partner of the outside auditor of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof, or was a partner or employee of the outside auditor of security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof who worked on the audit of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof, at any time within the past three years; or

(vii) In the case of a director that is a member of the audit committee, such director (other than in his or her capacity as a member of the audit committee, the Board, or any other Board committee), accepts, directly or indirectly, any consulting, advisory, or other compensatory fee from the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable, or any affiliate thereof or a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable, or any affiliate thereof, other than fixed amounts of pension and other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service.

(k) The term major security-based swap participant has the same meaning as set forth in section 3(a)(65) of the Exchange Act (15 U.S.C. 78c(a)(65)) or any rules or regulations thereunder.

(l) The term material relationship means a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.

(m) The term member has the same meaning as set forth in section 3(a)(3) of the Exchange Act (15 U.S.C. 78c(a)(30)).

(n) The term national securities exchange means any exchange registered pursuant to section 6 of the Exchange Act (15 U.S.C. 78f).

(o) The term participant when used with respect to a clearing agency has the same meaning set forth in section 3(a)(24) of the Exchange Act (15 U.S.C 78c(a)).

(p) The term person has the same meaning as set forth in section 3(a)(9) of the Exchange Act (15 U.S.C. 78c(a)(9)).

(q) The term person associated with a member has the same meaning as set forth in section 3(a)(21) of the Exchange Act (15 U.S.C. 78c(a)(21)).

(r) The term person associated with a participant in a security-based swap clearing agency means:

(1) Any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions);

(2) Any person directly or indirectly controlling, controlled by, or under common control with such security-based swap dealer or major security-based swap participant; or

(3) Any employee of such security-based swap dealer or major security-based swap participant. This term does not include any person associated with a participant in a security-based swap clearing agency whose functions are solely clerical or ministerial.

(s) The term person associated with a security-based swap dealer or major security-based swap participant has the same meaning as set forth in section 3(a)(70) of the Exchange Act (15 U.S.C. 78c(a)(70)) or any rules or regulations thereunder.

(t) The term person associated with a security-based swap execution facility participant means any partner, officer, director, or branch manager of such security-based swap execution facility participant (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such security-based swap execution facility participant, or any employee of such security-based swap execution facility participant.

(u) The term related person means:

(1) when used with respect to a security-based swap clearing agency:

(i) Any affiliate of a security-based swap clearing agency participant;

(ii) Any person associated with a security-based swap clearing participant;

(iii) Any immediate family member of a security-based swap clearing agency participant that is a natural person or any immediate family member of the spouse of such person, who, in each case, has the same home as the security-based swap clearing agency participant or who is a director or officer of the security-based swap clearing agency or any of its parents or subsidiaries; or

(iv) Any immediate family member of a person associated with a security-based swap clearing agency participant that is a natural person or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the security-based swap clearing agency participant or who is a director or officer of the security-based swap clearing agency or any of its parents or subsidiaries;

(2) When used with respect to a security-based swap execution facility:

(i) Any affiliate of a security-based swap execution facility participant;

(ii) Any person associated with a security-based swap execution facility participant;

(iii) Any immediate family member of a security-based swap execution facility participant or any immediate family member of the spouse of such person, who, in each case, has the same home as the security-based swap execution facility participant or who is a director or officer of the security-based swap execution facility or any of its parents or subsidiaries; or

(iv) Any immediate family member of a person associated with a security-based swap execution facility participant or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the security-based swap execution facility participant or who is a director or officer of the security-based swap execution facility or any of its parents or subsidiaries; and

(3) When used with respect to a national securities exchange or facility thereof that posts or makes available for trading security-based swaps:

(i) Any affiliate of a member of the national securities exchange that posts or makes available for trading security-based swaps;

(ii) Any person associated with a member of the national securities exchange that posts or makes available for trading security-based swaps;

(iii) Any immediate family member of a member of the national securities exchange that posts or makes available for trading security-based swaps or any immediate family member of the spouse of such person, who, in each case, has the same home as the member of the national securities exchange that posts or makes available for trading security-based swaps or who is a director or officer of the national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or any of its parents or subsidiaries; or

(iv) Any immediate family member of a person associated a member of the national securities exchange that posts or makes available for trading security-based swaps or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the national securities exchange that posts or makes available for trading security-based swaps or who is a director or officer of the national securities exchange or facility thereof that posts or makes available for trading security-based swaps or any of its parents or subsidiaries.

(v) The term <u>security-based swap</u> has the same meaning as set forth in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)) or any rules or regulations thereunder.

(w) The term <u>security-based swap dealer</u> has the same meaning as set forth in section

3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)) or any rules or regulations thereunder.

(x) The term security-based swap clearing agency means a clearing agency that clears security-based swaps.

(y) The term security-based swap execution facility has the same meaning as set forth in section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)) or any rules or regulations thereunder.

(z) The term security-based swap execution facility participant means a person permitted to directly effect transactions on the security-based swap execution facility.

§ 242.701 Mitigation of conflicts of interest of security-based swap clearing agencies.

Each security-based swap clearing agency must comply with the provisions of either paragraphs (a) or (b) this section, and must have the capacity to carry out the purposes of paragraphs (a) or (b) of this section, respectively.

(a)(1) Limits on voting interest. A security-based swap clearing agency shall not permit any security-based swap clearing agency participant, either alone or together with its related persons, to:

(i) Beneficially own, directly or indirectly, any interest in the security-based swap clearing agency that exceeds 20 percent of any class of securities, or other ownership interest, entitled to vote of such security-based swap clearing agency;

(ii) Directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap clearing agency that exceeds 20 percent of the voting power of any class of securities or other ownership interest of such security-based swap clearing agency;

(iii) In the aggregate with any other security-based swap clearing agency participants and their related persons, beneficially own, directly or indirectly, any interest in the security-based swap clearing agency that exceeds 40 percent of any class of securities, or other ownership interest, entitled to vote of such security-based swap clearing agency; or

(iv) In the aggregate with any other security-based swap clearing agency participants and their related persons, directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap clearing agency that exceeds 40 percent of the voting power of any class of securities or other ownership interest of such security-based swap clearing agency.

(2) Divestiture. (i) The rules of the security-based swap clearing agency must provide an effective mechanism to divest any participant of any voting interest owned in excess of the limitation in paragraph (a)(1) of this section.

(ii) The rules of the security-based swap clearing agency must be reasonably designed not to give effect to the portion of any voting interest held by one or more participants in excess of the limitations in paragraph (a)(1) of this section.

(iii) The rules of the security-based swap clearing agency must provide an effective mechanism for it to obtain information relating to voting interests in the security-based swap clearing agency by any participant in the security-based swap clearing agency and its related persons.

(3) Board. (i) The Board of each security-based swap clearing agency must be composed of at least 35 percent independent directors.

(ii) No director may qualify as an independent director unless the Board affirmatively determines that the director does not have a material relationship with the security-based swap clearing agency or any affiliate of the security-based swap clearing agency, or a participant in the security-based swap clearing agency, or any affiliate of a participant in the security-based swap clearing agency.

(iii) The security-based swap clearing agency must establish policies and procedures to require each director, on his or her own initiative or upon request of the security-based swap clearing agency, to inform the security-based swap clearing agency of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.

(4) Nominating committee. (i) A Board of any security-based swap clearing agency shall establish a nominating committee composed of a majority of independent directors.

(ii) The nominating committee of any security-based swap clearing agency must identify individuals qualified to become Board members through a consultative process with the participants of the security-based swap clearing agency consistent with criteria approved by the Board and consistent with the provisions of this section, and administer a process for the nomination of individuals to the Board.

(5) Other committees of the Board. A security-based swap clearing agency may establish such other committees of the Board, including a risk committee, as it deems appropriate. However, if such committee has the authority to act on behalf of the Board, the committee must be composed of at least 35 percent independent directors.

(6) Disciplinary panels. The disciplinary processes of a security-based swap clearing agency shall preclude any group or class of persons that is a participant from dominating or

exercising disproportionate influence on the disciplinary process. Any disciplinary panel of a security-based swap clearing agency shall also include at least one person who would qualify as an independent director. If the security-based swap clearing agency provides for a process of an appeal to the Board, or to a committee of the Board, then that appellate body also shall include at least one person who would qualify as an independent director.

(b)(1) Limits on voting interests. A security-based swap clearing agency shall not permit any security-based swap clearing agency participant, either alone or together with its related persons, to:

(i) Beneficially own, directly or indirectly, any interest in the security-based swap execution facility that exceeds 5 percent of any class of securities, or other ownership interest, entitled to vote of such security-based swap clearing agency; or

(ii) Directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap clearing agency that exceeds 5 percent of the voting power of any class of securities or other ownership interest of such security-based swap clearing agency.

(2) Divestiture. (i) The rules of the security-based swap clearing agency must provide an effective mechanism to divest any participant of any voting interest owned in excess of the limitation in paragraph (b)(1) of this section.

(ii) The rules of the security-based swap clearing agency must be reasonably designed not to give effect to the portion of any voting interest held by one or more participants in excess of the limitations in paragraph (b)(1) of this section.

(iii) The rules of the security-based swap clearing agency must provide an effective mechanism for it to obtain information relating to voting interests in the security-based swap clearing agency or its holding company by any participant in the security-based swap clearing agency.

(3) Board. (i) The Board of each security-based swap clearing agency must be composed of a majority of independent directors.

(ii) No director may qualify as an independent director unless the Board affirmatively determines that the director does not have a material relationship with the security-based swap clearing agency or any affiliate of the security-based swap clearing agency, or a participant in the security-based swap clearing agency, or any affiliate of a participant in the security-based swap clearing agency.

(iii) The security-based swap clearing agency must establish policies and procedures to require each director, on his or her own initiative or upon request of the security-based swap clearing agency, to inform the security-based swap clearing agency of the existence of any relationship or interest that may reasonably be considered to bear on whether such director is an independent director.

(4) Nominating committee. (i) A Board of any security-based swap clearing agency shall establish a nominating committee composed solely of independent directors.

(ii) The nominating committee of any security-based swap clearing agency must identify individuals qualified to become Board members through a consultative process with the participants of the security-based swap clearing agency consistent with criteria approved by the Board and consistent with the provisions of this section, and administer a process for the nomination of individuals to the Board.

(5) Other committees of the Board. A security-based swap clearing agency may establish such other committees of the Board, including a risk committee, as it deems appropriate. However, if such committee has the authority to act on behalf of the Board, the committee must be composed of a majority of independent directors.

(6) Disciplinary panels. The disciplinary processes of a security-based swap clearing agency shall preclude any group or class of persons that is a participant from dominating or exercising disproportionate influence on the disciplinary process. Any disciplinary panel of a security-based swap clearing agency shall also include at least one person who would qualify as an independent director. If the security-based swap clearing agency provides for a process of an appeal to the Board, or to a committee of the Board, then that appellate body also shall include at least one person who would qualify as an independent director.

§ 242.702 Mitigation of conflicts of interest of security-based swap execution facilities and national securities exchanges that post or make available for trading security-based swaps.

(a) General. Each security-based swap execution facility and national securities exchange or facility thereof that posts or makes available for trading security-based swaps must comply with the provisions of this section and must have the capacity to carry out the purposes of this section.

(b) Limits on ownership and voting.

(1) A security-based swap execution facility shall not permit any security-based swap execution facility participant, either alone or together with its related persons, to:

(i) Beneficially own, directly or indirectly, any interest in the security-based swap execution facility that exceeds 20 percent of any class of securities, or other ownership interest, entitled to vote of such security-based swap execution facility; or

(ii) Directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the security-based swap execution facility that exceeds 20 percent of the voting power of any class of securities or other ownership interest of such security-based swap execution facility.

(2) A national securities exchange or facility thereof that posts or makes available for trading security-based swaps shall not permit any member, either alone or together with its related persons, to:

(i) Beneficially own, directly or indirectly, any interest in the national securities exchange or facility thereof that posts or makes available for trading security-based swaps that exceeds 20 percent of any class of securities, or other ownership interest, entitled to vote of such national securities exchange or facility thereof that posts or makes available for trading security-based swaps; or

(ii) Directly or indirectly vote, cause the voting of, or give any consent or proxy with respect to the voting of, any interest in the national securities exchange or facility thereof that posts or makes available for trading security-based swaps that exceeds 20 percent of the voting power of any class of securities or other ownership interest of such national securities exchange or facility thereof that posts or makes available for trading security-based swaps.

(c) Divestiture. (1) The rules of a security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps must provide an effective mechanism to divest any security-based swap execution facility participant or member, as applicable, of any interest owned in excess of the ownership limitations in paragraphs (b)(1)(i) and (2)(i) of this section.

(2) The rules of a security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps must be reasonably designed not to give effect to the portion of any voting interest held by one or more security-based swap execution facility participant or member, as applicable, in excess of the limitations in paragraphs (b)(1)(ii) and (b)(2)(ii) of this section.

(3) The rules of a security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps must provide an effective mechanism for it to obtain information relating to ownership and voting interests in the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps by any security-based swap execution facility participant or member, as applicable.

(d) Board. (1) The Board of any security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps must be composed of a majority of independent directors.

(2) No director may qualify as an independent director of a security-based swap execution facility unless the Board affirmatively determines that the director does not have a material relationship with the security-based swap execution facility, any affiliate of the security-based swap execution facility, a security-based swap execution facility participant, or any affiliate of a security-based swap execution facility participant.

(3) No director may qualify as an independent director of a national securities exchange or facility thereof that posts or makes available for trading security-based swaps unless the Board

affirmatively determines that the director does not have a material relationship with the national securities exchange or facility thereof, any affiliate of the national securities exchange or facility thereof, a member of the national securities exchange, or any affiliate of such member.

(e) Regulatory oversight committee. (1) A Board of any security-based swap execution facility or national securities exchange that posts or makes available for trading security-based swaps shall establish a regulatory oversight committee, composed solely of independent directors, to assist it in minimizing actual and potential conflicts of interest. The regulatory oversight committee shall oversee the security-based swap execution facility's obligations under section 3D of the Exchange Act or the national securities exchange's obligation under section 6 of the Exchange Act (15 U.S.C. 78f), as applicable, on behalf of the Board. The Board shall delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the regulatory oversight committee to fulfill its mandate.

(2) The Board shall promptly report to the Commission any recommendations of the Regulatory Oversight Committee that the Board does not adopt or implement.

(f) Nominating committee. (1) The nominating committee of a security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps must be composed solely of independent directors.

(2) The nominating committee of a security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps must identify individuals qualified to become directors, consistent with criteria approved by the Board and consistent with the provisions of this section, and administer a process for the nomination of individuals to the Board.

(g) Other committees of the Board. A security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps may establish such other committees of the Board, including an executive committee, as it deems appropriate. However, if such committee has the authority to act on behalf of the Board, the committee must be composed of a majority of independent directors.

(h) Disciplinary panels. The disciplinary processes of a security-based swap execution facility or national securities exchange that posts or makes available for trading security-based swaps shall preclude any group or class of security-based swap execution facility participants or group or class of members of the national securities exchange that posts or makes available for trading security-based swaps, as applicable, from dominating or exercising disproportionate influence on the disciplinary process. Any disciplinary panel of a security-based swap execution facility or national securities exchange that posts or makes available for trading security-based swaps shall also include at least one person who would qualify as an independent director. If the security-based swap execution facility or national securities exchange that posts or makes available for trading security-based swaps provides for a process of an appeal to the Board, or to a committee of the Board, then that appellate body also shall include at least one person who would qualify as an independent director.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: October 14, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 230

[Release No. 33-9152; File No. S7-14-08]

RIN 3235-AK16

INDEXED ANNUITIES

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; withdrawal; request for comment on Paperwork Reduction Act burden estimate.

SUMMARY: We are withdrawing rule 151A under the Securities Act of 1933, which defines the terms "annuity contract" and "optional annuity contract" under the Act. On July 12, 2010, the United States Court of Appeals for the District of Columbia Circuit issued an order vacating the rule.

EFFECTIVE DATE: Rule 151A, published at 74 FR 3175 (January 16, 2009) and effective on January 12, 2011, is withdrawn as of **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER].**

FOR FURTHER INFORMATION CONTACT: Michael L. Kosoff, Senior Counsel, Office of Insurance Products, Division of Investment Management, at (202) 551-6795, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8629.

SUPPLEMENTARY INFORMATION: On January 8, 2009, the Commission issued a release adopting rule 151A under the Securities Act of 1933.[1] Rule 151A defines the terms "annuity contract" and "optional annuity contract" under the Securities Act. The rule was intended to

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1 15 U.S.C. 77a et seq.; Securities Act Release No. 8996 (Jan. 8, 2009) [74 FR 3138 (Jan. 16, 2009)].

clarify the status under the federal securities laws of indexed annuities, under which payments to the purchaser are dependent on the performance of a securities index. On July 12, 2010, the United States Court of Appeals for the District of Columbia Circuit issued an order vacating rule 151A in American Equity Investment Life Insurance Company, et al. v. Securities and Exchange Commission, No. 09-1021 (D.C. Cir.). Accordingly, the Commission hereby withdraws rule 151A, which was published at 74 FR 3175 (Jan. 16, 2009).

Paperwork Reduction Act

Notice is hereby given that, pursuant to the Paperwork Reduction Act of 1995,[2] the Commission is soliciting comment on changes to a collection of information necessitated by the Court order vacating rule 151A. The Commission is submitting this existing collection of information to the Office of Management and Budget for change and approval.

The burdens associated with rule 151A are currently approved under the "collection of information" requirements for Form S-1 under the Securities Act of 1933 ("Form S-1" (OMB Control No. 3235-0065)). This form sets forth the disclosure requirements for registration statements that are prepared by eligible issuers. The Commission previously estimated that there would be an annual increase of 400 responses on Form S-1. In connection with this increase in expected responses, the Commission increased the estimated burden for Form S-1 by 60,000 hours of internal staff time and $72 million of external professional costs.

Since the Commission's adoption of rule 151A, the Commission has adopted changes to the information required by Form S-1, which have further increased the total hours and cost burden associated with the 400 additional responses that we estimated would result from the

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2 44 U.S.C. 3501 et seq.

adoption of rule 151A by approximately 1,600 hours and $1,920,000.[3]

As a result of the Court order, the Commission no longer expects that there will be an annual increase of 400 responses on Form S-1, and believes that the estimate of the corresponding burdens for Form S-1 should be decreased by the amount of the burden associated with those 400 responses. Accordingly, the Commission estimates that the Court order will have the effect of decreasing the estimated burden for Form S-1 by 61,600 hours of internal staff time (60,000 plus 1,600) and $73,920,000 for external professional costs ($72,000,000 plus $1,920,000).

The information collection requirements related to Form S-1 are mandatory. There is no mandatory retention period for the information disclosed, and the information disclosed is made publicly available on the EDGAR filing system. An agency many 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.

We request comment on the accuracy of the Commission's estimate of the change in the burden for Form S-1. Persons wishing to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention Desk

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3 These changes in the burden estimates are the result of the adoption of rules enhancing information provided in connection with proxy solicitations and in other reports filed with the Commission. Securities Act Release No. 9089 (Dec. 16, 2009) [74 FR 68334 (Dec. 23, 2009)]. That rulemaking assigned an incremental burden increase of 16 hours per response on Form S-1. We estimated that 25% of that burden would be carried by the company internally and that 75% of the burden would by carried by outside professionals retained by the company at an average cost of $400 per hour. Accordingly, we estimated an incremental internal burden increase of 4 (25% of 16) hours and an incremental external cost increase of $4800 (75% of 16 = 12 and 12 x $400 = $4800) for each response, including the 400 additional responses that we had expected as a result of rule 151A. Thus, the rulemaking assigned an additional burden for the 400 responses of 1600 (400 x 4) hours and $1,920,000 (400 x $4800). In addition, another rulemaking following the adoption of rule 151A also resulted in a change in the burden estimate for Form S-1. Securities Release No. 33-8995 (Dec. 31, 2008) [74 FR 2158 (Jan. 14, 2009)]. However, that rulemaking modified reporting requirements for oil and gas companies and did not affect the estimated burden for the additional 400 filers under rule 151A.

Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503 and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-14-08. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-14-08, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication.

Procedural and Other Matters

Section 553 of the Administrative Procedure Act provides that when an agency for good cause finds that notice and public comment procedures are impracticable, unnecessary, or contrary to the public interest, the agency may issue a rule without providing notice and an opportunity for public comment.[4] The Commission has determined that there is good cause for making today's withdrawal of rule 151A final without prior proposal and opportunity for comment. Because of the Court order vacating rule 151A, the Commission's action to withdraw the rule is ministerial in nature. Accordingly, the Commission for good cause finds that a notice and comment period is unnecessary.[5]

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4 5 U.S.C. 553(b)(B).

5 This finding also satisfies the requirements of 5 U.S.C. 808(2) (if a federal agency finds that notice and public comment are "impracticable, unnecessary or contrary to the public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines"), allowing the withdrawal to become effective notwithstanding the requirement of 5 U.S.C. 801.

The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective. [6] This requirement, however, does not apply if the agency finds good cause for making this action to withdraw rule 151A effective sooner. For the reason discussed above, the Commission finds that there is good cause to make withdrawal of the rule effective immediately.

The Commission considers the costs and benefits of its rules and regulations. As discussed above, rule 151A was vacated by the Court and the action the Commission takes today merely implements the Court's decision. Our action to withdraw the rule is ministerial and therefore will have no separate economic effect.

Conclusion

Therefore, for the reasons set out in the preamble, rule 151A, published at 74 FR 3175 (January 16, 2009) and effective on January 12, 2011, is withdrawn.

By the Commission.

Elizabeth M. Murphy
Secretary

October 14, 2010

No analysis is required under the Regulatory Flexibility Act. <u>See</u> 5 U.S.C. 601(2) (for purposes of Regulatory Flexibility Act analysis, the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking).

6 <u>See</u> 5 U.S.C. 553(d).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-63108; File No. S7-29-10]

Study Required by Section 989G(b) of the Dodd-Frank Act Regarding Compliance with Section 404(b) of the Sarbanes-Oxley Act

AGENCY: Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Securities and Exchange Commission is requesting public comment related to a study of how the Commission could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose public float is between $75 million and $250 million, while maintaining investor protections for such companies, and whether any methods of reducing the compliance burden or a complete exemption for such companies from the auditor attestation requirement in Section 404(b) would encourage companies to list on exchanges in the United States in their initial public offerings. This study is required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

DATES: Comments should be received on or before [insert date 45 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 S7-29-10 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number S7-29-10. 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). 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. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John Offenbacher, Senior Associate Chief Accountant, or Jason Plourde, Professional Accounting Fellow, Office of the Chief Accountant, at (202) 551-5300, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

DISCUSSION:

Under Section 989G(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[1] the Commission is required to conduct a study to determine how the Commission could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 (Section 404(b))[2] for companies whose market capitalization is between $75 million and $250 million, while maintaining investor protections for such companies. Section 989G(b)

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[1] Pub. L. No. 111-203 (July 21, 2010).

[2] 15 U.S.C. 7201 et seq.

of the Dodd-Frank Act also provides that the study must consider whether any methods of reducing the compliance burden or a complete exemption for such companies from Section 404(b) compliance would encourage companies to list on exchanges in the United States in their initial public offerings.

The Dodd-Frank Act does not define "market capitalization" and it is not defined in Commission rules. For purposes of the study, we believe that public float is an appropriate measure of market capitalization. Public float, which is the aggregate worldwide market value of an issuer's voting and non-voting common equity held by its non-affiliates, is the measure used in Commission rules for determining "accelerated filer" and "large accelerated filer" status.[3] The Commission has used public float historically in its actions to phase issuers into Section 404 compliance,[4] and Section 404(c) of the Sarbanes-Oxley Act of 2002, as amended by Section 989G(a) of the Dodd-Frank Act, provides that Section 404(b) shall not apply with respect to issuers that are neither an "accelerated filer" nor a "large accelerated filer" pursuant to Commission rules, which are generally issuers with a public float below $75 million. We therefore believe it would be consistent to use public float between $75 million and $250 million to describe the group of issuers that are the subject of the study. For the remainder of the release, we generally will refer to issuers with a public float between $75 million and $250 million as the "subject issuers."

In addition, Section 404(b) only addresses the auditor attestation requirement with respect to a company's internal control over financial reporting. The required study will not evaluate the

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[3] See Exchange Act Rule 12b-2 [17 CFR 240.12b-2].

[4] See, e.g., Release No. 33-9072 (Oct. 13, 2009) [74 FR 53628]; and Release 33-8934 (June 26, 2008) [73 FR 38094].

compliance burden of Section 404(a) of the Sarbanes-Oxley Act of 2002, which addresses management's responsibility for reporting on the effectiveness of internal control over financial reporting.

The Commission is required to submit a report of this study to Congress no later than nine months after the date of enactment of the Dodd-Frank Act. All interested parties are invited to submit their views, in writing, on any of the following topics in which they are interested:

(1) quantitative and qualitative information about the trends of internal and external costs of having an external auditor attest to management's assessment under Section 404(b) for issuers with a public float between $75 million and $250 million from the first year of required compliance to the present;

(2) current cost of auditor attestation under Section 404(b) in relation to overall cost of compliance with all of Section 404 (i.e. including management's assessment required by Section 404(a)) and changes to this relative cost over time;

(3) characteristics of internal controls, management's evaluation process and corporate governance of subject issuers that distinguish them from other issuers;

(4) unique audit planning and performance characteristics, if any, associated with subject issuers;

(5) incremental effort for preparers and auditors to comply with the auditor attestation requirement of Section 404(b) for an integrated audit beyond the efforts that would already be incurred to comply with the requirements for a financial statement only audit, including the requirement to evaluate internal controls in connection with such an audit, for subject issuers;

(6) whether and how initiatives of the Commission, such as the Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934,[5] have reduced the burden of complying with Section 404(b) for subject issuers;

(7) whether and how any aspects of Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5,[6] such as its focus on risk and materiality, scalability, tailoring of testing to risk, and extent of permitted use of the work of others, have reduced costs of compliance with Section 404(b) versus PCAOB Auditing Standard No. 2 for subject issuers;

(8) whether and how other initiatives of the PCAOB, such as its staff guidance for auditors of smaller public companies,[7] have reduced the burden of complying with Section 404(b) for subject issuers;

(9) whether and how initiatives of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), such as the June 2006 guidance for smaller public companies on internal control over financial reporting,[8] and the January 2009 Guidance on Monitoring Internal Control Systems,[9] have reduced the burden of complying with Section 404(b) for subject issuers;

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[5] See Release No. 33-8810 (June 20, 2007) [72 FR 35324].

[6] See Order Approving Proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, a Related Independence Rule, and Conforming Amendments, Release No. 34-56152 (July 27, 2007) [72 FR 42141].

[7] See "Staff Views - An Audit of Internal Control that is Integrated with an Audit of the Financial Statements: Guidance for Auditors of Smaller Public Companies" (Jan. 23, 2009), available at www.pcaobus.org.

[8] For further information, see www.coso.org/ICFR-GuidanceforSPCs.htm.

[9] For further information, see www.coso.org/GuidanceonMonitoring.htm.

(10) whether and how initiatives of any other organization have reduced the burden of complying with Section 404(b) for subject issuers;

(11) the possibility that guidance or rules issued by the Commission, PCAOB or others could further reduce the burden of complying with the auditor attestation requirement of Section 404(b), while maintaining investor protection, for subject issuers, and any specific recommendations concerning any such guidance or rules;

(12) the impact on investor protection, investor confidence, and the cost of capital arising from the establishment and ongoing compliance with Section 404(b) by subject issuers, including in the context of initial public offerings;

(13) the degree to which investor protection, investor confidence, and the cost of capital would increase or decrease, if any, as a function of each specific recommendation by which the Commission, the PCAOB, or others might reduce the burden of complying with Section 404(b) for subject issuers, while maintaining investor protection;

(14) the impact of costs of complying with the auditor attestation requirement of Section 404(b) on company decisions to list on exchanges in the United States versus foreign exchanges in initial public offerings for subject issuers after the offering;

(15) the impact of costs of complying with Section 404(b) on company and investor decisions to engage in initial public offerings versus other financing alternatives for issuers whose public float is expected to be between $75 million and $250 million after the offering;

(16) potential effect on the number of companies listing initial public offerings in the United States of a complete exemption from the internal control audit requirements for subject issuers, and the potential effect on listings for each specific recommendation for reducing the compliance burden of such requirements on subject issuers;

(17) any qualitative differences between subject issuers that might list securities on a U.S. exchange in connection with their initial public offerings if the existing internal control audit requirement of Section 404(b) remains in effect and subject issuers that might list securities on a U.S. exchange in connection with their initial public offerings if subject issuers are completely exempt from the internal control audit requirements of Section 404(b), and any such qualitative differences that may arise from each specific recommendation for reducing the compliance burden of such requirements on subject issuers;

(18) the potential effect of a complete exemption from Section 404(b) for subject issuers on matters such as: raising capital; engaging in mergers, acquisitions and similar corporate transactions; and attracting and retaining qualified independent directors;

(19) whether and how the use of the auditor's attestation report on internal control over financial reporting for subject issuers differs from the use of the auditor's attestation report on internal control over financial reporting for issuers whose public float is greater than $250 million and the reason(s) for those differences;

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 249, 270, and 274

[Release Nos. 34-63123; IC-29463; File No. S7-30-10]

RIN 3235-AK67

REPORTING OF PROXY VOTES ON EXECUTIVE COMPENSATION AND OTHER MATTERS

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing rule and form amendments under the Securities Exchange Act of 1934 and the Investment Company Act of 1940 that, if adopted, would require an institutional investment manager that is subject to Section 13(f) of the Securities Exchange Act to report annually how it voted proxies relating to executive compensation matters as required by Section 14A of the Securities Exchange Act, which was added by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

DATES: Comments should be received on or before November 18, 2010.

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-30-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

is also proposing a technical amendment to rule 30b1-4 under the Investment Company Act.[4]

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2 17 CFR 274.129. Currently, Form N-PX is adopted under the Investment Company Act only. In this release, we are proposing to amend Form N-PX under both the Exchange Act and the Investment Company Act.

3 15 U.S.C. 80a-1 et seq.

4 17 CFR 270.30b1-4.

TEXT OF PROPOSED RULE AND FORM AMENDMENTS effective for shareholder meetings occurring on or after January 21, 2011.[7] The requirement for the vote on executive compensation agreements and understandings that relate to certain transactions required by Section 14A(b) will be effective when the Commission's rules implementing that provision become effective. In a companion release, we are proposing rules to implement the voting requirements of Sections 14A(a) and (b) of the Exchange Act.[8]

Section 14A(d) of the Exchange Act requires that every institutional investment manager subject to Section 13(f) of the Exchange Act report at least annually how it voted on the executive compensation-related shareholder votes required by Sections 14A(a) and (b) (the "Section 14A Votes"), unless such vote is otherwise required to be reported publicly by rule or regulation of the Commission. Today, we are proposing rule and form amendments to implement this reporting requirement.

II. Proposed Amendments

To implement Section 14A(d) of the Exchange Act, we are proposing new rule 14Ad-1 under the Exchange Act, which, if adopted, would require institutional investment managers that are required to file reports under Section 13(f) of the Exchange Act to file their record of Section 14A Votes with the Commission annually on Form N-PX. We are also proposing to amend Form N-PX, which is currently used by registered management investment companies ("funds") to file their complete proxy voting records with the Commission, to accommodate the new filings by institutional

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7 See Section 14A(a)(3) of the Exchange Act (making the requirements of Section 14A(a) effective for shareholder meetings occurring after the end of the six-month period beginning on the date of enactment of the Dodd-Frank Act).

8 Exchange Act Release No. 63124 (Oct. 18, 2010).

securities[13] having an aggregate fair market value on the last trading day of any month of any calendar year of at least $100 million.[14] Institutional investment managers meeting this threshold are required to file quarterly reports with the Commission on Form 13F disclosing their holdings of Section 13(f) securities for the final quarter of the calendar year in which the threshold is met and continuing for each of the first three quarters of the subsequent calendar year.[15] In order to implement the requirement of Section 14A(d) of the Exchange Act that "every institutional investment manager subject to section 13(f)" of the Exchange Act report its Section 14A Votes, we are proposing that an institutional

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under its control exercises investment discretion." Rule 13f-1(b) under the Exchange Act [17 CFR 240.13f-1(b)].

Under Section 3(a)(35) of the Exchange Act, "a person exercises 'investment discretion' with respect to an account if, directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and the rules and regulations thereunder."

13 "Section 13(f) securities" mean "equity securities of a class described in section 13(d)(1) of the [Exchange] Act that are admitted to trading on a national securities exchange or quoted on the automated quotation system of a registered securities association." Rule 13f-1(c) under the Exchange Act [17 CFR 240.13f-1(c)]. Equity securities of a class described in Section 13(d)(1) of the Exchange Act [15 U.S.C. 78m(d)(1)] include, among other things, equity securities of a class which is registered pursuant to Section 12 of the Exchange Act, equity securities of an insurance company which would have been required to be so registered except for the exemption contained in Section 12(g)(2)(G) of the Exchange Act, and equity securities issued by a closed-end investment company registered under the Investment Company Act. The Commission publishes a list of Section 13(f) securities that is available on the Commission's Internet website at: http://www.sec.gov/divisions/investment/13flists.htm.

14 Section 13(f)(1) of the Exchange Act [15 U.S.C. 78m(f)(1)]; rule 13f-1(a)(1) under the Exchange Act [17 CFR 240.13f-1(a)(1)].

15 Rule 13f-1(a)(1).

an issuer. Institutional investment managers would not be required to include votes on any other matters in the reports on Form N-PX.[17]

2. Voting Power

Under the proposal, an institutional investment manager would be required to report a Section 14A Vote for a security only if the manager, whether directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, had or shared the power to vote, or to direct the voting of, the security.[18] An institutional investment manager would be required to report a Section 14A Vote if the manager had or shared voting power over the particular Section 14A Vote, without regard to whether the manager had voting power over other matters. Whether a manager has the requisite voting power would depend on an analysis of all the relevant facts and circumstances.[19]

Basing an institutional investment manager's requirement to report a Section 14A Vote on whether it has or shares voting power with respect to the Section 14A Vote appears to be consistent with the plain language of Section 14A(d), which requires a manager to report on "how it voted" on Section 14A Votes. In the case of Section 14A

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17 Funds would continue to be required to report their complete proxy voting record on Form N-PX. See rule 30b1-4 under the Investment Company Act; current and proposed Item 1 of Form N-PX (requiring disclosure of proxy voting information ''for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the report and with respect to which the [fund] was entitled to vote'').

18 Proposed rule 14Ad-1(a); proposed Item 1 of Form N-PX. This is similar to the language of rule 13d-3(a) under the Exchange Act [17 CFR 240.13d-3(a)], which provides that a beneficial owner of a security includes any person who, "directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares . . . [v]oting power which includes the power to vote, or to direct the voting of, such security . . . ."

19 Cf. Exchange Act Release No. 13291 (Feb. 24, 1977) [42 FR 12342, 12344 (Mar. 3, 1977)] (stating that "[a]n analysis of all relevant facts and circumstances in a particular situation is essential in order to identify each person possessing the requisite voting power" to be considered a beneficial owner within the meaning of rule 13d-3 under the Exchange Act).

investment manager is otherwise required to file reports under Section 13(f) of the Exchange Act.

We request comment on the use of voting power as the basis for determining which Section 14A Votes would be reported by an institutional investment manager and, in particular, on the following issues:

- Should the reporting requirement be based on having the power to vote with respect to Section 14A Votes or should we use some other basis, such as investment discretion? Should we, as proposed, base the requirement to file on a manager having either sole or shared voting power?
- Should we provide guidance concerning the circumstances under which a manager has sole or shared voting power? For example, would it be helpful for the Commission to provide guidance regarding the application of the Form N-PX "sole or shared voting power" standard as it would apply to ERISA plans? Commenters who believe that guidance would be helpful are asked to specify the nature of the guidance that would be helpful.

3. Securities with Respect to Which Votes are Required to be Reported

We are proposing that an institutional investment manager report Section 14A Votes with respect to "any security" with respect to which it meets the voting power test described above. Thus, we are not proposing to limit in any way the types of securities with respect to which an institutional investment manager must report its Section 14A Votes.[23] As a result, the proposal would require an institutional investment manager to

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23 Section 14A(a), by its terms, applies to a proxy or consent or authorization for a shareholder meeting "for which the proxy solicitation rules of the Commission require

- Should we prescribe any threshold position size below which a manager would not be required to report its Section 14A Votes? For example, consistent with Form 13F, should a manager be permitted to omit Section 14A Votes from Form N-PX reports with respect to securities where it held fewer than 10,000 shares (or less than $200,000 principal amount in case of convertible debt securities) and less than $200,000 aggregate fair market value? If we adopt a reporting threshold that is different from the Form 13F reporting threshold, or adopt no threshold, will this make the information required to be reported on Form N-PX more difficult to track or impose any other burdens?

C. Time of Reporting

We are proposing to require institutional investment managers to report their Section 14A Votes annually on Form N-PX not later than August 31 of each year, for the most recent twelve-month period ended June 30.[25] This is the same schedule on which funds are required to report their complete proxy voting records on Form N-PX.[26] This reporting schedule is intended to have the same advantages for institutional investment manager reporting that it has for funds, namely, each institutional investment manager's proxy voting record will be available within a relatively short period of time after the proxy voting season, and all institutional investment managers will provide their voting records over a uniform July 1-June 30 period.[27] A uniform reporting schedule for all

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25 Proposed rule 14Ad-1(a); proposed General Instruction A to Form N-PX.

26 Rule 30b1-4.

27 See Investment Company Act Release No. 25922 (Jan. 31, 2003) [68 FR 6564, 6569 (Feb. 7, 2003)] ("Form N-PX Adopting Release") (noting that the approach taken under Form N-PX "will have the advantages of making each fund's proxy voting record

period ending December 31, 2013.[31] Under the proposal, the manager would not be required to file a Form N-PX report for the twelve-month period ending June 30, 2014, but would be required to file a Form N-PX report no later than August 31, 2015, for the twelve-month period from July 1, 2014, through June 30, 2015. The manager would have a minimum of six months (December 31, 2013 - June 30, 2014) before it is required to begin recording its Section 14A Votes for the purposes of reporting on Form N-PX.[32]

In addition, an institutional investment manager would not be required to file a report on Form N-PX with respect to any shareholder vote at a meeting that occurs after September 30 of the calendar year in which the manager's final filing on Form 13F is due. For this purpose, a "final filing" on Form 13F means any quarterly filing on Form 13F if no filing on Form 13F is required for the immediately subsequent calendar quarter.[33] Instead, the manager would be required to file a report on Form N-PX for the period July 1 through September 30 of the calendar year in which the manager's final filing on Form 13F is due. This short-period Form N-PX filing would be due no later than February 28 of the immediately following calendar year.[34] An institutional investment manager's obligation to file Form 13F reports always terminates with the

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[31] The obligation to file Form 13F arises when an institutional investment manager exercises investment discretion over accounts holding at least $100 million in Section 13(f) securities as of the "last trading day of any month of any calendar year." However, the manager's obligation to file Form 13F commences with the report for December 31 of that year, which is required to be filed within 45 days after December 31. Rule 13f-1(a)(1); General Instruction 1 to Form 13F.

[32] An institutional investment manager who crosses the $100 million threshold for the first time on December 31, 2013, would have six months before it is required to begin recording Section 14A Votes on July 1, 2014. By contrast, an institutional investment manager that passes the $100 million threshold on January 31, 2013, would have 17 months before it is required to begin recording Section 14A Votes on July 1, 2014.

[33] Proposed rule 14Ad-1(c); proposed General Instruction A to Form N-PX.

[34] Proposed rule 14Ad-1(c); proposed General Instruction A to Form N-PX.

monthly, quarterly, or semi-annually)? If we require reporting on a schedule other than that proposed, should we also change the schedule on which funds report so that institutional investment managers and funds would report on the same schedule?

- We are proposing that an institutional investment manager would not be required to file a Form N-PX report for the twelve-month period ending June 30 of the calendar year in which the manager's initial filing on Form 13F is due. Is this transition rule appropriate for managers entering the Form 13F and Form N-PX filing requirements, or is some other rule more appropriate? For example, should we require an institutional investment manager to report Section 14A Votes for the period commencing January 1 (rather than July 1) of the calendar year in which the manager's initial filing on Form 13F is due? Or should we require an institutional investment manager to report Section 14A Votes for the period commencing on the first day of the month immediately following the date on which it meets the $100 million threshold? That is, if a manager meets the $100 million threshold on the last trading day of August 2013, should the manager be required to report Section 14A Votes commencing September 1, 2013, rather than July 1, 2014, as proposed? If we require institutional investment managers to report Section 14A Votes for periods earlier than proposed, what, if any, implementation issues would this raise for managers?

We are proposing that if two or more institutional investment managers, each of which is required to report on Form N-PX for the reporting period, shared the power to vote, or to direct the voting of, the same securities on a Section 14A Vote, only one such manager must include the information regarding that vote in its Form N-PX report.[38] In addition, an institutional investment manager would not be required to report Section 14A Votes that are reported on a Form N-PX report that is filed by a fund.[39] An institutional investment manager may, however, choose to report Section 14A Votes that are also reported by another institutional investment manager or a fund.

If an institutional investment manager's Section 14A Votes are reported by another institutional investment manager or a fund, the non-reporting manager must file a Form N-PX report that identifies each institutional investment manager and fund reporting on its behalf.[40] The Form N-PX report of an institutional investment manager that, as permitted, reports Section 14A Votes that are subject to shared voting power must identify any other institutional investment managers on whose behalf the filing is made.[41] The Form N-PX report of a fund that reports proxy votes that would otherwise be required to be reported by an institutional investment manager must identify any institutional investment managers on whose behalf the filing is made.[42] This information

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38 Proposed General Instruction D.1 to Form N-PX.

39 Proposed General Instruction D.2 to Form N-PX. Because Form N-PX will permit cross-references to Form N-PX reports filed by other institutional investment managers and by funds, we propose to delete the current instruction that prohibits incorporating any information by reference. See current General Instruction D to Form N-PX.

40 Proposed General Instruction D.3 to Form N-PX.

41 Proposed General Instruction D.4 to Form N-PX.

42 Proposed General Instruction D.5 to Form N-PX.

be presented in the format and order provided in the form, and additional information would not be permitted in the Cover Page or Summary Page.[44] A report filed by an institutional investment manager would be required to be signed on behalf of the manager by an authorized person.[45]

1. The Cover Page

The Cover Page of Form N-PX would, as it does today, require the name of the reporting person, the address of its principal executive offices, the name and address of the agent for service, the telephone number of the reporting person, identification of the reporting period, and the reporting person's file number.[46] We are proposing to delete the requirement that the Cover Page include the date of the reporting person's fiscal year end which currently applies to Form N-PX filings by funds because the fiscal year end of the reporting person appears to be unrelated to the information reported on Form N-PX, which would be filed on a uniform July 1-June 30 basis. In addition, for funds, the fiscal year end information in Form N-PX duplicates information that is required in other Commission filings.[47]

Currently, Form N-PX does not expressly provide for amendments to a previously filed report. We are proposing to include a new section on the Cover Page of Form N-PX to be used in cases where the filing is an amendment to a previously filed Form N-PX

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44 Proposed Special Instruction A.2 to Form N-PX.

45 Proposed General Instruction E.2.a to Form N-PX. A report filed by a fund would continue to be required to be signed on behalf of the fund by its principal executive officer or officers. Id.; current General Instruction F.2 to Form N-PX.

46 In the case of a fund, the file number is an Investment Company Act number beginning "811-." In the case of an institutional investment manager, the file number is a Form 13F number beginning "28-."

47 See, e.g., Form N-CSR [17 CFR 249.331 and 274.128] (cover page); Form N-Q [17 CFR 249.332 and 274.130] (cover page).

investment managers or funds under the provisions to prevent duplicative reporting; and (4) institutional investment manager "combination" report when the report contains some Section 14A Votes of the manager and some Section 14A Votes of the manager are reported by other institutional investment managers or funds under the provisions to prevent duplicative reporting. In addition, when the report type is in the third or fourth category, the Cover Page would be required to include a list of the file numbers and names of the other institutional investment managers and funds whose Form N-PX reports include Section 14A Votes of the reporting manager.[50]

We request comment on the proposed Cover Page of Form N-PX and, in particular, on the following issues:

- Should we adopt the Cover Page as proposed, or should we modify it in any way, e.g., by adding or removing information? Would the proposed Cover Page adequately identify the reporting person and the reporting period? Would the proposed Cover Page adequately enable users to identify a reporting person's Form N-PX report for a given period and any amendments to that report? Would the proposed Cover Page adequately enable users to identify the type of reporting person? In the case of a report filed by an institutional investment manager, would the proposed Cover Page adequately enable users to identify reports filed by other persons that contain Section 14A Votes for which the manager had, or shared, voting power?

[50] Proposed Special Instruction B.2 to Form N-PX.

votes of an institutional investment manager other than the reporting person, the word "NONE" would be entered under the title and the column headings and list entries would not be included.[56] If a Form N-PX report does report the proxy votes of one or more institutional investment managers other than the reporting person, the list would be required to include all such managers (not including the reporting person) together with their respective Form 13F file numbers. In addition, each such manager in the list should be assigned a number (which need not be consecutive), and the list should be presented in sequential order.[57] These numbers would be used in identifying the particular manager(s) who had or shared the power to vote, or to direct the voting of, the securities voted.[58] Requiring the list to be sequential is intended to make the list easier to use. Permitting the list to be non-consecutive is intended to facilitate assigning the same number to the same manager across filings of different reporting persons and different time periods.

<u>We request comment on the proposed Summary Page of Form N-PX and, in particular, on the following issues</u>:

- Should we adopt the Summary Page, as proposed, or should we modify it in any way? Will the Summary Page enable users to readily identify any institutional investment managers whose Section 14A Votes are included in a Form N-PX report?

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56 Proposed Special Instruction C.2.a to Form N-PX.

57 Proposed Special Instruction C.2.b to Form N-PX. <u>Cf.</u> Special Instruction 8.b to Form 13F (requirement to assign sequential numbers to managers included in another manager's report on Form 13F).

58 <u>See</u> <u>infra</u> note 87 and accompanying text.

- The name of the issuer of the security;[64]
- The exchange ticker symbol of the security;[65]
- The Council on Uniform Securities Identification Procedures ("CUSIP") number for the security;[66]
- The shareholder meeting date;[67]
- A brief identification of the matter voted on;[68]
- For reports filed by funds (but not by institutional investment managers), whether the matter was proposed by the issuer or by a security holder;[69]
- The number of shares the reporting person was entitled to vote (for funds) or had or shared voting power over (for institutional investment managers);[70]
- The number of shares that were voted;[71]
- How the reporting person voted those shares (e.g., for or against proposal, or abstain; for or withhold regarding election of directors) and, if the votes

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64 Proposed Item 1(a) of Form N-PX.

65 Proposed Item 1(b) of Form N-PX. As is currently the case, the exchange ticker symbol may be omitted if it is not available through reasonably practicable means, e.g., in the case of certain securities of foreign issuers. Proposed Special Instruction D.2 to Form N-PX; current Instruction 2 to Item 1 of Form N-PX.

66 Proposed Item 1(c) of Form N-PX. As is currently the case, the CUSIP number may be omitted if it is not available through reasonably practicable means, e.g., in the case of certain securities of foreign issuers. Proposed Special Instruction D.2 to Form N-PX; current Instruction 2 to Item 1 of Form N-PX.

67 Proposed Item 1(d) of Form N-PX.

68 Proposed Item 1(e) of Form N-PX.

69 Proposed Item 1(f) of Form N-PX.

70 Proposed Item 1(g) of Form N-PX.

71 Proposed Item 1(h) of Form N-PX.

As noted above, we are proposing to amend Form N-PX to require that information be disclosed in a standardized order.[75] This change is intended to facilitate comparisons of voting records among reporting persons.[76] This requirement would apply to both institutional investment managers and funds.

As proposed, Form N-PX would continue to require funds to disclose whether a matter was proposed by the issuer or by a security holder, but would not extend this requirement to institutional investment managers.[77] We are not proposing that institutional investment managers make this disclosure because Section 14A Votes relate exclusively to matters proposed by issuers and not by security holders.

We are proposing to amend Form N-PX to provide information about the number of shares voted which will, among other things, accommodate different votes on the same matter by the same reporting person.[78] This could occur, for example, when an institutional investment manager votes for a matter, on behalf of one client, and against the same matter, on behalf of a different client. We are concerned that, if we do not make specific provision for this situation, the information filed on Form N-PX could, in a number of cases, be rendered largely meaningless because it would indicate that a

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75 See proposed Special Instruction D.1 to Form N-PX.

76 In July of this year, we published a concept release in which we requested comment on amending Form N-PX to require either a standardized reporting format or tagged information in order to facilitate comparisons of proxy voting records among funds. See Exchange Act Release No. 62495 (July 14, 2010) [75 FR 42982, 43008 (July 22, 2010)] ("Concept Release"). The comment period for the Concept Release closes on October 20, 2010.

77 See proposed Item 1(f) of Form N-PX; cf. current Item 1(f) of Form N-PX (requirement currently applicable to funds).

78 See Concept Release, supra note 76, 75 FR at 42994-95 (requesting comment on amending Form N-PX to require funds to disclose the actual number of shares voted).

We are proposing to extend the disclosures relating to the number of shares the reporting person was entitled to vote and the number of those shares that were voted in each manner to funds. In the case of Section 14A Votes, we believe these disclosures by funds are necessary to achieve consistent reporting with respect to institutional investment manager votes because a portion of the votes of those managers may be reported on Form N-PX reports filed by funds under the provisions to prevent duplicative reporting.[84] Therefore, unless we require funds to report this information, the record of institutional investment managers will be incomplete. In addition, information about the magnitude of a fund's voting power and the number of votes cast contribute to the transparency of proxy voting. For that reason, we are also proposing to extend the new requirements to the complete proxy voting records of funds. This is intended to improve transparency of fund proxy voting records and enable fund shareholders to better monitor their funds' involvement in the governance activities of portfolio companies.[85]

As described above, in order to prevent duplicative reporting, the Section 14A Votes of an institutional investment manager may, in some cases, be reported on the Form N-PX report of another institutional investment manager or a fund.[86] In order to ensure that the particular votes with respect to which each institutional investment manager had or shared voting power may be identified, we are proposing to require that

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reported. Similarly, a fund would be required to separately report shares with respect to which different institutional investment managers or groups of institutional investment managers have or share voting power.

84 See discussion supra Part II.D.

85 See Form N-PX Adopting Release, supra note 27, at 6580 (noting Commission's belief "that requiring funds to disclose their complete proxy voting records will benefit investors by improving transparency and enabling fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies").

86 See discussion supra Part II.D.

management's recommendation."[90] Currently, Form N-PX requires funds to disclose whether the vote was "for or against management."[91] This amendment is intended to clarify that the report is required to disclose how the vote was cast in relation to management's recommendation, as opposed to how the vote may have affected management.

We request comment on the information that we propose to require be disclosed in Form N-PX reports, and, in particular, on the following issues:

- We are proposing to require the disclosure of substantially the same information under amended Form N-PX that we currently require funds to disclose on Form N-PX. Should we modify the proposed content requirements in any way for either institutional investment managers or funds? Is there any information that we propose to require that should not be required? Is there additional information that should be required?
- Should we, as proposed, require the information in Form N-PX reports to be disclosed in a standardized order? Would this facilitate comparisons or be otherwise useful to users of this information? What costs, if any, would be associated with standardization? Should the requirement to standardize apply to institutional investment managers, funds, or both? If we standardize the order of the information in Form N-PX reports, should we use the order set forth in our proposal, or would some other order of information be more appropriate?

90 Proposed Item 1(j) of Form N-PX. Management's recommendation would include any recommendation from a company's board of directors or any board committee (e.g., audit committee or compensation committee).

91 Current Item 1(i) of Form N-PX.

- Should we, as proposed, require a reporting person to identify, for each vote reported, each institutional investment manager who had or shared voting power as to the securities voted? Or is it sufficient to require a reporting person to disclose on the Summary Page the institutional investment managers for whom it is reporting, without identifying, for each vote reported, the institutional investment managers who have or share voting power? If we require identification of the institutional investment managers that have or share voting power for each vote reported, should we use the sequential numbering system that we have proposed for the Summary Page, or should we instead use the managers' Form 13F file numbers, i.e., the numbers beginning "28-?"
- Should we, as proposed, require standardized descriptions to be used to identify Section 14A Votes? Is the proposed standardization likely to be useful to users of the information? Should we modify the proposed descriptions in any way? What would be the benefits and costs of requiring this standardization? What are the benefits of standardizing descriptions only with respect to Section 14A Votes while not standardizing descriptions with respect to other matters? Are there alternative methods for achieving any benefits that would accrue from such standardization, e.g., by requiring standardized computer tags to be used to identify various types of proxy vote matters? What would be the costs associated with these alternatives?

We are proposing to include instructions in Form N-PX that prescribe the specific procedures to be used in requesting confidential treatment of information filed on Form N-PX, the required content of a confidential treatment request, and the required filing of information that is no longer entitled to confidential treatment.[96] These instructions are based on the Form 13F confidential treatment instructions, which apply in similar circumstances.[97] We note that current Form N-PX does not include any confidential treatment instructions. Currently, there is transparency of fund portfolio holdings information apart from Form N-PX,[98] and, as a result, we are not aware of any situation in which confidential treatment would be appropriate for information filed by funds on Form N-PX.

We request comment on the confidential treatment provisions of the proposed amendments to Form N-PX and, in particular, on the following issues:

- In what, if any, circumstances would it be appropriate for the Commission to grant confidential treatment to information filed on Form N-PX by institutional investment managers? Should Form N-PX or rules of the Commission identify certain circumstances in which confidential treatment may be appropriate?
- Are the proposed instructions to Form N-PX that prescribe the specific procedures to be used by institutional investment managers that are requesting confidential treatment, the required content of a confidential

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96 See proposed Confidential Treatment Instructions to Form N-PX.

97 See Form 13F Instructions for Confidential Treatment Requests.

98 Portfolio holdings information is required to be disclosed by funds on a quarterly basis with a 60-day lag, through semi-annual shareholder reports pursuant to rule 30e-1 under the Investment Company Act [17 CFR 270.30e-1] and Form N-Q.

compliance dates are intended to provide a uniform mechanism of reporting votes at meetings that occur on or after January 21, 2011, because funds will be permitted to report Section 14A Votes for institutional investment managers. However, in order to reduce the burden of compliance, funds would not be required to report pre-January 21, 2011 votes using the new requirements.

We request comment on the proposed compliance dates and, in particular, on the following issues:

- Would the proposed compliance dates provide adequate lead time for institutional investment managers that would be required to file Form N-PX for the first time? Would the proposed compliance dates provide adequate lead time for funds that would be required to comply with the amendments to Form N-PX? What, if any, implementation issues would be raised for institutional investment managers, funds, and their service providers in complying with the proposals?
- How should we address any implementation issues? Should we, for example, permit delayed filing (e.g., to September 30, October 31, November 30, or December 31, 2011) of Form N-PX for institutional investment managers, funds, or both for the period ended June 30, 2011, in order to provide more time to prepare the initial filings on revised Form N-PX? As another alternative, should we not require institutional investment managers to report Section 14A Votes that occur before July 1, 2011, on Form N-PX, with the result that institutional investment managers would file their first report on Form N-PX not later than August

Section 14A(d) of the Exchange Act requires that every institutional investment manager subject to Section 13(f) of the Exchange Act report at least annually how it voted on the executive compensation-related shareholder votes required by Sections 14A(a) and (b) (the "Section 14A Votes"), unless such vote is otherwise required to be reported publicly by rule or regulation of the Commission. To implement Section 14A(d), we are proposing new rule 14Ad-1 under the Exchange Act, which, if adopted, would require institutional investment managers that are required to file reports under Section 13(f) of the Exchange Act to file their record of Section 14A Votes with the Commission annually on Form N-PX. We are also proposing to amend Form N-PX (OMB Control No. 3235-0582), which was adopted pursuant to Section 30 of the Investment Company Act[103] and is currently used by funds to file their complete proxy voting records with the Commission, to accommodate the new filings by institutional investment managers.

Form N-PX, including the proposed amendments, contains collection of information requirements. Form N-PX is currently used by funds to file their complete proxy voting records with the Commission. Compliance with the disclosure requirements of the form is mandatory. Responses to the disclosure requirements would not be kept confidential unless granted confidential treatment.

The proposed amendments to Form N-PX would accommodate reporting of Section 14A Votes by institutional investment managers. The amended form, as proposed, would consist of three parts: an amended Cover Page, a new Summary Page, and proxy voting information. Under the proposed amendments, funds and institutional

[103] 15 U.S.C. 80a-29.

be 14.4 hours per response for portfolios holding equity securities and 0.17 hours (10 minutes) per response for portfolios holding no equity securities, for a total annual hour burden of approximately 89,900 hours when calculated using the current number of portfolios.[105] There are currently no external costs associated with Form N-PX for purposes of the PRA.

We are proposing to revise our current PRA estimates of the burden to funds of complying with Form N-PX. It is our understanding that most funds hire third-party service providers, such as proxy advisory firms, to assist with the administrative tasks associated with voting, recording voting decisions, and preparing the reports to be filed on Form N-PX. As a result, we are proposing to reduce our estimate of the current PRA burden of Form N-PX for portfolios holding equity securities from 14.4 hours to 7.2 hours[106] and add external costs of $1,000 per portfolio paid to third-party service providers.[107] We propose no changes to our current estimate for portfolios holding no equity securities because they generally have no proxy votes to report and therefore do

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Assets (June 2010); Investment Company Institute, Supplemental Trends Tables (June 2010).

105 (6,200 portfolios that hold equity securities x 14.4 hours per year) + (3,900 portfolios holding no equity securities x 0.17 hours per year) = 89,943 hours. See also 74 FR 475 (Jan. 6, 2009) (most recent submission to OMB to request extension of the previously approved collection of information for Form N-PX).

106 When we adopted Form N-PX in 2003, we estimated a PRA burden of 14.4 hours and no external costs. Form N-PX Adopting Release, supra note 27, at 6573-74. We also estimated that attorneys and programmers would divide time equally on compliance with the proxy voting disclosure requirements. Id. at 6576 n.77. Our revised estimate removes the estimated hours allocated to programmers because we believe that this burden is now generally borne through external costs charged by third-party service providers.

107 This estimate is based on the Commission staff's consultations with third-party service providers that assist funds with the administrative tasks associated with voting, recording voting decisions, and preparing reports to be filed on Form N-PX.

the proposed amendments would increase the total annual PRA burden for funds to comply with Form N-PX by approximately 9,300 hours[112] and would not increase or decrease external costs.

The Commission estimates that there are approximately 4,000 institutional investment managers that are required to file reports under Section 13(f) of the Exchange Act that would be required under the proposed amendments to file their record of Section 14A Votes with the Commission annually on Form N-PX.[113] We also estimate that approximately 200 amendments to Form N-PX reports will be filed annually by institutional investment managers as a result of the final adverse disposition of a request for confidential treatment or upon expiration of previously granted confidential treatment.[114] We further estimate that for each institutional investment manager required to file its record of Section 14A Votes on Form N-PX, compliance attorneys would spend an average of 8.7 hours per year to review filings on Form N-PX made under the

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112 6,200 portfolios holding equity securities x 1.5 hours per year = 9,300 hours per year.

113 Based on Commission staff analysis of Form 13F reports filed with the Commission.

114 See proposed Confidential Treatment Instructions 6 and 7 to Form N-PX. Our estimate is based on the number of Form 13F amendments received by the Commission during the year ended June 30, 2010, divided by four. We have assumed there will be fewer amendments for Form N-PX because we believe that an annual filing (as opposed to quarterly filings in the case of Form 13F) will result in fewer confidential treatment requests for Form N-PX. For purposes of this estimate, we are conservatively assuming that all 200 amendments filed are related to the adverse disposition of a request for confidential treatment or the expiration of previously granted confidential treatment, although some may be amendments filed to correct errors or omissions in a previous filing. Like the current PRA estimate for Form N-PX, our proposed estimate does not allocate a separate burden to amendments that merely correct errors or omissions in a separate filing. For that reason, and because we do not expect funds to file confidential treatment-related amendments, we are not including a burden estimate for amendments filed by funds. See supra text accompanying note 98.

managers) to comply with the requirements of Form N-PX would be approximately 89,600 hours[120] and approximately $10.2 million in external costs.[121] We do not believe that there will be any initial PRA burden that will be incurred beyond the annual PRA burden.[122] We further believe that many reporting persons are already tracking the data required to be reported by our proposal.[123]

Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comments to: (1) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the proposed collections of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology. We request comment and supporting empirical data on our burden and cost estimates for the proposed amendments, including the external costs that reporting persons may incur.

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120 45,303 hours under revised current burden for funds + 9,300 hours estimated to be incurred by funds under proposed amendments + 35,000 hours estimated to be incurred by institutional investment managers under proposed amendments = 89,603 hours.

121 $6,200,000 under revised current burden for funds + $4,000,000 estimated to be incurred by institutional investment managers under proposed amendments = $10,200,000.

122 Based on Commission staff consultations with funds and third-party service providers.

123 Id. See also DOL Interpretive Bulletin, supra note 20 (noting the Department of Labor's view that an investment manager or other ERISA plan fiduciary would be required to maintain accurate records as to proxy voting decisions).

the Commission, to accommodate the new filings by institutional investment managers. The Commission is sensitive to the costs and benefits imposed by its rules and has identified certain costs and benefits of the proposed rule and form amendments, as described below.

A. Benefits

The proposed new rule and form amendments would make important information about Section 14A Votes by institutional investment managers publicly available. The information would include the number of shares over which the manager had or shared voting power, the number of shares voted, and how the shares were voted by the manager. For funds, the proposed amendments to Form N-PX would require funds to disclose enhanced information by presenting the information in a standardized order and by disclosing the number of shares that the fund was entitled to vote and the number of shares voted. We believe that the information required to be provided by our proposal would increase the transparency regarding Section 14A Votes by institutional investment managers and funds.

The proposed new rule and amendments to Form N-PX may benefit the securities markets by providing access to information about how institutional investment managers exercise proxies with respect to Section 14A Votes. We note that institutional investment managers that file reports on Form 13F exercised investment discretion over approximately $11.1 trillion in Section 13(f) equity securities as of December 31, 2009.[124] In many cases, the institutional investment managers also have or share the power to vote proxies relating to these equity securities. This voting power gives

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[124] Based on information obtained from the Thomson Reuters Institutional (13F) Holdings database.

we believe that the additional information may benefit fund investors by helping them to understand a fund's proxy voting record.

B. Costs

The new rule and form amendments would lead to some additional costs for institutional investment managers and funds and fund investors. The resulting costs may include both internal costs (for compliance attorneys to review the required disclosures) and external costs (such as costs associated with third-party service providers to collect and report the information disclosed in Form N-PX reports). If an institutional investment manager has voting power with respect to a client's securities, these costs may be passed on to the client.

First, if adopted, our proposals would impose costs on institutional investment managers because they would implement the disclosure requirements of Section 14A by requiring institutional investment managers to file their record of Section 14A Votes with the Commission annually on Form N-PX. Based on our PRA analysis, we estimate that the costs for each institutional investment manager attributable to the proposed new rule and form amendments would be approximately \$2,350 in internal costs for compliance attorneys per annual filing,[125] \$270 in internal costs for compliance attorneys per amendment,[126] and \$1,000 in external costs for third-party service providers[127] to prepare,

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125 We estimate that compliance attorneys will spend 8.7 hours to review annual filings on Form N-PX. See supra note 115 and accompanying text. The hourly wage rate of \$270 for a compliance attorney is based on the salary information from the Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2009, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. Therefore, the internal costs associated with this burden equal approximately \$2,350 per institutional investment manager (8.7 hours x \$270 per hour = \$2,349).

126 We estimate that compliance attorneys will spend 1 hour per amendment to review amendments to filings on Form N-PX. See supra note 116 and accompanying text. For

These proposals are intended to implement the disclosure required by Section 14A(d) of the Exchange Act, which was added by Section 951 of the Dodd-Frank Act. In general, the costs and other economic effects that result from requiring such disclosure are mandated under Section 14A(d). We believe that our proposal to use Form N-PX to implement the congressionally mandated proxy vote reporting requirements would mitigate the costs of compliance, because the existing form is supported by a number of third-party service providers and is already used by the many institutional investment managers who currently file Form N-PX reports on behalf of funds. We further believe that many reporting persons are already tracking the data required to be reported by our proposal. Finally, the proposal would mitigate compliance costs by including provisions intended to prevent duplicative reporting of Section 14A Votes.

C. Request for Comments

We request comments on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of, or suggested alternatives to, the proposed amendments. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 23(a)(2) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and 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.[131] Further, Section 3(f) of the Exchange Act requires the Commission,

131 15 U.S.C. 78w(a)(2).

rule and form amendments may encourage competition by raising awareness about institutional investment manager voting on Section 14A Votes and facilitate differentiation among institutional investment managers. Although we recognize that the proxy vote reporting requirements may require institutional investment managers and funds to expend resources that could be used for other purposes, we do not anticipate that the proposed new rule and form amendments would impose an undue burden on competition or efficiency because we believe that many reporting persons are already tracking the data required to be reported by our proposal. Our proposal implements the requirements of Section 14A(d) in a manner that is intended to minimize the costs for reporting persons and may have a positive effect on capital formation.

We request comment on whether the proposed rule and form amendments, if adopted, would promote efficiency, competition, and capital formation. We also request comment on whether the proposed rule and form amendments would impose a burden on competition. Commenters are requested to provide empirical data and other factual support for their views if possible.

VII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act.[134] It relates to the Commission's proposed new rule 14Ad-1 under the Exchange Act and proposed amendments to Form N-PX under the Exchange Act and the Investment Company Act.

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[134] 5 U.S.C. 603 et seq.

The Commission's rules under the Exchange Act that define a "small business" and "small organization" do not provide a definition specifically covering institutional investment managers. The Commission's rules do, however, provide definitions with respect to the terms "person" and "broker or dealer." Under our rules, "small business" and "small organization," when used with reference to (1) a person other than an investment company, generally means a person with total assets of $5 million or less on the last day of its most recent fiscal year; and (2) a broker or dealer, generally means a broker or dealer that has total capital 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 that is not a small business or small organization.[136]

We believe that the categories "person" and "broker or dealer" are appropriate categories of entities for purposes of analyzing whether the proposed rule and form amendments would have a significant economic impact on a substantial number of small entities that are institutional investment managers that are required to file reports under Section 13(f). We believe that institutional investment managers that invest in or buy and sell securities for their own account would be covered under the "person" category. Institutional investment managers that exercise investment discretion with respect to the account of another person generally will be either a "broker or dealer" or otherwise be in the "person" category. Therefore, we believe that the affected managers would be covered under the categories "person" or "broker or dealer."

With respect to institutional investment managers that invest in or buy and sell securities for their own account, such managers are only required to file reports under

[136] 17 CFR 240.0-10.

D. Reporting, Recordkeeping, and Other Compliance Requirements

We are proposing new rule 14Ad-1 under the Exchange Act, which, if adopted, would require institutional investment managers that are required to file reports under Section 13(f) of the Exchange Act to file their record of how they voted on Section 14A Votes with the Commission annually on Form N-PX. We are also proposing to amend Form N-PX, which is currently used by funds to file their complete proxy voting records with the Commission, to accommodate the new filings by institutional investment managers.

Proposed new rule 14Ad-1, if adopted, would apply to institutional investment managers required to file reports under Section 13(f) of the Exchange Act. We are proposing to require an institutional investment manager that is required to report on Form N-PX to include in the report the manager's proxy voting record for each Section 14A Vote with respect to which the manager, whether directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, had or shared the power to vote, or to direct the voting of, any security. We are also proposing to require institutional investment managers to report their Section 14A Votes annually on Form N-PX not later than August 31 of each year, for the most recent twelve-month period ended June 30.

The proposed amendments to Form N-PX would apply to institutional investment managers and funds, including those that are small entities. We are proposing to include a new section on the Cover Page of Form N-PX where the reporting person would provide information in cases where the form is filed as an amendment to a previously filed Form N-PX report. We are also proposing to require that the Cover Page include

(2) an institutional investment manager to satisfy its reporting obligations by reference to the Form N-PX report of a fund that includes the manager's Section 14A Votes.

Finally, we are proposing to require that, in the case of Section 14A Votes, standardized descriptions be used to provide the required brief identification of the matter voted on. Under our proposal, votes pursuant to Section 14A(a)(1) of the Exchange Act would be identified as "14A Executive Compensation," votes pursuant to Section 14A(a)(2) of the Exchange Act would be identified as "14A Executive Compensation Vote Frequency," and votes pursuant to Section 14A(b) of the Exchange Act would be identified as "14A Extraordinary Transaction Executive Compensation."

For purposes of the cost/benefit analysis, we have estimated that the aggregate annual costs imposed by the proposed rule and form amendments on institutional investment managers would be approximately $13.5 million.[139] We have further estimated that the aggregate annual costs imposed by the proposed form amendments on funds would be approximately $2.5 million.[140]

The Commission solicits comment on these estimates and the anticipated effect the proposed amendments would have on small entities subject to the rule.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap, or conflict with the proposed rule and rule and form amendments.

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[139] See supra note 128 and accompanying text.

[140] See supra note 130 and accompanying test.

managers will be reported on Form N-PX reports filed by funds under the provisions to prevent duplicative reporting. Therefore, unless we require funds to report this information, the record of institutional investment managers will be incomplete. In addition, information about the magnitude of a reporting person's voting power and the number of votes cast contributes to the transparency of proxy voting. For that reason, we are also proposing to extend the new requirements to the complete proxy voting records of funds. This is intended to improve transparency of fund proxy voting records and enable fund shareholders to better monitor their funds' involvement in the governance activities of portfolio companies. Therefore, we believe it is important for the proposed amendments to apply to all funds, regardless of size.

We have endeavored through the proposed amendments to Form N-PX to minimize the regulatory burden on institutional investment managers and funds, including small entities, while meeting our regulatory objectives. Form N-PX is supported by a number of third-party service providers and is already used by the many institutional investment managers who currently file Form N-PX reports on behalf of funds. We have endeavored to clarify, consolidate, and simplify the requirements applicable to institutional investment managers and funds, including those that are small entities. Finally, we do not consider the use of performance rather than design standards to be consistent with the congressional mandate in the Dodd-Frank Act.

G. Request for Comment

The Commission encourages the submission of written comments with respect to any aspect of this analysis. Comment is specifically requested on the number of small entities that would be subject to the proposed rule and form amendments and the likely impact of the proposal on those small entities. Commenters are asked to describe the

Protection Act. The Commission is proposing amendments to rule 30b1-4 pursuant to the authority set forth in Section 951(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Sections 8, 30, 31, 38, and 45 of the Investment Company Act [15 U.S.C. 80a-8, 80a-29, 80a-30, 80a-37, and 80a-44]. The Commission is proposing amendments to Form N-PX pursuant to the authority set forth in Sections 13, 23(a), 24, and 36 of the Exchange Act [15 U.S.C. 78m, 78w(a), 78x, and 78mm]; Section 951(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and Sections 8, 30, 31, 38, and 45 of the Investment Company Act [15 U.S.C. 80a-8, 80a-29, 80a-30, 80a-37, and 80a-44].

List of Subjects

17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE AND FORM AMENDMENTS

For the reasons set out in the preamble, the Commission proposes to amend Title 17, Chapter II, of the Code of Federal Regulations as follows:

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

1. The authority citation for Part 240 is amended by adding the following citation in numerical order 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–

paragraph, "initial filing" on Form 13F means any quarterly filing on Form 13F if no filing on Form 13F was required for the immediately preceding calendar quarter.

(c) An institutional investment manager is not required to file a report on Form N-PX (§§ 249.326 and 274.129 of this chapter) with respect to any shareholder vote at a meeting that occurs after September 30 of the calendar year in which the manager's final filing on Form 13F (§ 249.325 of this chapter) is due pursuant to § 240.13f-1 of this part. An institutional investment manager is required to file a Form N-PX for the period July 1 through September 30 of the calendar year in which the manager's final filing on Form 13F is due pursuant to § 240.13f-1 of this part; this filing is required to be made not later than February 28 of the immediately following calendar year. For purposes of this paragraph, "final filing" on Form 13F means any quarterly filing on Form 13F if no filing on Form 13F is required for the immediately subsequent calendar quarter.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249 is amended by adding the following citation in numerical order to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Section 249.326 is also issued under sec. 951(d), Pub. L. 111-203, 124 Stat. 1376.

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4. The heading for Subpart D is revised to read as follows:

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PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

8. The authority citation for Part 274 is amended by adding the following citation in numerical order to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

Section 274.129 is also issued under sec. 951(d), Pub. L. 111-203, 124 Stat. 1376.

* * * * *

9. The heading of § 274.129 is revised to read as follows:

§ 274.129 Form N-PX, annual report of proxy voting record.

* * * * *

10. Form N-PX (referenced in §§ 249.326 and 274.129) is revised to read as follows:

Note: The text of Form N-PX does not, and these amendments will not, appear in the Code of Federal Regulations.

Institutional Manager is not required to file a report on Form N-PX with respect to any shareholder vote at a meeting that occurs after September 30 of the calendar year in which the manager's final filing on Form 13F is due pursuant to Rule 13f-1 under the Exchange Act. An Institutional Manager is required to file a Form N-PX for the period July 1 through September 30 of the calendar year in which the manager's final filing on Form 13F is due pursuant to Rule 13f-1 under the Exchange Act; this filing is required to be made not later than February 28 of the immediately following calendar year. For purposes of this paragraph, an "initial filing" on Form 13F means any quarterly filing on Form 13F if no filing on Form 13F was required for the immediately preceding calendar quarter, and "final filing" on Form 13F means any quarterly filing on Form 13F if no filing on Form 13F is required for the immediately subsequent calendar quarter.

B. Application of General Rules and Regulations.

The General Rules and Regulations under the Investment Company Act and the Exchange Act contain certain general requirements that are applicable to reporting on any form under those Acts. 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 instructions shall be controlling.

C. Preparation of Report.

1. This form is not to be used as a blank form to be filled in, but only as a guide in preparing the report in accordance with Rules 12b-11 (17 CFR 240.12b-11) and 12b-12 (17 CFR 240.12b-12) under the Exchange Act (for reports filed by Institutional Managers) and Rules 8b-11 (17 CFR 270.8b-11) and 8b-12 (17 CFR 270.8b-12) under the Investment Company Act (for reports filed by

Managers on whose behalf the filing is made in the manner described in Special Instruction C.2.

5. A registered management investment company reporting proxy votes that would otherwise be required to be reported by an Institutional Manager must identify any Institutional Managers on whose behalf the filing is made in the manner described in Special Instruction C.2.

E. Signature and Filing of Report.

1. If the report is filed in paper pursuant to a hardship exemption from electronic filing (see Item 201 et seq. of Regulation S-T (17 CFR 232.201 et seq.)), eight complete copies of the report shall be filed with the Commission. At least one complete copy of the report filed with the Commission must be manually signed. Copies not manually signed must bear typed or printed signatures.

2. a. For reports filed by registered management investment companies, the report must be signed on behalf of the registered management investment company by its principal executive officer or officers. For reports filed by Institutional Managers, the report must be signed on behalf of the Institutional Manager by an authorized person.

   b. The name and title of each person who signs the report shall be typed or printed beneath his or her signature. Attention is directed to Rule 12b-11 under the Exchange Act and Rule 8b-11 under the Investment Company Act concerning manual signatures and signatures pursuant to powers of attorney.

a. For a report by a registered management investment company, check the box for Report Type "Registered Management Investment Company Report," omit from the Cover Page the List of Other Persons Reporting for this Manager, and include both the Summary Page and the Proxy Voting Information.

b. For a report by an Institutional Manager that includes all proxy votes required to be reported by the Institutional Manager, check the box for Report Type "Institutional Manager Voting Report," omit from the Cover Page the List of Other Persons Reporting for this Manager, and include both the Summary Page and the Proxy Voting Information.

c. For a report by an Institutional Manager, when all proxy votes required to be reported by the Institutional Manager are reported by another Institutional Manager or Managers or by one or more registered management investment companies, check the box for Report Type "Institutional Manager Notice," include (on the Cover Page) the List of Other Persons Reporting for this Manager, and file the Cover Page and required signature only.

d. For a report by an Institutional Manager, if only part of the proxy votes required to be reported by the Institutional Manager are reported by another Institutional Manager or Managers or one or more registered management investment companies, check the box for Report Type "Institutional Manager Combination Report," include (on the Cover Page)

D. Proxy Voting Information.

1. Disclose the information required by Item 1 in the order presented in paragraphs (a)-(k) of Item 1.

2. The exchange ticker symbol or CUSIP number required by paragraph (b) or (c) of Item 1 may be omitted if it is not available through reasonably practicable means, e.g., in the case of certain securities of foreign issuers.

3. Item 1(e) requires a brief identification of the matter for all matters. In responding to Item 1(e), the reporting person should identify any matter that is a shareholder vote pursuant to Section 14A of the Exchange Act in the following manner:

   a. Identify a Section 14A(a)(1) vote as "14A Executive Compensation."

   b. Identify a Section 14A(a)(2) vote as "14A Executive Compensation Vote Frequency."

   c. Identify a Section 14A(b) vote as "14A Extraordinary Transaction Executive Compensation."

4. In responding to Item 1(g), an Institutional Manager must report the number of shares over which the Institutional Manager had sole voting power separately from the number of shares over which the Institutional Manager had shared voting power. In responding to Item 1(g), an Institutional Manager also must separately report shares when the groups of Institutional Managers who share voting power are different. For example, if the reporting Institutional Manager shares voting power with respect to 10,000 shares with Manager A and shares voting power with respect to 50,000 shares with

that confidential information has been omitted from the public Form N-PX report and filed separately with the Commission.

3. A reporting person must file in paper, in accordance with Rule 101(c)(1)(i) of Regulation S-T (17 CFR 232.101(c)(1)(i)), all requests for and information subject to the request for confidential treatment. If a reporting person requests confidential treatment with respect to information required to be reported on Form N-PX, the reporting person must file in paper with the Secretary of the Commission an original and two copies of the Form N-PX reporting information for which the reporting person requests confidential treatment.

4. A reporting person requesting confidential treatment must provide enough factual support for its request to enable the Commission to make an informed judgment as to the merits of the request. If a request for confidential treatment of information filed on Form N-PX relates to a request for confidential treatment of information included in an Institutional Manager's filing on Form 13F, the Institutional Manager should so state and identify the related request. In such cases, the Institutional Manager need not repeat the analysis set forth in the request for confidential treatment in connection with the Form 13F filing. The Institutional Manager's request, however, must explain whether and, if so, how the Form N-PX and Form 13F confidential treatment requests are related.

5. State the period of time for which confidential treatment of the proxy voting information is requested. The time period specified may not exceed one (1) year from the date that the Form N-PX report is required to be filed with the

treatment and for which (that request was denied/confidential treatment expired) on (date).

PAPERWORK REDUCTION ACT INFORMATION

Form N-PX is to be used by a registered management investment company, other than a small business investment company registered on Form N-5 (17 CFR 239.24 and 274.5), to file reports with the Commission pursuant to Section 30 of the Investment Company Act and Rule 30b1-4 thereunder. Form N-PX is also to be used by an institutional investment manager subject to Section 13(f) of the Exchange Act to file reports with the Commission as required by Section 14A(d) of the Exchange Act and Rule 14Ad-1 thereunder. Form N-PX is to be filed not later than August 31 of each year, containing the reporting person's proxy voting record for the most recent twelve-month period ended June 30. The Commission may use the information provided on Form N-PX in its regulatory, disclosure review, inspection, and policymaking roles.

Registered management investment companies and institutional investment managers are required to disclose the information specified by Form N-PX, and the Commission will make this information public. Registered management investment companies and institutional investment managers are not required to respond to the collection of information contained in Form N-PX 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.

☐ Institutional Manager Combination Report (Check here if a portion of the proxy votes for this reporting manager are reported in this report and a portion are reported by other reporting person(s).)

List of Other Persons Reporting for this Manager:
[If there are no entries in this list, omit this section.]

Investment Company Act or Form 13F File Number	Name
[811-] [28-]____________________	____________________________________

[Repeat as necessary.]

FORM N-PX

Item 1. Proxy Voting Record.

If the reporting person is a registered management investment company, disclose the following information for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the report and with respect to which the reporting person was entitled to vote. If the reporting person is an Institutional Manager, disclose the following information for each shareholder vote pursuant to Sections 14A(a) and (b) of the Exchange Act considered at any shareholder meeting held during the period covered by the report and with respect to which the reporting person, whether directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, had or shared the power to vote, or to direct the voting of, any security. If a reporting person does not have any proxy votes to report for the reporting period, the reporting person shall file a report with the Commission stating that the reporting person does not have proxy votes to report.

(a) The name of the issuer of the security;

(b) The exchange ticker symbol of the security;

(c) The Council on Uniform Securities Identification Procedures ("CUSIP") number for the security;

(d) The shareholder meeting date;

(e) A brief identification of the matter voted on;

(f) For reports filed by registered management investment companies, disclose whether the matter was proposed by the issuer or by a security holder;

SIGNATURE
[See General Instruction E]

Pursuant to the requirements of the [Securities Exchange Act of 1934 (for Institutional Managers)] [Investment Company Act of 1940 (for registered management investment companies)], the reporting person has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(Reporting Person)____

By (Signature and Title)*__________________________________

Date____

* Print the name and title of each signing officer under his or her signature.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: October 18, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63131 / October 19, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14092

In the Matter of Electrosound Group, Inc., Elektryon, Evolutions, Inc., Excelsior-Henderson Motorcycle Manufacturing Co., Executive National Development Corp., and Ezcony Interamerica, 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 Electrosound Group, Inc., Elektryon, Evolutions, Inc., Excelsior-Henderson Motorcycle Manufacturing Co., Executive National Development Corp., and Ezcony Interamerica, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Electrosound Group, Inc. (CIK No. 103542) is an inactive New York corporation located in Smithtown, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Electrosound Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended August 31, 1992. On May 9, 1994, the company

filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of New York, and the case was terminated on April 15, 1998.

2. Elektryon (CIK No. 1139184) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Elektryon is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on April 30, 2001, which reported a net loss of over $27 million since the company's April 1994 inception. On February 1, 2002, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Nevada, and the case was still pending as of October 12, 2010.

3. Evolutions, Inc. (CIK No. 1009326) is a void Delaware corporation located in Glen Rock, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Evolutions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1997, which reported a net loss of $7,560,754 for the prior nine months. On January 5, 1998, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of New Jersey which was terminated on July 19, 2000.

4. Excelsior-Henderson Motorcycle Manufacturing Company (CIK No. 1017904) is an inactive Minnesota corporation located in Belle Plaine, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Excelsior-Henderson 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 October 2, 1999, which reported a loss of over $16 million for the prior nine months. On December 6, 2001, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of Florida, and the case was terminated on June 18, 2002.

5. Executive National Development Corp. (CIK No. 703805) is a Florida corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Executive National Development 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, 1993.

6. Ezcony Interamerica, Inc. (CIK No. 887947) is a British Virgin Islands corporation located in Road Town, Tortola, British Virgin Islands with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ezcony is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001.

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 hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 19, 2010

IN THE MATTER OF Cape Systems Group, Inc., Caribbean Cigar Company, Casual Male Corp. (n/k/a Casual Male Retail Group, Inc.), Cell Power Technologies, Inc., Cellmetrix, Inc. (f/k/a BCAM International, Inc.), Cellular Products, Inc. (n/k/a 872 Main Street Corp.), Ceptor Corp., CGS Scientific Corp., and Ciprico, 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 Cape Systems Group, Inc. because it has not filed any periodic reports since the period ended December 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Caribbean Cigar Company 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 Casual Male Corp. (n/k/a Casual Male Retail Group, Inc.) because it has not filed any periodic reports since the period ended February 3, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cell Power Technologies, Inc. because it has not filed any periodic reports since the period ended April 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cellmetrix, Inc. (f/k/a BCAM International, Inc.) because it has not filed any periodic reports since the period ended June 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cellular Products, Inc. (n/k/a 872 Main Street Corp.) because it has not filed any periodic reports since the period ended December 31, 1994.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ceptor Corp. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of CGS Scientific Corp. because it has not filed any periodic reports since the period ended February 29, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ciprico, Inc. because it has not filed any periodic reports since the period ended December 31, 2007.

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. EDT on October 19, 2010, through 11:59 p.m. EDT on November 1, 2010.

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. 63128A / October 19, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14091

In the Matter of **Cape Systems Group, Inc.,** **Caribbean Cigar Company,** **Casual Male Corp.,** **Cell Power Technologies, Inc.,** **Cellmetrix, Inc. (f/k/a BCAM International, Inc.),** **Cellular Products, Inc. (n/k/a 872 Main Street Corp.),** **Ceptor Corp.,** **CGS Scientific Corp., and** **Ciprico, 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 Cape Systems Group, Inc., Caribbean Cigar Company, Casual Male Corp., Cell Power Technologies, Inc., Cellmetrix, Inc. (f/k/a BCAM International, Inc.), Cellular Products, Inc. (n/k/a 872 Main Street Corp.), Ceptor Corp., CGS Scientific Corp., and Ciprico, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Cape Systems Group, Inc. (CIK No. 779681) is a New Jersey corporation located in South Plainfield, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cape Systems 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, 2006, which reported a net loss of $1 million for the prior three months. On March 10, 1989, Cape Systems filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Massachusetts, and the case was terminated on January 11, 1994. As of October 8, 2010, the company's common stock (symbol "CYSG") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Caribbean Cigar Co. (CIK No. 1009769) is a revoked Florida corporation located in Knoxville, Tennessee with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Caribbean Cigar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1998, which reported a net loss of $89,214 for the prior three months. On February 8, 1999, Caribbean Cigar filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Eastern District of Tennessee, and the case was closed on November 14, 2007. As of October 8, 2010, the company's common stock (symbol "CIGR") 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).

3. Casual Male Corp. (CIK No. 792570) is a Delaware corporation located in Canton, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Casual Male is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the year ended February 3, 2001, which reported a net loss of over $101 million for the prior twelve months. On May 18, 2001, Casual Male filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of New York, and the case was closed on June 14, 2005.

4. Cell Power Technologies, Inc. (CIK No. 1202034) is a Florida corporation located in McLean, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cell Power 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, 2006, which reported a net loss of $2.6 million from the date of inception on September 22, 2003 to April 30, 2006. As of October 8, 2010, the company's common stock (symbol "CPWT") 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).

5. Cellmetrix, Inc. (f/k/a BCAM International, Inc.) (CIK No. 856143) is a dissolved New York corporation located in Melville, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cellmetrix 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 June 30, 2000, which reported a net loss of over $1.8 million for the prior six months. As of October 8, 2010, the

company's common stock (symbol "CLMI") was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Cellular Products, Inc. (n/k/a 872 Main Street Corp.) (CIK No. 718585) is a dissolved New York corporation located in Buffalo, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cellular 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, 1994, which reported a net loss of $890,079 for the fiscal year ended December 31, 1994. On November 23, 1994, Cellular filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of New York, which was converted to Chapter 7, and the case was terminated on August 23, 2001. As of October 8, 2010, the company's stock (symbol "CELP") was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Ceptor Corp. (CIK No. 1231472) 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). Ceptor 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, 2007. As of October 8, 2010, the company's common stock (symbol "CEPO") 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).

8. CGS Scientific Corp. (CIK No. 19047) is a Pennsylvania corporation located in West Chester, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CGS 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 February 29, 2000, which reported a net loss of $60,897 for the prior three months. As of October 8, 2010, the company's common stock (symbol "CGSC") was quoted on the Pink Sheets, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

9. Ciprico, Inc. (CIK No. 720145) is a delinquent Delaware corporation located in St. Louis Park, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ciprico 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 December 31, 2007, which reported a net loss of more than $2.9 million for the prior three months. On July 28, 2008, Ciprico filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Minnesota, which was converted to Chapter 7, and the case was still pending as of October 8, 2010. As of October 8, 2010, the company's common stock (symbol "CPCIQ") 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).

B. DELINQUENT PERIODIC FILINGS

10. 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.

11. 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.

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

III.

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 19, 2010

IN THE MATTER OF **Cape Systems Group, Inc.,** **Caribbean Cigar Company,** **Casual Male Corp.** **Cell Power Technologies, Inc.,** **Cellmetrix, Inc. (f/k/a BCAM International, Inc.),** **Cellular Products, Inc. (n/k/a 872 Main Street Corp.),** **Ceptor Corp.,** **CGS Scientific Corp., and** **Ciprico, Inc.,** **File No. 500-1**	**AMENDED** **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 Cape Systems Group, Inc. because it has not filed any periodic reports since the period ended December 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Caribbean Cigar Company 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 Casual Male Corp. (n/k/a Casual Male Retail Group, Inc.) because it has not filed any periodic reports since the period ended February 3, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cell Power Technologies, Inc. because it has not filed any periodic reports since the period ended April 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cellmetrix, Inc. (f/k/a BCAM International, Inc.) because it has not filed any periodic reports since the period ended June 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cellular Products, Inc. (n/k/a 872 Main Street Corp.) because it has not filed any periodic reports since the period ended December 31, 1994.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ceptor Corp. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of CGS Scientific Corp. because it has not filed any periodic reports since the period ended February 29, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ciprico, Inc. because it has not filed any periodic reports since the period ended December 31, 2007.

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. EDT on October 19, 2010, through 11:59 p.m. EDT on November 1, 2010.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Casey not participating

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. IC-29464; 812-13808]

Citigroup Global Markets Inc., et al.; Notice of Application and Temporary Order

October 19, 2010

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

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary of Application: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against Citigroup Inc. ("Citigroup") on October 19, 2010 by the United States District Court for the District of Columbia (the "Injunction"), until the Commission takes final action on an application for a permanent order. Applicants also have applied for a permanent order.

Applicants: Citigroup Global Markets Inc. ("CGMI"), CEFOF GP I Corp. ("CEFOF"), CELFOF GP Corp. ("CELFOF"), Citibank, N.A. ("Citibank"), Citigroup Alternative Investments LLC ("Citigroup Alternative"), Consulting Group Advisory Services LLC ("Advisory Services"), Citigroup Capital Partners I GP I Corp. ("CCP I"), and Citigroup Capital Partners I GP II Corp. ("CCP II") (collectively, "Applicants").[1]

Filing Date: The application was filed on July 29, 2010 and amended on July 30, 2010, and amended on October 19, 2010.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to

[1] Applicants request that any relief granted pursuant to the application also apply to any other company of which Citigroup is or hereafter may become an affiliated person within the meaning of section 2(a)(3) of the Act (together with the Applicants, the "Covered Persons").

the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on November 12, 2010, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: CGMI , CEFOF, CELFOF, CCP I and CCP II, 388 Greenwich Street, New York, NY 10013; Citibank, 399 Park Avenue, New York, NY 10043; Citigroup Alternative, 731 Lexington Avenue, 28th Floor, New York, NY 10022; and Advisory Services, 222 Delaware Avenue, Wilmington, DE 19801.

For Further Information Contact: Laura J. Riegel, Senior Counsel, at (202) 551-6873, or Mary Kay Frech, Branch Chief, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's Web site by searching for the file number, or for an applicant using the Company name box, at http://www.sec.gov/search/search.htm, or by calling (202) 551-8090.

Applicants' Representations:

1. Each of the Applicants is either an indirect wholly-owned subsidiary of Citigroup or is owned by an entity in which Citigroup has an indirect interest. Citigroup is a global financial holding company whose businesses provide a broad range of financial

services. CGMI is registered as a broker-dealer under the Securities Exchange Act of 1934 ("Exchange Act") and serves as principal underwriter for one or more registered investment companies ("Funds"). Citigroup Alternative and Advisory Services are registered as investment advisers under the Investment Advisers Act of 1940 and serve as investment advisers for one or more Funds. CEFOF, CELOF, Citibank, Citigroup Alternative, CCP I and CCP II ("ESC Advisers") serve as investment advisers to certain employees' securities companies within the meaning of section 2(a)(13) of the Act, which provide investment opportunities for certain eligible employees, officers, directors and persons on retainer of Citigroup and its affiliates ("ESCs" and included in the term "Funds").[2]

2. On October 19, 2010, the United States District Court for the District of Columbia ("District Court") entered a judgment against Citigroup ("Judgment") in a matter brought by the Commission.[3] The Commission alleged in the complaint ("Complaint") that Citigroup had violated section 17(a)(2) of the Securities Act of 1933 and section 13(a) of the Exchange Act and Exchange Act rules 12b-20 and 13a-11 in connection with disclosures made between July 2007 and October 2007 about the subprime exposure in Citigroup's investment banking unit. Without admitting or denying the allegations in the Complaint, except as to jurisdiction, Citigroup consented to the entry of the Judgment that included, among other things, the entry of the Injunction, a civil penalty of $75 million, and certain undertakings requested by the District Court.

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[2] Greenwich Street Employees Fund, L.P., et al., Investment Company Act Release Nos. 25324 (Dec. 21, 2001) (notice) and 25367 (Jan. 16, 2002) (order) ("ESC Order").

[3] Securities and Exchange Commission v. Citigroup Inc., Judgment on Consent Against Defendant Citigroup Inc., Civil Action No. 1:10-cv-01277 (ESH) (D.D.C. October 19, 2010).

Applicants' Legal Analysis:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from engaging in or continuing any conduct or practice in connection with the purchase or sale of a security or in connection with activities as an underwriter, broker or dealer, from acting, among other things, as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company, registered unit investment trust or registered face-amount certificate company. Section 9(a)(3) of the Act makes the prohibition in section 9(a)(2) applicable to a company, any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that Citigroup is an affiliated person of each of the Applicants within the meaning of section 2(a)(3) of the Act. Applicants state that the entry of the Injunction results in Applicants being subject to the disqualification provisions of section 9(a) of the Act.

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) if it is established that these provisions, as applied to the Applicants, are unduly or disproportionately severe or that the Applicants' conduct has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a temporary and permanent order exempting them and Covered Persons from the disqualification provisions of section 9(a) of the Act.

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to the Applicants would be unduly and disproportionately severe and that the conduct of Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state that the alleged conduct giving rise to the Injunction did not involve any of the Applicants acting in the capacity of investment adviser, subadviser or depositor to a Fund, or principal underwriter for any Fund, and no such Funds bought or held any securities issued by Citigroup during the period of misconduct alleged in the Complaint, other than with respect to index Funds. Applicants also state that none of the current or former directors, officers, or employees of the Applicants participated in the violative conduct alleged in the Complaint, with the exception of one employee of an Applicant. Applicants further state that the personnel at Citigroup who were involved in the violations alleged in the Complaint are either no longer employed at Citigroup or have had no and will not have any future involvement in providing advisory, subadvisory or depository services to the Funds, or principal underwriting services to the Funds.

5. Applicants state that the inability of the Applicants to continue to serve as investment adviser, depositor or principal underwriter to the Funds would result in potentially severe financial hardships for the Funds and their shareholders. The Applicants have distributed, or will distribute as soon as reasonably practical, written materials, including an offer to meet in person to discuss the materials, to the board of directors of each Fund, including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of such Fund, and their independent legal counsel as defined in rule 0-

1(a)(6) under the Act, if any, regarding the Judgment, any impact on the Funds, and the application. The Applicants state they will provide the Funds with all information concerning the Judgment and the application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

6. Applicants also state that, if they were barred from continuing to serve as investment adviser or principal underwriter to the Funds, the effect on their businesses and employees would be severe. Applicants state that they have committed substantial resources to establish an expertise in providing services covered by section 9(a) of the Act to Funds. Applicants further state that prohibiting them from continuing to serve as investment adviser or principal underwriter to Funds would not only adversely affect their businesses, but would also adversely affect approximately 250 employees that are involved in those activities. Applicants also state that disqualifying the ESC Advisers from continuing to provide investment advisory services to ESCs is not in the public interest or in furtherance of the protection of investors. Because the ESCs have been formed for certain eligible, officers, directors and persons on retainer of Citigroup and its affiliates, it would not be consistent with the purposes of the ESC provisions of the Act or the ESC Order to require another entity not affiliated with Citigroup to manage the ESCs. In addition, participating employees of Citigroup and its affiliates subscribed for interests with the expectation that the ESCs would be managed by an affiliate of Citigroup.

7. Applicants previously have received exemptions under section 9(c) as the result of conduct that triggered section 9(a) as described in greater detail in the application.

Applicants' Condition:

Applicants agree that any order granting the requested relief will be subject to the following condition:

Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order:

The Commission has considered the matter and finds that Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the Injunction, subject to the condition in the application, from October 19, 2010, until the Commission takes final action on their application for a permanent order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9154 / October 20, 2010

In the Matter of **CITIGROUP INC.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(b)(4) and 602(c)(2) DISQUALIFICATION PROVISIONS.**

I.

Citigroup Inc. ("Citigroup") has submitted a letter, dated July 15, 2010, requesting a waiver of the Rule 602(b)(4) and 602(c)(2) disqualifications from the exemption from registration under Regulation E arising from Citigroup's settlement of an injunctive action commenced by the Commission.

II.

On July 29, 2010, the Commission filed a civil injunctive action in the United States District Court for the District of Columbia, charging Citigroup with violations of Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"), Section 13(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rules 13a-11 and 12b-20. In its complaint, the Commission alleged that Citigroup made repeated misleading public disclosures relating to the extent of its exposure to sub-prime mortgages during 2007. On October 8, 2010, pursuant to Citigroup's consent, the Court entered a Judgment permanently enjoining Citigroup from violating Section 17(a)(2) of the Securities Act, Section 13(a) of the Exchange Act, and Exchange Act Rules 13a-11 and 12b-20 ("Final Judgment").

III.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if the issuer or any of its affiliates is subject to any order, judgment, or decree of a court "temporarily or permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security." *See* Rule 602(b)(4) under the Securities Act. The Regulation E exemption is also not available for the securities of an issuer if a director, officer, principal security holder, investment adviser or underwriter of the securities to be offered, or any partner, director or officer of such investment adviser or underwriter, is temporarily or permanently restrained or enjoined by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser. *See* Rule 602(c)(2) under the Securities Act. Rule 602(e) provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

IV.

Based upon the representations set forth in Citigroup's request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Final Judgment.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rule 602(b)(4) and 602(c)(2) under the Securities Act resulting from the entry of the Final Judgment is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63144 / October 21, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12720

In the Matter of

GENERAL AMERICAN LIFE INSURANCE COMPANY AND WILLIAM C. THATER,

Respondents.

ORDER DISCHARGING PLAN ADMINISTRATOR AND TERMINATING FAIR FUND

On August 9, 2007, General American Life Insurance Co. ("General American") and William C. Thater ("Thater") consented to the entry of an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (Securities Act Release No. 8832) (the "Order"), which directed, among other things, that General American pay disgorgement of $1 and a civil money penalty of $3.3 million and Thater pay disgorgement of $100,000, prejudgment interest in the amount of $13,137.49, and a civil money penalty in the amount of $50,000, for a total payment of $3,463,138.49, and established a Fair Fund to provide for the distribution of these payments to the mutual funds whose value was diluted by the late trading activities described in the Order ("Affected Mutual Funds"). The Order also ordered General American to undertake to develop, in consultation with the advisors of the Affected Mutual Funds, a Distribution Plan to distribute the Fair Fund fairly and proportionately to the Affected Mutual Funds.

On May 23, 2008, the Commission issued a Notice of Proposed Distribution Plan and Opportunity for Comment (Exchange Act Release No. 57863) ("Notice") in connection with this proceeding. The Notice advised parties they could obtain a copy of the Distribution Plan at www.sec.gov. The Notice also advised that all persons desiring to comment on the Plan could submit their comments, in writing, no later than June 23, 2008. No comments were received by the Commission in response to the Notice. On July 25, 2008, the Commission approved the Distribution Plan and appointed General American as the Plan Administrator (Exchange Act Release No. 58225). The Plan provided for the distribution of the Fair Fund to the Affected Mutual Funds using a next-day

NAV analysis and that any residual funds remaining after all distributions would be transferred to the U.S. Treasury.

On August 5, 2009, the Commission entered an order directing disbursement of the Fair Fund consisting of $3,532,822.80 (Exchange Act Release No. 60447). Beginning in August 2009, wires or checks were sent to each of the 16 Affected Mutual Funds. A total of $3,532,822.80 was disbursed to the Affected Mutual Funds and due to interest accumulation, $4,435.67 in residual funds remains.

A Final Accounting of the Fair Fund was submitted to the Commission pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans. The Final Accounting was approved by the Commission. Pursuant to the Final Accounting, $4,435.67 in residual funds is to be transmitted to the U.S. Treasury.

Accordingly, IT IS ORDERED that the Fair Fund is terminated.

IT IS FURTHER ORDERED THAT the Plan Administrator is discharged.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63154/October 21, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14096

In the Matter of **PATRICIA A. MCKAY, CPA** **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 Patricia A. McKay ("Respondent").

II.

In anticipation of the institution of these proceedings, 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 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:

Summary

1. Office Depot, Inc. ("Office Depot") violated Regulation FD in 2007 by selectively communicating to analysts that it would not meet analysts' quarterly earnings estimates for Office Depot. After a discussion between McKay and the company's Chief Executive Officer ("CEO"), Office Depot conducted one-on-one calls with the analysts late in the second quarter of 2007. The company did not directly tell the analysts that it would not meet their expectations; rather, this message was signaled through its references to recent public statements of comparable companies about the impact of the slowing economy on their earnings, and reminders of Office Depot's prior cautionary public statements. The analysts promptly lowered their estimates for the period. McKay assisted in preparing the talking points for the calls and she and the CEO were aware of the declining estimates while the company made the calls. The company also continued to make the calls despite McKay being notified of some analysts' concerns of, among other things, the lack of public disclosure. Six days after the calls began, Office Depot filed a Form 8-K announcing to the market, among other things, that its sales and earnings would be negatively impacted due to a continued soft economy. Prior to that Form 8-K, Office Depot's share price had significantly dropped on increased trading volume.

Respondent

2. McKay, a Florida licensed certified public accountant, age 52, served from September 2005 through February 2008 as executive vice president and Chief Financial Officer ("CFO") of Office Depot. McKay also served as a member of Office Depot's board of directors from May 2004 until assuming her role as CFO.

Related Party

3. Office Depot, a Delaware corporation based in Boca Raton, Florida, is an office products supplier. Office Depot's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is traded on the New York Stock Exchange.

Background

4. Office Depot, as a company policy, did not offer specific quarterly earnings guidance during the relevant time period. In late 2006 and early 2007, the CEO and McKay believed the significant earnings per share ("EPS") growth the company achieved in 2005 and early 2006 was not sustainable and set out to temper analysts' expectations. In February 2007, during a publicly broadcasted earnings conference call, the CEO and McKay described Office Depot's business model, which contemplated mid to upper teens EPS growth over the long-term.

[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.

On another public conference call in late April 2007, the company warned investors that its largest business segments were facing a softening in demand that was continuing into the second quarter. Shortly following the analysts' publication of EPS estimates for Office Depot in late April (when most analysts lowered their estimates for Office Depot), the company reiterated at a publicly available investor conference in early May that its business model contemplated only mid to upper teens EPS growth over the long-term and that the company faced a softening demand environment.

5. On May 31, 2007, the CEO alerted Office Depot's board of directors and the executive committee that the company would not likely meet the analysts' consensus $0.48 EPS estimate for the second quarter and that senior management was discussing a strategy for advance communication to avoid a complete surprise to the market.

6. Office Depot did not have written Regulation FD policies or procedures at the time. The company had also never conducted any formal Regulation FD training prior to June 2007, although its general counsel had occasionally distributed guidance and updates on Regulation FD.

Office Depot's Selective Disclosures to Analysts

7. In early June 2007, in response to the CEO's May 31, 2007 notice to the board of directors, McKay instructed the director of investor relations and his immediate supervisor to prepare a draft press release for her review previewing certain second quarter earnings information should the company later determine to issue one. By mid June 2007, certain of the company's preliminary internal estimates forecasted up to $0.44 EPS for the quarter. McKay and the CEO were uncomfortable with issuing a press release because the company's internal estimates were incomplete at this point.

8. On June 20, 2007, ten days prior to the close of Office Depot's second quarter for 2007, the CEO and McKay, both of whom had investor relations experience, discussed how to encourage analysts to revisit their analysis of the company. The CEO, in an attempt to get analysts to lower their estimates, proposed to McKay that the company talk to the analysts and refer them to recent earnings announcements by two comparable companies that had recently publicly announced results which were impacted by the slowing economy. The CEO further suggested that Office Depot point out on the calls what the company had said to the market in April and May 2007. The CEO and McKay jointly decided to adopt this approach.

9. McKay, the director of investor relations, and the director's immediate supervisor drafted talking points, based on the CEO's suggestions, for use as a guide for the calls with analysts. The agreed upon talking points are set forth below.

- Haven't spoken in a while, just want to touch base.
- At beg. of Qtr we've talked about a number of head winds that we were facing this quarter including a softening economy, especially at small end.

- I think the earnings release we have seen from the likes of [Company A], [Company B], and [Company C] have been interesting.
  - On a sequential basis, [Company A] and [Company B] domestic comps were down substantially over prior quarters.
  - [Company C] mentioned economic conditions as a reason for their slowed growth.
- Some have pointed to better conditions in the second half of the year – however who knows?
- Remind you that economic model contemplates stable economic conditions – that is midteens growth

10. On Friday, June 22, 2007, and the following Monday, June 25, 2007, the director of investor relations spoke individually with all 18 analysts covering Office Depot and conveyed to them the information contained in the talking points. Office Depot did not regularly initiate calls of this type to all 18 analysts covering the company. Word of these calls quickly spread among analysts, some of whom believed that Office Depot was "talking down" analysts' earnings estimates.

11. McKay and the CEO were in communication with the director of investor relations during and after the calls. On Saturday, June 23, 2007, McKay emailed the analysts' revised estimates to the CEO and advised that the director of investor relations had spoken to most of the company's analysts and that two had reduced their estimates. The CEO responded positively and encouraged the calls to continue so that additional analysts would lower their estimates. On Monday, June 25, 2007, McKay asked the director of investor relations' immediate supervisor whether the director of investor relations had contacted a particular analyst whose EPS estimate was the highest and had not yet been revised. Also on Monday, the CEO requested and received an update, which showed that the analysts' consensus estimate was still $0.46. With McKay's knowledge, the CEO then commented to the director of investor relations that they still needed conversations with a few more analysts.

12. Office Depot's calls influenced many analysts to revise and lower their second quarter 2007 forecasts. By the end of the second day of the calls, fifteen of the eighteen analysts lowered their estimates, bringing the consensus estimate down from $0.48 to $0.45.

Analyst and Investor Reaction to Calls and Calls to Institutional Investors

13. During a call on Friday, June 22, 2007, one analyst expressed concern to the director of investor relations about the lack of a press release. That same day, the director of investor relations conveyed to McKay this concern and that one other analyst was informing his customers that he expected Office Depot's earnings to be down based on his call.

14. On Monday, June 25, 2007, the director of investor relations notified McKay that another analyst told him that he was surprised at the lack of a press release and indicated that several of his clients were also surprised. Also, late Monday evening, McKay instructed the

director of investor relations to call the company's top twenty institutional investors and relay the same talking points to them, which he did the following day.

Office Depot Files an 8-K

15. After the close of the market on Thursday, June 28, 2007, six days after the calls to analysts began, Office Depot filed a Form 8-K publicly disclosing, among other things, that its earnings would be "negatively impacted due to continued soft economic conditions."

Market Reaction

16. Between Friday, June 22, 2007 (the day Office Depot began calling analysts) and June 28, 2007 (the last market close before Office Depot filed its 8-K), the company's stock dropped 7.7%. On the first day of the calls, Office Depot's stock closed at $33.49 per share. This was a decrease of 2.8% from the previous close, on trading volume of almost 7.5 million shares, which was two and half times the average volume for the remainder of that week. On the second day of calls, the stock dropped another 3.5% to $32.32 per share on trading volume of 7 million shares.

Violations

17. Regulation FD prohibits issuers or persons acting on their behalf from disclosing material nonpublic information to securities analysts, institutional investors, or other enumerated persons without disclosing that information to the public. See generally Regulation FD, Rule 100; Final Rule: Selective Disclosure and Insider Trading, Exchange Act Rel. No. 43154, 65 Fed. Reg. 51,716 (Aug. 15, 2000) ("Adopting Release"). Where a selective disclosure of material nonpublic information is "intentional," issuers must make a public disclosure simultaneously with the selective disclosure. Regulation FD, Rule 100(a)(1). Intentional means "when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic." Regulation FD, Rule 101(a). Where the selective disclosure is "non-intentional," Regulation FD requires issuers to make a public disclosure of the information promptly after a senior official of the issuer learns of the non-intentional disclosure. Rules 100(a)(2) & 101(d). Regulation FD defines "promptly" to mean "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange)." Rule 101(d).

18. An issuer's failure to make a required public disclosure pursuant to Regulation FD constitutes a violation of both Regulation FD and Section 13(a) of the Exchange Act. See Adopting Release, 65 Fed. Reg. at 51,726.

19. The Commission adopted Regulation FD out of concern that issuers were "disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public." Id. at 51,716. The Commission explained in the Adopting Release:

> When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD. This is true whether the information about earnings is communicated expressly or through indirect "guidance," the meaning of which is apparent though implied.

Id. at 51,721.

20. Furthermore, the Division of Corporation Finance has stated in its interpretations of Regulation FD that "a confirmation of expected quarterly earnings made near the end of a quarter might convey information about how the issuer actually performed. In that respect, the inference a reasonable investor may draw from such a confirmation may differ significantly from the inference he or she may have drawn from the original forecast early in the quarter." Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations, Regulation FD, Item 1 (4th supp., May 2001) ("Telephone Interpretations"). (On August 14, 2009, the Telephone Interpretations regarding Regulation FD were migrated over to the Compliance & Disclosure Interpretation format.)

21. As a result of the conduct described above, McKay was a cause of Office Depot's violations of Regulation FD and Section 13(a) of the Exchange Act.

IV.

Undertaking

Respondent has agreed to the following undertaking:

McKay shall, within 10 days of the entry of this Order, make a payment in the nature of a penalty in the amount of $50,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies McKay as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and money order or check shall be sent to Glenn S. Gordon, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

Respondent agrees that she shall not seek or accept, directly or indirectly, reimbursement or indemnification from any source including, but not limited to, payment made pursuant to any insurance policy, with regard to any amounts that Respondent shall pay pursuant to this Order, regardless of whether such penalty amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors. Respondent further agrees that she shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state or local tax for any amounts that Respondent shall pay pursuant to this Order, regardless of whether such amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors.

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

V.

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

Accordingly, IT IS HEREBY ORDERED that pursuant to Section 21C of the Exchange Act, Respondent McKay cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act and Regulation FD.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63153/October 21, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14095

In the Matter of **STEPHEN A. ODLAND,** **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 Stephen A. Odland ("Respondent").

II.

In anticipation of the institution of these proceedings, 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 him 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:

Summary

1. Office Depot, Inc. ("Office Depot") violated Regulation FD in 2007 by selectively communicating to analysts that it would not meet analysts' quarterly earnings estimates for Office Depot. After a discussion between Odland and the company's then-Chief Financial Officer ("CFO"), Office Depot conducted one-on-one calls with the analysts late in the second quarter of 2007. The company did not directly tell the analysts that it would not meet their expectations; rather, this message was signaled through its references to recent public statements of comparable companies about the impact of the slowing economy on their earnings, and reminders of Office Depot's prior cautionary public statements. The analysts promptly lowered their estimates for the period. Odland and the CFO were aware of the declining estimates while the company made the calls, and Odland encouraged the calls to be completed. Six days after the calls began, Office Depot filed a Form 8-K announcing to the market, among other things, that its sales and earnings would be negatively impacted due to a continued soft economy. Prior to that Form 8-K, Office Depot's share price had significantly dropped on increased trading volume.

Respondent

2. Odland, age 51, has been since March 2005 the Chief Executive Officer ("CEO") and the chairman of the board of directors of Office Depot.

Related Party

3. Office Depot, a Delaware corporation based in Boca Raton, Florida, is an office products supplier. Office Depot's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is traded on the New York Stock Exchange.

Background

4. Office Depot, as a company policy, did not offer specific quarterly earnings guidance during the relevant time period. In late 2006 and early 2007, Odland and the CFO believed the significant earnings per share ("EPS") growth the company achieved in 2005 and early 2006 was not sustainable and set out to temper analysts' expectations. In February 2007, during a publicly broadcasted earnings conference call, Odland and the CFO described Office Depot's business model, which contemplated mid to upper teens EPS growth over the long-term. On another public conference call in late April 2007, the company warned investors that its largest business segments were facing a softening in demand that was continuing into the second

[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.

quarter. Shortly following the analysts' publication of EPS estimates for Office Depot in late April (when most analysts lowered their estimates for Office Depot), the company reiterated at a publicly available investor conference in early May that its business model contemplated only mid to upper teens EPS growth over the long-term and that the company faced a softening demand environment.

5. On May 31, 2007, Odland alerted Office Depot's board of directors and the executive committee that the company would not likely meet the analysts' consensus $0.48 EPS estimate for the second quarter and that senior management was discussing a strategy for advance communication to avoid a complete surprise to the market.

6. Office Depot did not have written Regulation FD policies or procedures at the time. The company had also never conducted any formal Regulation FD training prior to June 2007, although its general counsel had occasionally distributed guidance and updates on Regulation FD.

Office Depot's Selective Disclosures to Analysts

7. By mid June 2007, certain of the company's preliminary internal estimates forecasted up to $0.44 EPS for the quarter. On June 20, 2007, ten days prior to the close of Office Depot's second quarter for 2007, Odland and the CFO, both of whom had investor relations experience, discussed how to encourage analysts to revisit their analysis of the company. Odland and the CFO were uncomfortable with issuing a press release because the company's internal estimates were incomplete at this point. Odland, in an attempt to get analysts to lower their estimates, proposed to the CFO that the company talk to the analysts and refer them to recent earnings announcements by two comparable companies that had recently publicly announced results which were impacted by the slowing economy. Odland further suggested that Office Depot point out on the calls what the company had said to the market in April and May 2007. Odland and the CFO jointly decided to adopt this approach. Odland believed that if the analysts looked at Office Depot again in that light, they would come to the point of view that their estimates were too high and likely would lower them.

8. The CFO, the director of investor relations, and the director's immediate supervisor drafted talking points as a guide for the calls with analysts, which were based in part on Odland's suggestions. Odland was not asked to review the talking points and did not do so.

9. On Friday, June 22, 2007, and the following Monday, June 25, 2007, the director of investor relations spoke individually with all 18 analysts covering Office Depot and conveyed to them the information contained in the talking points. Office Depot did not regularly initiate calls of this type to all 18 analysts covering the company. Word of these calls quickly spread among analysts, some of whom believed that Office Depot was "talking down" analysts' earnings estimates.

10. Odland and the CFO were in communication with the director of investor relations during and after the calls. On Saturday, June 23, 2007, the CFO emailed the analysts' revised estimates to Odland and advised that the director of investor relations had spoken to most

of the company's analysts and that two had reduced their estimates. Odland responded positively and encouraged the calls to continue so that additional analysts would lower their estimates. Also on Monday, Odland requested and received an update, which showed that the analysts' consensus estimate was still $0.46. With the CFO's knowledge, Odland then commented to the director of investor relations that they still needed conversations with a few more analysts.

11. Office Depot's calls influenced many analysts to revise and lower their second quarter 2007 forecasts. By the end of the second day of the calls, fifteen of the eighteen analysts lowered their estimates, bringing the consensus estimate down from $0.48 to $0.45.

Office Depot Files an 8-K

12. After the close of the market on Thursday, June 28, 2007, six days after the calls to analysts began, Office Depot filed a Form 8-K publicly disclosing, among other things, that its earnings would be "negatively impacted due to continued soft economic conditions."

Market Reaction

13. Between Friday, June 22, 2007 (the day Office Depot began calling analysts) and June 28, 2007 (the last market close before Office Depot filed its 8-K), the company's stock dropped 7.7%. On the first day of the calls, Office Depot's stock closed at $33.49 per share. This was a decrease of 2.8% from the previous close, on trading volume of almost 7.5 million shares, which was two and half times the average volume for the remainder of that week. On the second day of calls, the stock dropped another 3.5% to $32.32 per share on trading volume of 7 million shares.

Violations

14. Regulation FD prohibits issuers or persons acting on their behalf from disclosing material nonpublic information to securities analysts, institutional investors, or other enumerated persons without disclosing that information to the public. <u>See generally</u> Regulation FD, Rule 100; <u>Final Rule: Selective Disclosure and Insider Trading</u>, Exchange Act Rel. No. 43154, 65 Fed. Reg. 51,716 (Aug. 15, 2000) ("Adopting Release"). Where a selective disclosure of material nonpublic information is "intentional," issuers must make a public disclosure simultaneously with the selective disclosure. Regulation FD, Rule 100(a)(1). Intentional means "when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic." Regulation FD, Rule 101(a). Where the selective disclosure is "non-intentional," Regulation FD requires issuers to make a public disclosure of the information promptly after a senior official of the issuer learns of the non-intentional disclosure. Rules 100(a)(2) & 101(d). Regulation FD defines "promptly" to mean "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange)." Rule 101(d).

15. An issuer's failure to make a required public disclosure pursuant to Regulation FD constitutes a violation of both Regulation FD and Section 13(a) of the Exchange Act. See Adopting Release, 65 Fed. Reg. at 51,726.

16. The Commission adopted Regulation FD out of concern that issuers were "disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public." Id. at 51,716. The Commission explained in the Adopting Release:

> When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD. This is true whether the information about earnings is communicated expressly or through indirect "guidance," the meaning of which is apparent though implied.

Id. at 51,721.

17. Furthermore, the Division of Corporation Finance has stated in its interpretations of Regulation FD that "a confirmation of expected quarterly earnings made near the end of a quarter might convey information about how the issuer actually performed. In that respect, the inference a reasonable investor may draw from such a confirmation may differ significantly from the inference he or she may have drawn from the original forecast early in the quarter." Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations, Regulation FD, Item 1 (4th supp., May 2001) ("Telephone Interpretations"). (On August 14, 2009, the Telephone Interpretations regarding Regulation FD were migrated over to the Compliance & Disclosure Interpretation format.)

18. As a result of the conduct described above, Odland was a cause of Office Depot's violations of Section 13(a) of the Exchange Act and Regulation FD.

IV.

Undertaking

Respondent has agreed to the following undertaking:

Odland shall, within 10 days of the entry of this Order, make a payment in the nature of a penalty in the amount of $50,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order;

(B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Odland as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and money order or check shall be sent to Glenn S. Gordon, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

Respondent agrees that he shall not seek or accept, directly or indirectly, reimbursement or indemnification from any source including, but not limited to, payment made pursuant to any insurance policy, with regard to any amounts that Respondent shall pay pursuant to this Order, regardless of whether such penalty amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors. Respondent further agrees that he shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state or local tax for any amounts that Respondent shall pay pursuant to this Order, regardless of whether such amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors.

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

V.

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

Accordingly, IT IS HEREBY ORDERED that pursuant to Section 21C of the Exchange Act, Respondent Odland cease and desist from causing any violations and any future violations of Section 13(a) of the Exchange Act and Regulation FD.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63152/October 21, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3198/October 21, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14094

In the Matter of **OFFICE DEPOT, INC.,** **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 Office Depot, Inc. ("Respondent").[1]

II.

In anticipation of the institution of these proceedings, 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 it 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.

[1] In addition, the Commission has contemporaneously filed a complaint in the United States District Court for the Southern District of Florida charging Office Depot with violating 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, and Regulation FD, and seeking a civil penalty. Without admitting or denying the Commission's allegations, Office Depot has consented to the entry of a final judgment by the Court that would require it to pay a civil penalty of $1,000,000.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

Summary

1. Office Depot violated Regulation FD in 2007 by selectively communicating to analysts that it would not meet analysts' quarterly earnings estimates for Office Depot. After a discussion between the company's Chief Executive Officer ("CEO") and then-Chief Financial Officer ("CFO"), Office Depot conducted one-on-one calls with the analysts late in the second quarter of 2007. The company did not directly tell the analysts that it would not meet their expectations; rather, this message was signaled through its references to recent public statements of comparable companies about the impact of the slowing economy on their earnings, and reminders of Office Depot's prior cautionary public statements. The analysts promptly lowered their estimates for the period. The CFO assisted in preparing the talking points for the calls. The CFO and the CEO were aware of the declining estimates while the company made the calls, and they encouraged the calls to be completed. The company also continued to make the calls despite the CFO being notified of some analysts' concerns of, among other things, the lack of public disclosure. Six days after the calls began, Office Depot filed a Form 8-K announcing to the market, among other things, that its sales and earnings would be negatively impacted due to a continued soft economy. Prior to that Form 8-K, Office Depot's share price had significantly dropped on increased trading volume.

2. Unrelated to the conduct above, Office Depot overstated its net earnings in its financial statements for the third quarter of 2006 through the second quarter of 2007 as a result of accounting violations. Office Depot prematurely recognized approximately $30 million in funds received from vendors in exchange for the company's merchandising and marketing efforts instead of recognizing the funds over the relevant reporting periods in a manner consistent with Generally Accepted Accounting Principles ("GAAP"). In November 2007, the company restated the above financials and announced a material weakness in its internal controls over financial reporting, resulting from the failure of its personnel responsible for negotiating agreements with vendors to communicate all of the relevant information to accounting personnel. As a result of this conduct, Office Depot violated 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.

Respondent

3. <u>Office Depot</u>, a Delaware corporation based in Boca Raton, Florida, is an office products supplier. Office Depot's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is traded on the New York Stock Exchange.

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

Background

A. Regulation FD Violation

4. Office Depot, as a company policy, did not offer specific quarterly earnings guidance during the relevant time period. In late 2006 and early 2007, the CEO and the CFO believed the significant earnings per share ("EPS") growth the company achieved in 2005 and early 2006 was not sustainable and set out to temper analysts' expectations. In February 2007, during a publicly broadcasted earnings conference call, the CEO and the CFO described Office Depot's business model, which contemplated mid to upper teens EPS growth over the long-term. On another public conference call in late April 2007, the company warned investors that its largest business segments were facing a softening in demand that was continuing into the second quarter. Shortly following the analysts' publication of EPS estimates for Office Depot in late April (when most analysts lowered their estimates for Office Depot), the company reiterated at a publicly available investor conference in early May that its business model contemplated only mid to upper teens EPS growth over the long-term and that the company faced a softening demand environment.

5. On May 31, 2007, the CEO alerted Office Depot's board of directors and the executive committee that the company would not likely meet the analysts' consensus $0.48 EPS estimate for the second quarter and that senior management was discussing a strategy for advance communication to avoid a complete surprise to the market.

6. Office Depot did not have written Regulation FD policies or procedures at the time. The company had also never conducted any formal Regulation FD training prior to June 2007, although its general counsel had occasionally distributed guidance and updates on Regulation FD.

Office Depot's Selective Disclosures to Analysts

7. In early June 2007, in response to the CEO's May 31, 2007 notice to the board of directors, the CFO instructed the director of investor relations and his immediate supervisor to prepare a draft press release for her review previewing certain second quarter earnings information should the company later determine to issue one. By mid June 2007, certain of the company's preliminary internal estimates forecasted up to $0.44 EPS for the quarter. The CFO and CEO were uncomfortable with issuing a press release because the company's internal estimates were incomplete at this point.

8. On June 20, 2007, ten days prior to the close of Office Depot's second quarter for 2007, the CEO and the CFO, both of whom had investor relations experience, discussed how to encourage analysts to revisit their analysis of the company. The CEO, in an attempt to get analysts to lower their estimates, proposed to the CFO that the company talk to the analysts and refer them to recent earnings announcements by two comparable companies that had recently publicly announced results which were impacted by the slowing economy. The CEO further

suggested that Office Depot point out on the calls what the company had said to the market in April and May 2007. The CEO and the CFO jointly decided to adopt this approach. The CEO believed that if the analysts looked at Office Depot again in that light, they would come to the point of view that their estimates were too high and likely would lower them.

9. The CFO, the director of investor relations, and the director's immediate supervisor drafted talking points, based in part on the CEO's suggestions, for use as a guide for the calls with analysts. The CEO was not asked to review the talking points and did not do so. The agreed upon talking points are set forth below.

- Haven't spoken in a while, just want to touch base.
- At beg. of Qtr we've talked about a number of head winds that we were facing this quarter including a softening economy, especially at small end.
- I think the earnings release we have seen from the likes of [Company A], [Company B], and [Company C] have been interesting.
    - On a sequential basis, [Company A] and [Company B] domestic comps were down substantially over prior quarters.
    - [Company C] mentioned economic conditions as a reason for their slowed growth.
- Some have pointed to better conditions in the second half of the year – however who knows?
- Remind you that economic model contemplates stable economic conditions – that is midteens growth

10. On Friday, June 22, 2007, and the following Monday, June 25, 2007, the director of investor relations spoke individually with all 18 analysts covering Office Depot and conveyed to them the information contained in the talking points. Office Depot did not regularly initiate calls of this type to all 18 analysts covering the company. Word of these calls quickly spread among analysts, some of whom believed that Office Depot was "talking down" analysts' earnings estimates.

11. The CFO and the CEO were in communication with the director of investor relations during and after the calls. On Saturday, June 23, 2007, the CFO emailed the analysts' revised estimates to the CEO and advised that the director of investor relations had spoken to most of the company's analysts and that two had reduced their estimates. The CEO responded positively and encouraged the calls to continue so that additional analysts would lower their estimates. On Monday, June 25, 2007, the CFO asked the director of investor relations' immediate supervisor whether the director of investor relations had contacted a particular analyst whose EPS estimate was the highest and had not yet been revised. Also on Monday, the CEO requested and received an update, which showed that the analysts' consensus estimate was still $0.46. With the CFO's knowledge, the CEO then commented to the director of investor relations that they still needed conversations with a few more analysts.

12. Office Depot's calls influenced many analysts to revise and lower their second quarter 2007 forecasts. By the end of the second day of the calls, fifteen of the eighteen analysts lowered their estimates, bringing the consensus estimate down from $0.48 to $0.45.

Analyst and Investor Reaction to Calls and Calls to Institutional Investors

13. During a call on Friday, June 22, 2007, one analyst expressed concern to the director of investor relations about the lack of a press release. That same day, the director of investor relations conveyed to the CFO this concern and that one other analyst was informing his customers that he expected Office Depot's earnings to be down based on his call.

14. On Monday, June 25, 2007, the director of investor relations notified the CFO that another analyst told him that he was surprised at the lack of a press release and indicated that several of his clients were also surprised. Also, late Monday evening, the CFO instructed the director of investor relations to call the company's top twenty institutional investors and relay the same talking points to them, which he did the following day.

Office Depot Files an 8-K

15. After the close of the market on Thursday, June 28, 2007, six days after the calls to analysts began, Office Depot filed a Form 8-K publicly disclosing, among other things, that its earnings would be "negatively impacted due to continued soft economic conditions."

Market Reaction

16. Between Friday, June 22, 2007 (the day Office Depot began calling analysts) and June 28, 2007 (the last market close before Office Depot filed its 8-K), the company's stock dropped 7.7%. On the first day of the calls, Office Depot's stock closed at $33.49 per share. This was a decrease of 2.8% from the previous close, on trading volume of almost 7.5 million shares, which was two and half times the average volume for the remainder of that week. On the second day of calls, the stock dropped another 3.5% to $32.32 per share on trading volume of 7 million shares.

B. Books, Records, and Internal Controls Violations

17. Office Depot often arranges with its vendors to receive funding for its various marketing and promotional activities relating to the vendors' products, such as advertising, store displays, and product exclusivity. For example, vendors frequently pay Office Depot to place their products in prominent store locations.

18. Under GAAP, the funds from these agreements are recognizable during the reporting period in which Office Depot provides the marketing and promotional activities called for in the agreements. When the activities cover multiple reporting periods, the funds are to be recognized over the relevant reporting periods in a manner consistent with GAAP.

19. Between the third quarter of 2006 and the second quarter of 2007, Office Depot prematurely recognized funds from approximately 100 vendor agreements. Many of the transactions involved an email arrangement between Office Depot personnel and the vendors that were separate from, but in addition to, the original documented agreement. These supplemental agreements often included terms that bound Office Depot to some kind of future performance and thus, would have caused the recognition of these funds to be deferred into future periods. The premature recognition of vendor funds inflated Office Depot's operating profit from the third quarter of 2006 through the second quarter of 2007 by a total of approximately $30 million. Office Depot's quarterly and annual financial statements during this period overstated net earnings by 1.3% to 6.7%.

20. In November 2007, Office Depot announced that it would be restating its financial statements for the third quarter of 2006 through the second quarter of 2007 due to material errors in the accounting recognition of vendor funds that should have been deferred into later periods. The company also announced having a material weakness in its internal controls over financial reporting based on the failure to ensure that complete and accurate documentation was provided to individuals responsible for the proper recognition of vendor funds.

21. The accounting errors leading to Office Depot's restatements resulted from a communication breakdown between the Office Depot personnel responsible for negotiating and executing vendor agreements (internally referred to at Office Depot as "Merchants") and the personnel responsible for accounting for the funds. During either the negotiation or execution of vendor agreements, the Merchants often had email or other communications with the vendors that modified the terms of existing agreements. However, the Merchants often failed to provide all of the documentation to the accounting department for consideration.

Violations

Violations of Regulation FD and Section 13(a) of the Exchange Act

22. Regulation FD prohibits issuers or persons acting on their behalf from disclosing material nonpublic information to securities analysts, institutional investors, or other enumerated persons without disclosing that information to the public. See generally Regulation FD, Rule 100; Final Rule: Selective Disclosure and Insider Trading, Exchange Act Rel. No. 43154, 65 Fed. Reg. 51,716 (Aug. 15, 2000) ("Adopting Release"). Where a selective disclosure of material nonpublic information is "intentional," issuers must make a public disclosure simultaneously with the selective disclosure. Regulation FD, Rule 100(a)(1). Intentional means "when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic." Regulation FD, Rule 101(a). Where the selective disclosure is "non-intentional," Regulation FD requires issuers to make a public disclosure of the information promptly after a senior official of the issuer learns of the non-intentional disclosure. Rules 100(a)(2) & 101(d). Regulation FD defines "promptly" to

mean "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange)." Rule 101(d).

23. An issuer's failure to make a required public disclosure pursuant to Regulation FD constitutes a violation of both Regulation FD and Section 13(a) of the Exchange Act. See Adopting Release, 65 Fed. Reg. at 51,726.

24. The Commission adopted Regulation FD out of concern that issuers were "disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public." Id. at 51,716. The Commission explained in the Adopting Release:

> When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD. This is true whether the information about earnings is communicated expressly or through indirect "guidance," the meaning of which is apparent though implied.

Id. at 51,721.

25. Furthermore, the Division of Corporation Finance has stated in its interpretations of Regulation FD that "a confirmation of expected quarterly earnings made near the end of a quarter might convey information about how the issuer actually performed. In that respect, the inference a reasonable investor may draw from such a confirmation may differ significantly from the inference he or she may have drawn from the original forecast early in the quarter." Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations, Regulation FD, Item 1 (4th supp., May 2001) ("Telephone Interpretations"). (On August 14, 2009, the Telephone Interpretations regarding Regulation FD were migrated over to the Compliance & Disclosure Interpretation format.)

26. As a result of the conduct described above, Office Depot violated Regulation FD and Section 13(a) of the Exchange Act.

Violations of the Books and Records and Internal Controls Provisions

27. Also as a result of the conduct described above, Office Depot violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may

require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

28. Because Office Depot improperly recognized funds from its vendor agreements, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

29. In addition, Office Depot failed to implement internal accounting controls relating to its vendor agreements which were sufficient to provide reasonable assurances that its accounts were accurately stated in accordance with GAAP.

30. As a result of the conduct described above, Office Depot violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

31. Lastly, as a result of the conduct described above, Office Depot violated Section 13(b)(2)(B) of the Exchange Act which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP.

Remedial Efforts

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

IV.

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

Accordingly, it is hereby ORDERED that pursuant to Section 21C of the Exchange Act, Respondent Office Depot cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, and Regulation FD.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3099 / October 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14097

In the Matter of **SANDS BROTHERS ASSET MANAGEMENT LLC, STEVEN SANDS, AND MARTIN SANDS,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (the "Advisers Act") against Sands Brothers Asset Management LLC ("SBAM"), Steven Sands ("S. Sands"), and Martin Sands ("M. Sands").

II.

In anticipation of the institution of these proceedings, SBAM, S. Sands, and M. Sands have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, SBAM, S. Sands, and M. Sands consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f), And 203(k) of the Investment Advisers Act of 1940, as set forth below.

III.

On the basis of this Order and SBAM, S. Sands, and M. Sands' Offer, the Commission finds that:

RESPONDENTS

1. **SBAM**, a New York limited liability company formed in June 1998, has been registered with the Commission as an investment adviser since July 1998. SBAM maintains offices in New York, New York and provides portfolio management and investment advisory services to its clients, among which are a number of funds organized as limited liability companies or limited partnerships. According to its Form ADV filed on March 22, 2010, SBAM has $95,340,474 in assets under management.

2. **S. Sands**, age 51, resides in Locust Valley, New York. He is a direct owner and currently serves as co-chairman of Sands Brothers Asset Management Ltd., the manager of SBAM. S. Sands is also a founder, partner and senior portfolio manager of SBAM. S. Sands is also currently employed as a registered representative at Lane Capital Markets LLC, a broker-dealer located in Greenwich, CT, and was formerly employed as a registered representative at Laidlaw & Company (UK) Ltd., a broker-dealer with its main office in London, England. He maintains Series 7, 24, and 63 licenses.

3. **M. Sands**, age 49, resides in Greenwich, Connecticut. He is a direct owner and currently serves as co-chairman of Sands Brothers Asset Management Ltd., the manager of SBAM. M. Sands is also a founder, partner and senior portfolio manager of SBAM. M. Sands is also currently employed as a registered representative at Lane Capital Markets LLC and was also formerly employed as a registered representative at Laidlaw & Company (UK) Ltd. He maintains Series 3, 7, 8, 24 and 63 licenses.

FACTS

4. These proceedings stem from the failures of SBAM, an investment adviser registered with the Commission, to comply with certain record-keeping and other provisions of the Advisers Act. In particular, SBAM violated (i) Section 204 of the Advisers Act and Rule 204(2) governing the retention and production to the staff upon request of certain required documents and books and records; (ii) Section 206(4) of the Advisers Act and Rule 206(4)-2 governing the delivery of account statements and surprise examination requirements for certain SBAM funds; and (iii) Sections 204 and 207 of the Advisers Act and Rule 204-1 governing the disclosures and amendments to SBAM's investment adviser registration statement on Form ADV. M. Sands and S. Sands, sometimes acting through employees and agents including compliance personnel, were principal contact persons for SBAM in responding to the Commission staff's inquiries and otherwise communicating with the staff during examinations of SBAM. As the lead principals of SBAM, S. Sands and M. Sands, acting through employees and agents including compliance personnel, were also responsible for ensuring that SBAM's filings on Form ADV were accurate and up to date.

Advisers Act Books And Records Deficiencies

5. Section 204 of the Advisers Act provides that every investment adviser who makes use of the mails or interstate commerce in connection with its advisory business shall make and keep for prescribed periods those records that the Commission, by rule, may prescribe as necessary, and that all records are "subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors." Rule 204-2(a) sets forth certain categories of books and records that registered investment advisers are required to "make and keep true, accurate and current" with respect to their investment advisory business. Rule 204-2(b) sets forth categories of additional documents that must be maintained by registered investment advisers that have custody of client assets.

6. SBAM failed to maintain or provide to the staff, among other things, the following documents relating to one or more of its advisory clients: bank and brokerage account opening documents for certain advisory clients, as required by Rule 204-2(a)(10); bank account statements for certain advisory clients, as required by Rule 204-2(a)(7); brokerage account statements or similar records, as required by Rules 204-2(b)(3) and (4); certain client advisory contracts, as required by Rule 204-2(a)(10); order memoranda detailing each purchase, sale, receipt or delivery of securities on behalf of certain advisory clients, as required by Rule 204-2(a)(3); securities transaction confirmations for certain advisory clients, as required by Rule 204-2(b)(3); and documentation of deposits into and payments out of certain client accounts, as required by Rules 204-2(b)(1) and (2).

Advisers Act Custody Rule Deficiencies

7. SBAM failed to comply with the provisions of Section 206(4) of the Advisers Act and Rule 206(4)-2(a) thereunder, which, during the relevant period,[1] imposed on registered investment advisers, like SBAM, that have custody of clients' funds or securities certain requirements concerning the distribution of client account statements and surprise examinations for certain funds. Rule 206(4)-2(a)(3) required investment advisers with custody of client assets (i) to have a reasonable belief that a qualified custodian holding the client assets, such as a bank or a broker-dealer, was providing quarterly account statements directly to the clients or (ii) to send quarterly account statements directly to their clients and have an independent public accountant conduct a surprise examination of the funds at least once a year.

8. During the relevant period, Rule 206(4)-2(b)(3) provided an exception to the requirements of Rule 206(4)-2(a)(3) if the client is organized as a limited partnership, limited liability company or similar pooled investment vehicle. In such cases, the adviser need not comply with Rule 206(4)-2(a)(3) provided that the funds' financial statements are subject to an annual audit by an independent accountant, such financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), and the financial statements are distributed to investors in accordance with the Rule.

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[1] Rule 206(4)-2 of the Advisers Act was amended on December 30, 2009.

9. With respect to several SBAM funds organized as limited partnerships or limited liability companies, SBAM improperly relied on the custody rule exception that was, at the time, set forth at Rule 206(4)-2(b)(3). The staff's exam revealed that the year-end December 31, 2003 financial statements for nine funds managed by SBAM came with the auditor's disclaimer of opinion. The auditor's disclaimer of opinion states that the auditor does not express an opinion on the financial statements. According to AU 508 paragraph 61, the auditor disclaims his or her opinion "whenever he or she is unable to form or has not formed an opinion as to the fairness of presentation of the financial statements in conformity with generally accepted accounting principles." Footnote 21 to paragraph 63 of AU 508 also notes that when an opinion is disclaimed, the auditor's report states that the auditor was "engaged to audit" because the auditor was not able to perform an audit in accordance with U.S. generally accepted auditing standards ("GAAS"). Accordingly, a disclaimer of opinion does not constitute the performance of an audit in accordance with GAAS and, therefore, fails to satisfy the custody rule exception requirements that the financial statements be prepared in accordance with GAAP and that an audit be performed in accordance with GAAS. In addition, the staff's exam revealed that the year-end December 31, 2007 financial statements for eight funds and four funds of funds managed by SBAM were not distributed to investors in accordance with the Rule. Because SBAM did not satisfy the exception in Rule 206(4)-2(b)(3), it was obligated to comply with Rule 206(4)-2(a)(3), which it failed to do.

Advisers Act Form ADV Deficiencies

10. Section 203(c) of the Advisers Act requires registered investment advisers, like SBAM, to file with the Commission, and Rule 204-1 requires them to periodically update, their registration statement on Form ADV. SBAM's annual and periodic investment adviser registration statements on Form ADV were deficient in several respects. For example, SBAM's Form ADV for the year ended December 31, 2003, which was filed with the Commission on March 17, 2004, contained several material misstatements and inaccuracies. First, the Form ADV incorrectly stated that SBAM did not maintain custody of client assets. SBAM did maintain custody of client assets due to its principals' direct access to such assets. Second, the Form ADV incorrectly stated that the owners of SBAM were the "Loius Trust" and the "Sunquam Trust." Documents provided to the staff show that the owners of SBAM were the "Julios Trust" and the "Targhee Trust."

11. SBAM's subsequent Forms ADV repeated certain of these misstatements. On May 9, 2008 and June 12, 2008, SBAM filed amended Forms ADV that again incorrectly stated that SBAM did not have custody of client assets.

12. SBAM also failed to file its annual amendment to Form ADV for the year ended December 31, 2004. The amended Form ADV was required to be filed within 90 days of the close of the year and was required to include such material information as the amount of assets under management and the number of client accounts for the year. However, SBAM failed to file any amended Form ADV for the 2004 reporting period.

VIOLATIONS

13. As a result of the conduct described above,

(a) SBAM willfully violated Section 204 of the Advisers Act and Rules 204-2(a) and 204-2(b) thereunder, which, among other things, impose upon every registered investment adviser the duty to make, keep and furnish copies of certain books and records as the Commission, by rule, prescribes as necessary or appropriate in the public interest or for the protection of investors;

(b) SBAM willfully violated Section 204 of the Advisers Act and Rule 204-1, which require a registered investment adviser to amend its Form ADV at least annually, within 90 days of the end of its fiscal year or more frequently, if, among other things, certain specified information becomes inaccurate in any way, or where the investment adviser's successions, participation or interest in client transactions, information regarding the adviser's control persons or its other business activities, or information provided in its brochure becomes materially inaccurate;

(c) SBAM willfully violated Section 206(4) and Rule 206(4)-2 thereunder, which, among other things, impose on investment advisers that have custody of client funds or securities certain requirements with respect to the preparation and disseminations of client account statements and surprise examinations for certain funds;

(d) SBAM willfully violated Section 207 of the Advisers Act, which prohibits any person from willfully making any untrue statement of a material fact in any registration application or report, such as Form ADV, filed with the Commission under Section 203 or Section 204 of the Advisers Act, or willfully omitting in any such application or report any material fact which is required to be stated therein; and

(e) S. Sands and M. Sands willfully aided and abetted and caused SBAM's violations of Sections 204, 206(4), and 207 of the Advisers Act and Rules 204-1, 204-2(a) and (b) and 206(4)-2 thereunder.

UNDERTAKINGS

Respondent SBAM has undertaken to:

14. Provide to the Commission staff copies of all periodic written reports prepared by the third-party independent compliance consultant retained by SBAM in connection with its September 9, 2009 Stipulation and Agreement, Docket No. RCF-2007-7093-S, with the State of Connecticut, Department of Banking.

IV.

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

Accordingly, pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. SBAM, S. Sands and M. Sands shall cease and desist from committing or causing any violations and any future violations of Sections 204, 206(4), and 207 of the Advisers Act and Rules 204-1, 204-2(a) and (b), and 206(4)-2 thereunder.

B. SBAM, S. Sands, and M. Sands are censured; and

C. SBAM shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $60,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies the payee as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Karen Lee, Staff Attorney, Securities and Exchange Commission, Division of Enforcement, New York Regional Office, 3 World Financial Center, Suite 400, New York, NY 10281.

D. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. Respondent SBAM shall comply with the undertakings set forth in Section III, paragraph 14, above.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-63174; File No. 4-617]

Study on Extraterritorial Private Rights of Action

AGENCY: Securities and Exchange Commission.

ACTION: Request for Comments.

SUMMARY: Section 929Y of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") directs the Securities and Exchange Commission (the "Commission") to solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities Exchange Act of 1934 (the "Exchange Act") should be extended to cover transnational securities fraud. The Commission is soliciting comment on this question and on related questions.

DATES: The Commission will accept comments regarding issues related to the study on or before February 18, 2011.

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 4-617 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 4-617. 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). Comments are also available for website 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. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John W. Avery, Office of the General Counsel, at (202) 551-5107, or Robert Peterson, Office of International Affairs, at (202) 551-6696, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

In a recent decision in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010), the Supreme Court significantly limited the extraterritorial scope of Section 10(b) of the Exchange Act. In the Dodd-Frank Act, Congress restored the ability of the Commission and the United States to bring actions under Section 10(b) in cases involving transnational securities fraud. Congress further directed the Commission to conduct a study to determine whether, and to what extent, private plaintiffs should also be able to bring such actions. Consideration of the *Morrison* decision and of extending the extraterritorial scope of the antifraud provisions of the Exchange Act to private actions raises important questions touching on the Commission's mandate to protect investors, to maintain fair, orderly and efficient markets, and to facilitate capital formation. It also raises issues regarding international comity and the respect that governments afford each other regarding their decisions on regulation of their home markets. Exploration of these issues will also help inform how the Commission can best protect investors and the integrity of U.S. markets in an environment in which a significant volume of securities transactions are conducted across borders.

II. Background

In *Morrison*, the Supreme Court considered "whether § 10(b) of the Securities Exchange Act of 1934 provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges." The text of the Exchange Act had been silent as to the transnational reach of Section 10(b). In a decision issued on June 24, 2010, the Supreme Court said: "When a statute gives no clear indication of an extraterritorial application, it has none." *Morrison*, 130 S. Ct. at 2878. "[T]here is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially," the Court found, "and we therefore conclude that it does not." *Id.* at 2883. Thus, the Court concluded, "it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies." *Id.* at 2884 (footnote omitted). The Court summarized the test as follows:

> Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.

Id. at 2888.

The *Morrison* decision rejected long-standing precedents in most federal courts of appeals that applied some variation or combination of an "effects" test and a "conduct" test to determine the extraterritorial reach of Section 10(b) of the Exchange Act. See, *e.g.*, *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991); *Itoba Ltd v. LEP Group PLC*, 54 F.3d 118, 121-22 (2d Cir. 1995). The effects test centered its inquiry on whether domestic investors or markets were affected as a result of actions occurring outside the United States. *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 125 (2d Cir. 1998). See also *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983). By contrast, the conduct test focused "on the nature of [the] conduct within the United States as it relates to carrying out the alleged fraudulent scheme." *Psimenos*, 722 F.2d at 1045.

On July 21, 2010, less than a month after the decision in *Morrison*, President Obama signed the Dodd-Frank Act. Section 929P of the Dodd-Frank Act amended the Exchange Act to provide that the United States district courts shall have jurisdiction over an action brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of the Exchange Act involving:

> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
>
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. [1]

Under section 929Y of the Dodd-Frank Act, the Commission is required to conduct a study to determine whether *private* rights of action should be similarly extended. The report of the study

[1] With respect to U.S. Government and Commission actions, the Dodd-Frank Act largely codified the long-standing appellate court interpretation of the law that had existed prior to the Supreme Court's decision in *Morrison* by setting forth an expansive conducts and effects test, and providing that the inquiry is one of subject matter jurisdiction. The Dodd-Frank Act made similar changes to the Securities Act of 1933 and the Investment Advisers Act of 1940.

must be submitted and recommendations made to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House not later than January 21, 2012.

III. Request for Comments

Section 929Y(a) of the Dodd-Frank Act directs the Commission to solicit public comment on whether the scope of the antifraud provisions of the Exchange Act in cases of transnational securities fraud should be extended to private rights of action to the same extent as that provided to the Commission by Section 929P, or to some other extent.[2] Section 929Y(b) directs that the study shall consider and analyze, among other things—

> (1) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise;
>
> (2) what implications such a private right of action would have on international comity;
>
> (3) the economic costs and benefits of extending a private right of action for transnational securities frauds; and
>
> (4) whether a narrower extraterritorial standard should be adopted.

Accordingly, we request comment on these issues and questions. We also encourage commenters to:

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[2] Section 929Y(a) of the Dodd-Frank Act provides that the Commission "shall solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities Exchange Act of 1934 (15 U.S.C. 78u-4) should be extended to cover: conduct within the United States that constitutes a significant step in the furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; and conduct occurring outside the United States that has a foreseeable substantial effect within the United States."

- Propose the circumstances, if any, in which a private plaintiff should be allowed to pursue claims under the antifraud provisions of the Exchange Act with respect to a particular security where the plaintiff has purchased or sold the security outside the United States. Does it make a difference whether the security was issued by a U.S. company or by a non-U.S. company? Does it make a difference whether the security was purchased or sold on a foreign stock exchange or whether it was purchased or sold on a non-exchange trading platform or other alternative trading system outside of the United States? Does it make a difference whether the company's securities are traded exclusively outside of the United States?
    - If you disagree with extending the test set forth in Section 929P to private plaintiffs, what other test would you propose?
    - Should there be an effects test, a conduct test, a combination of the two, or another test?
    - Address whether any such test should be limited only to certain types of private plaintiffs, such as United States citizens or residents, or such as institutional investors. How would such investors be defined?
- Identify any cases that have been dismissed as a result of *Morrison* or pending cases in which a challenge based on *Morrison* has been filed. Describe the facts of the case.
- Identify any cases brought prior to *Morrison* that likely could not have been brought or maintained after *Morrison*. Describe the facts of the case.
- In *Morrison*, the Supreme Court held that in the case of securities that are not listed on an American stock exchange, Section 10(b) only reaches the use of a manipulative or deceptive device or contrivance in connection with the purchase or sale of a security *in the United States*.

Address the criteria for determining where a purchase or sale can be said to take place in various transnational securities transactions. Discuss the degree to which investors know, when they place a securities purchase or sale order, whether the order will take place on a foreign stock exchange or on a non-exchange trading platform or other alternative trading system outside of the United States.

- What would be the implications on international comity and international relations of allowing private plaintiffs to pursue claims under the antifraud provisions of the Exchange Act in cases of transnational securities fraud? Identify any studies that purport to show the effect that the extraterritorial application of domestic laws have on international comity or international relations.

- Discuss the cost and benefits of allowing private plaintiffs to pursue claims under the antifraud provisions of the Exchange Act in cases of transnational securities fraud, including the costs and benefits to domestic and international financial systems and securities markets. Identify any studies that have been conducted that purport to show the positive or negative implications that such a private right of action would have.

- What remedies outside of the United States would be available to U.S. investors who purchase or sell shares on a foreign stock exchange, or on a non-exchange trading platform or other alternative trading system outside of the United States, if their securities fraud claims cannot be brought in U.S. courts?

- What impact would the extraterritorial application of the private right of action have on the protection of investors? On the maintenance of fair, orderly and efficient markets in the United States? On the facilitation of capital formation?

- Address any other considerations commenters would like to comment on to assist the

Commission in determining whether to recommend changes to the extraterritorial scope of the antifraud private rights of action under the Exchange Act.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: October 25, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63173 / October 25, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12936

In the Matter of **Heartland Advisors, Inc., William J. Nasgovitz, Paul T. Beste, Thomas J. Conlin, Greg D. Winston, Kevin D. Clark, Kenneth J. Della, and Hugh F. Denison,** **Respondents.**	**ORDER DIRECTING DISBURSEMENT OF FAIR FUND**

On February 3, 2010, the Commission published a "Notice of Proposed Plan of Distribution and Opportunity for Comment" ("Notice") in connection with this proceeding pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103 (Exchange Act Rel. No. 61481). The Notice advised parties that they could obtain a copy of the Proposed Plan of Distribution ("Plan") at www.sec.gov. The Notice also advised that all persons desiring to comment on the Plan could submit their comments, in writing, no later than 30 days from the date of the Notice. No comments were received by the Commission in response to the Notice. On April 1, 2010, the Commission issued an Order Approving the Plan, Appointing a Fund Administrator and Approving Administrator Bond (Exchange Act Rel. No. 61823).

The Plan provides that a Fair Fund consisting of disgorgement and civil penalties, plus any accrued interest, less a reserve for expenses and taxes, be transferred by the Commission to U.S. Bank for distribution by the Fund Administrator when a validated list of payees with the identification information required to make the distribution has been received and accepted by the Commission staff. The validated list of payees, which is in the amount of $3,931,808.05, has been received and accepted.

Accordingly, it is ORDERED that the Commission staff shall transfer $3,931,808.05 of the Fair Fund to U.S. Bank and the Fund Administrator shall distribute such monies to investors, as provided for in the Plan.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-63169; File No. 265-26]

Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues

AGENCY: Commodity Futures Trading Commission ("CFTC") and Securities and Exchange Commission ("SEC").

ACTION: Notice of Meeting of Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues.

SUMMARY: The Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues will hold a public meeting on November 5, 2010, from 9:00 am to 12:00 pm, at the CFTC's Washington, D.C. headquarters. At the meeting, the committee will:

1) receive a summary and recap from the staffs of the SEC and CFTC on the report issued September 30, 2010;
2) hear a report from the subcommittee on cross-market linkages;
3) hear a report from the subcommittee on pre-trade risk management; and
4) discuss potential recommendations and responses.

DATES: The meeting will be held on November 5, 2010 from 9:00 am to 12:00 pm. Members of the public who wish to submit written statements in connection with the meeting should submit them by November 4, 2010.

ADDRESSES: The meeting will take place in the first floor hearing room at the CFTC's headquarters, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

Written statements may be may be submitted to either the CFTC or the SEC; all submissions will be reviewed jointly by the two agencies. Please use the title "Joint

CFTC-SEC Advisory Committee" in any written statement you may submit. Statements may be submitted to any of the addresses listed below. Please submit your statement to only one address.

E-mail

Jointcommittee@cftc.gov

or

rule-comments@sec.gov. If e-mailing to this address, please refer to "File No. 265-26" on the subject line.

SEC's Internet Submission Form

http://www.sec.gov/rules/other.shtml

Regular Mail

Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581, attention Office of the Secretary

or

Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, Mail Stop 1090, 100 F St., NE., Washington, DC 20549. Comments mailed to this address should be submitted in triplicate and should refer to File No. 265-26.

Fax

(202) 418-5521

Any statements submitted in connection with the committee meeting will be made available to the public.

FOR FURTHER INFORMATION CONTACT: Martin White, Committee Management Officer, at (202) 418-5129, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581; Ronesha Butler, Special Counsel, at (202) 551-5629, Division of Trading and Markets, Securities and Exchange Commission, 100 F St., NE., Washington, DC 20549; or Elizabeth M. Murphy, Committee Management Officer, at (202) 551-5400, Securities and Exchange Commission, 100 F St., NE., Washington, DC 20549

SUPPLEMENTARY INFORMATION:

The meeting will be webcast on the CFTC's website, www.cftc.gov. Members of the public also can listen to the meeting by telephone. The public access call-in numbers will be announced at a later date. The CFTC and SEC are providing less than fifteen calendar days Federal Register notice of this meeting because of the urgency of the issues being addressed.

AUTHORITY: 5 U.S.C. app. 2 § 10(a)(2)

By the Commodity Futures Trading Commission.

Martin White
Committee Management Officer

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Committee Management Officer

Dated: October 25, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63201 / October 27, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14101

In the Matter of **Spendthrift Farm, Inc.,** **Sport of Kings, Inc.,** **Sportsend, Inc.,** **Stacey's Buffet, Inc.,** **Star Partners, Ltd.,** **Sterling Equity Holdings, Inc.,** **Sterling Financial Corp., and** **Storage @ccess Technologies, Inc.,** **(n/k/a Bluepoint Data, 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 Spendthrift Farm, Inc., Sport of Kings, Inc., Sportsend, Inc., Stacey's Buffet, Inc., Star Partners, Ltd., Sterling Equity Holdings, Inc., Sterling Financial Corp., and Storage @ccess Technologies, Inc. (n/k/a Bluepoint Data, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Spendthrift Farm, Inc. (CIK No. 729499) is a void Delaware corporation located in Tulsa, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Spendthrift 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 June 30, 1993, which reported a net loss of $18,539 for the prior twelve months.

2. Sport of Kings, Inc. (CIK No. 317191) is a void Delaware corporation located in Atlantic Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sport of Kings 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 August 31, 1994, which reported a net loss of over $2.8 million for the prior nine months.

3. Sportsend, Inc. (CIK No. 857132) is a Nevada corporation located in Clearwater, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sportsend 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 October 31, 2001, which reported a net loss of $123,959 for the prior nine months. As of October 25, 2010, the company's stock (symbol "SPSD") was traded on the over-the-counter markets.

4. Stacey's Buffet, Inc. (CIK No. 831984) is a dissolved Florida corporation located in Clearwater, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stacey's Buffet 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 25, 1998, which reported a net loss of over $2.24 million for the prior three months. On June 17, 1998, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Middle District of Florida, which was terminated on October 31, 2001. As of October 25, 2010, the company's stock (symbol "SBUFQ") was traded on the over-the-counter markets.

5. Star Partners, Ltd. (CIK No. 820760) is a revoked Florida corporation located in Winter Park, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Star Partners 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, 1992, which reported a net loss of $303,217 for the prior twelve months.

6. Sterling Equity Holdings, Inc. (CIK No. 1160544) is a revoked Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sterling Equity 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, 2005, which reported a net loss of $585,900 for the prior twelve months.

7. Sterling Financial Corp. (CIK No. 94140) is a dissolved Illinois corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sterling Financial 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, 1996, which reported a net loss of $46,861 for the year ended December 31, 1995. On October 16, 1995, the U.S. District Court for the Western District of Missouri permanently enjoined Sterling Financial from violations of Exchange Act Section 13(a) and Rule 13a-1. The company has violated that injunction.

8. Storage @ccess Technologies, Inc. (n/k/a Bluepoint Data, Inc.) (CIK No. 1136395) is a Yukon corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Storage Access is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on April 26, 2002, which reported a net loss of over $18.2 million for the prior twelve months. As of October 25, 2010, the company's stock (symbol "BLPXF") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

9. 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.

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 issuers to file quarterly reports.

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

III.

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63200 / October 27, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14100

In the Matter of **Speedlane.com, Inc.,** **Spintek Gaming Technologies, Inc.,** **Standard Brands Paint Co.,** **Star Casinos International, Inc.,** **Stardrive Solutions, Inc.,** **Sterling Media Capital Group, Inc. (n/k/a Crystal Properties Holdings, Inc.),** **Stormedia, Inc. (f/k/a Sym-Tek Systems, Inc.),** **Strategic Partners, Inc.,** **STS Liquidating Corp., and** **Symplex Communications Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Speedlane.com, Inc., Spintek Gaming Technologies, Inc., Standard Brands Paint Co., Star Casinos International, Inc., Stardrive Solutions, Inc., Sterling Media Capital Group, Inc. (n/k/a Crystal Properties Holdings, Inc.), Stormedia, Inc. (f/k/a Sym-Tek Systems, Inc.), Strategic Partners, Inc., STS Liquidating Corp., and Symplex Communications Corp.

II.

After an investigation, the Division of Enforcement alleges that:

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A. RESPONDENTS

1. Speedlane.com, Inc. (CIK No. 1091563) is a revoked Nevada corporation located in Sanibel, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Speedlane.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 September 30, 2000, which reported a net loss of over $1.4 million for the prior nine months.

2. Spintek Gaming Technologies, Inc. (CIK No. 1003479) is a permanently revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Spintek is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2000, which reported a net loss of over $2.8 million for the prior nine months. On November 13, 2000, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Nevada, which was terminated on August 15, 2005. As of October 14, 2010, the company's stock (symbol "SPTK") was traded on the over-the-counter markets.

3. Standard Brands Paint Co. (CIK No. 93308) is a Delaware corporation located in El Segundo, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Standard Brands 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 October 25, 1995, which reported a net loss of over $14.2 million for the prior nine months. On December 27, 1995, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was terminated on March 24, 2005.

4. Star Casinos International, Inc. (CIK No. 831674) is an expired Colorado corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Star Casinos 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 June 30, 1995, which reported a net loss of $294,458 for the prior three months. On May 3, 1996, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Colorado, which was terminated on December 22, 1997.

5. Stardrive Solutions, Inc. (CIK No. 1088116) is an inactive Washington corporation located in Agoura Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stardrive 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 June 30, 2001, which reported a net loss of over $9.7 million for the prior nine months.

6. Sterling Media Capital Group, Inc. (n/k/a Crystal Properties Holdings, Inc.) (CIK No. 723616) 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). Sterling Media 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 $406,821 for the prior three months.

7. Stormedia, Inc. (CIK No. 942787) is a delinquent Delaware corporation located in Santa Clara, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stormedia is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended June 26, 1998, which reported a net loss of over $48.7 million for the prior six months. On October 11, 1998, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California, which was terminated on January 28, 2003. As of October 14, 2010, the company's stock (symbol "STMDQ") was traded on the over-the-counter markets.

8. Strategic Partners, Inc. (CIK No. 1100313) is a delinquent Wyoming corporation located in Oxnard, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Strategic Partners is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2002, which failed to include any financial statements as required. The company's Form 10-QSB for the period ended September 30, 2002 reported a net loss of $161,556 for the prior nine months.

9. STS Liquidating Corp. (f/k/a Sym-Tek Systems, Inc.) (CIK No. 350615) is a dissolved California corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). STS is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 1994, which reported a net loss of $308,000 for the prior nine months.

10. Symplex Communications Corp. (CIK No. 1039920) is a void Delaware corporation located in Whitmore Lake, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Symplex 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 $209,917 for the prior three 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, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

12. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

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

III.

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63204 / October 28, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12805

In the Matter of **Evergreen Investment Management Company, LLC, Evergreen Investment Services, Inc., Evergreen Service Company, LLC and Wachovia Securities, LLC** **Respondents.**	**ORDER DIRECTING DISBURSEMENT OF FAIR FUND**

On March 19, 2010, the Commission issued a "Notice of Proposed Plan of Distribution and Opportunity for Comment" ("Notice") in connection with this proceeding pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103 (Exchange Act Release No. 61745). The Notice advised parties that they could obtain a copy of the Plan of Distribution ("Distribution Plan") at www.sec.gov. The Notice also advised that all persons desiring to comment on the Distribution Plan could submit their comments, in writing, within 30 days of the date of the Notice. No comments were received by the Commission in response to the Notice. On April 30, 2010, the Commission issued an Order Approving Distribution Plan (Exchange Act Rel. No. 62017).

The Distribution Plan provides that the Fair Fund consisting of disgorgement, civil penalties, plus any accrued interest be transferred by the Commission to Deutsche Bank Trust Company Americas for distribution by the Fund Administrator when a validated list of payees and amounts with the identification information required to make the distribution has been received and accepted by the staff. The validated list of payees and amounts, which is in the amount of $9,842,383.88, has been received and accepted.

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Accordingly, it is ORDERED that the Commission staff shall transfer $9,842,383.88 of the Fair Fund to Deutsche Bank Trust Company Americas, and the Fund Administrator shall distribute such monies to investors, as provided for in the Distribution Plan.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary