

SECURITIES AND EXCHANGE COMMISSION

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

MARY L. SCHAPIRO, CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(73 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63805 / February 1, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14213

In the Matter of

Eternal Technologies Group, Inc.,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Eternal Technologies Group, Inc. (CIK No. 1096662) is a defaulted Nevada corporation located in Shenzhen, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Eternal 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 September 30, 2008. As of January 24, 2011, the company's stock (symbol "ETLT") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc., had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, have repeatedly failed to meet its obligations to file

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

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of 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 Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

If Respondent fails to file the directed Answers, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a),

220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means 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. 63808 / February 1, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14214

In the Matter of

Andresmin Gold Corp.,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Andresmin Gold Corp. (CIK No. 1109744) is a dissolved Montana corporation located in Lima, Peru with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Andresmin 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, 2005, which reported a net loss of over \$5.02 million since the company's May 6, 1991 inception. As of January 24, 2011, the company's stock (symbol "ADGD") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc., had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, have repeatedly failed to meet its obligations to file timely periodic reports, and failed to heed delinquency letters sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations or, through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of 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 Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2

or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means 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

February 1, 2011

IN THE MATTER OF

Andresmin Gold 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 Andresmin Gold Corp. because it has not filed any periodic reports since the period ended December 31, 2005.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EST on February 1, 2011, through 11:59 p.m. EST on February 14, 2011.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63812 / February 1, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13673

In the Matter of

J.P. MORGAN SECURITIES INC.

Respondent.

**ORDER DIRECTING
DISBURSEMENT
OF FAIR FUND**

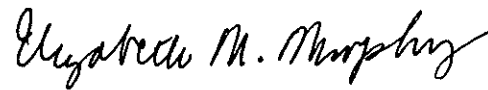
On August 18, 2010, the United States Securities and Exchange Commission ("Commission") issued a Notice of Proposed Plan of Distribution and Opportunity for Comment (Exchange Act Rel. No. 62738) pursuant to Rule 1103 of the Commission's Rules on Fair Funds and Disgorgement, 17 C.F.R. §201.1103. The Notice advised parties they could obtain a copy of the proposed 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, no later than 30 days from the date of the Notice. No comments were received by the Commission in response to the Notice. On October 7, 2010, the Commission issued an Order Approving Distribution Plan and Appointing a Plan Administrator (Exchange Act Rel. No. 63060).

The Distribution Plan states that monies from the Fair Fund will be distributed to Jefferson County, Alabama ("the County"), which was harmed by the Respondent's conduct, as further described in the Distribution Plan. The County will not be required to make a claim or submit documentation to establish its eligibility. The validated electronic payment file has been received and accepted for the disbursement of \$25,033,692.30.

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Accordingly, it is ORDERED that the Commission staff shall disburse the Fair Fund in the amount stated in the validated electronic payment file of \$25,033,692.30, as provided for in the Distribution Plan.

By the Commission.



Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 1, 2011

In the Matter of
Eternal Technologies Group, 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 Eternal Technologies Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EST on February 1, 2011, through 11:59 p.m. EST on February 14, 2011.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63817 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14215

In the Matter of

China 9D Construction Group,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE
PROCEEDINGS AND NOTICE OF
HEARING PURSUANT TO
SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent China 9D Construction Group.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. China 9D Construction Group ("CNAG")¹ (CIK No. 1321223) is a revoked Nevada corporation located in Hangzhou City, Zhejiang Province, People's Republic of China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CNAG 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 September 30, 2007. As of January 25, 2011, the common stock of CNAG was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group, Inc., had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

¹ The short form of the issuer's name is also its ticker symbol.

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports, and, through its failure to maintain a valid address on file with the Commission as required by Commission rules, failed to receive the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of 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 Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

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

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-

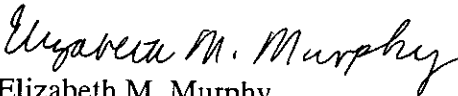
3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63818 / February 2, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3237 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14216

In the Matter of

**Deerfield Capital Corp. and
Danielle Valkner, CPA,**

Respondents.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Deerfield Capital Corp. ("Deerfield Capital") and Danielle Valkner (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers 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 them and the subject matter of these proceedings, which are admitted, Respondents consent 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 Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. Deerfield Capital Corp. ("Deerfield Capital") violated the books and records and internal control provisions of the Exchange Act in connection with three transactions involving securities issued by a Real Estate Mortgage Investment Conduit ("REMIC")—an investment vehicle used for the pooling of mortgage loans and the issuance of mortgage-backed securities. In each of the transactions, one of which occurred in December 2005 and two in March 2006, Deerfield Capital improperly recognized a gain from the purported sales of the REMIC while simultaneously purporting to purchase a "new" security (or "re-REMIC") representing nearly the same rights to nearly the same stream of payments. Deerfield Capital's recognition of a gain on the sale of the REMIC was contrary to Generally Accepted Accounting Principles ("GAAP").

2. For the December 2005 transaction, Deerfield Capital recognized \$3.9 million of gain on the sale of the REMIC, which constituted 15 percent of Deerfield Capital's reported net income for the fourth quarter of 2005 and 6 percent of its net income for the year ended December 31, 2005. For the March 2006 transactions, Deerfield Capital recognized gains of \$3.6 million, which constituted 14 percent of its net income for the quarter ended March 31, 2006 and 4 percent of its net income for the year ended December 31, 2006.

3. The misstatement related to the December 2005 transaction caused an excess payment of \$977,000 in performance fees to Deerfield Capital Management LLC ("Deerfield Management"), which by virtue of its provision of investment management and administrative services to Deerfield Capital, made the decision to account for the December 2005 transaction as a sale.

Respondents

4. Deerfield Capital Corp. is a Maryland corporation with its principal place of business located in Rosemont, Illinois. At all relevant times, Deerfield Capital traded on the New York Stock Exchange ("NYSE") and was a specialty finance company that invested in real-estate securities and various other asset classes and elected to be taxed as a real estate investment trust ("REIT"), which meant that it was required to distribute to investors at least 90 percent of its taxable income. The company's stated objective was to provide attractive returns to its investors through a combination of dividends and capital appreciation. At all times relevant to this Order, Deerfield Capital was externally managed by Deerfield Management. As an externally-managed

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

company, Deerfield Capital had its own CEO and CFO, but it had no employees and relied on Deerfield Management to conduct its business and operations. On December 21, 2007, Deerfield Management became a wholly-owned subsidiary of Deerfield Capital. On October 1, 2008, Deerfield Capital terminated its REIT status retroactive to January 1, 2008. Deerfield Capital is now a Nasdaq-listed company.

5. Danielle Valkner ("Valkner"), age 41, is a CPA and was the CFO of Deerfield Management during the relevant time period. During the relevant time period, Valkner worked closely with Deerfield Capital's CFO and the staff responsible for Deerfield Capital's accounting. Valkner did not sign any of Deerfield Capital's public filings, but signed management representation letters in connection with the 2005 and 2006 audits and quarterly reviews of Deerfield Capital by its outside auditor.

Background

6. The three REMIC securities at issue in this matter were "digital" interest-only ("IO") securities, which paid an annualized return of 8.375 percent when the one-month LIBOR exceeded 4.0 percent, but nothing when LIBOR was at or below 4.0 percent. During 2005, as the one-month LIBOR rose, these digital IOs increased in value.

7. Due to differences in tax accounting for the original issue discount on the digital IO, Deerfield Capital's reported taxable income was greater than its reported GAAP income. Deerfield Capital's REIT status required it to distribute substantially all of its taxable income to its shareholders, and the difference in taxable income and GAAP income would have led to Deerfield Capital showing negative retained earnings on its GAAP balance sheet. Deerfield Capital's board was concerned about the tax/GAAP disparity and the possibility of shareholder confusion, as shareholders might have interpreted dividend payments in excess of GAAP earnings as a premature return of capital. In October 2005, Deerfield Capital's board of directors requested that Deerfield Management attempt to resolve the difference between Deerfield Capital's GAAP and taxable income, and Deerfield Management then began exploring the possible sale of the digital IOs. Thus, in late 2005, Deerfield Management personnel explored the option of selling one of the digital IOs in order to eliminate a difference between the income reported for tax purposes and the income reported for GAAP purposes and to capture the gain on the increasing value of the digital IO.

8. The trader responsible for Deerfield Capital's mortgage-backed securities portfolio did not want to sell the digital IO because he felt that the security provided an effective hedge against increased funding costs of Deerfield Capital's portfolio. The trader wanted either to retain the digital IO or to acquire an identical or similar security to provide that hedge. In order to accommodate the divergent goals of realizing a gain with respect to the digital IO, preserving its perceived hedge value, and more closely aligning Deerfield Capital's GAAP and tax income, Deerfield Capital explored a number of options during the last quarter of 2005.

9. The efforts to consummate a transaction or series of transactions, which had begun in October, intensified as the year end approached. During December, Deerfield Management personnel continued their attempts to sell the digital IO but were unable to obtain what they felt was a fair price.

10. Finally, on December 28, a sales person for a third-party broker-dealer proposed the following transaction:

- The third-party broker-dealer would purchase the digital IO by the end of 2005, with settlement on January 24, 2006.
- The third-party broker-dealer would re-securitize the digital IO cash flows by combining the cash flows with those from an unrelated stream of principal-only ("PO") payments representing approximately 10 percent of the total value of the "new" security.
- Deerfield Capital would purchase the "new" security for settlement on January 30, 2006.
- The price of the digital IO component would be the same in both the sale and purchase transactions. Deerfield Capital and the third-party broker-dealer agreed upon a price halfway between the bid and ask price of the security on the date of the transaction. Since the third-party broker-dealer's "purchase" and "sale" of the IO component would be at the same price, the third-party broker-dealer's salesman told Deerfield Management's trader that he was "indifferent" to the pricing of the security.

11. On December 29, the parties agreed to the transaction described above. In its financial statements for the year ended December 31, 2005, Deerfield Capital recognized a gain of \$3.9 million as a result of the transaction.

Application of GAAP

12. These transactions do not qualify for sale treatment under SFAS 140, *Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the applicable generally accepted accounting principle. Under SFAS 140(9)(a)-(c), a transaction may be accounted for as a sale, and a gain or loss recognized, only if all of certain conditions are met. Otherwise, the sale must be treated as a financing, upon which a gain or loss cannot be recognized.

13. Deerfield Capital's three REMIC transactions in late 2005 and early 2006 did not meet the requirements of SFAS 140(9)(b) and therefore should not have been treated as sales under GAAP. SFAS 140(9)(b) requires that the transferee have the right to pledge or exchange the transferred assets it received and that no conditions both constrain the transferee from taking advantage of its right to pledge or exchange and provide more than a trivial benefit to the transferor. Deerfield Capital agreed to purchase a re-REMIC security that included the same cash flows represented by the IOs sold through a forward purchase contract concurrent with the third-

party broker-dealer's purchase, effectively constraining the third-party broker-dealer from pledging or exchanging the assets. Further, the IOs Deerfield Capital purportedly sold represented all payments from the underlying REMIC trust, constraining the third-party broker-dealer's ability to obtain a similar security. SFAS 140(32) states that, "A free standing forward purchase-sale contract between the transferor and the transferee on transferred assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner" as a free standing call option.

14. In addition, neither Deerfield Capital nor Deerfield Management performed a sufficient analysis or obtained the legal advice necessary to determine if the transactions satisfied SFAS 140(9)(a), which requires that the assets be "presumptively beyond the reach of the transferor and its creditors." The third-party broker-dealer had a contractual obligation to deliver a security for which 90 percent of the price represented the same stream of payments from the same pool of specifically identified assets. Deerfield Capital and Deerfield Management did not fully analyze the available evidence or obtain a legal opinion and therefore did not have reasonable assurance that the transactions would be deemed a true sale at law.

Deerfield Capital's Accounting for the Transactions

15. In late December 2005, Valkner played a significant role in the operations of Deerfield Capital. Although others participated in the structuring of the December 2005 transaction, Deerfield Capital's management relied primarily upon Valkner, the CFO of Deerfield Management, to determine whether the transaction qualified for sales treatment under GAAP. Valkner was aware of the difficulties that Deerfield Capital faced in executing a transaction that met all the previously stated objectives. Additionally, Deerfield Management's head of trading told Valkner in a December 21 email that "an outright sale" of the IO security was "very challenging as no one wanted to provide a firm bid at a reasonable level in an acceptable time frame.

16. In a series of December 29 communications between Valkner and other members of Deerfield Management personnel, including the mortgage trader who had negotiated the transaction, and after consultation with other Deerfield Capital accounting personnel, Valkner stated she believed that the December 29 transaction qualified for sale treatment. Deerfield Capital had not previously engaged in a transaction similar to the December 29 transaction, and Valkner did not correctly analyze the application of SFAS 140. When analyzing the transaction, Valkner did not ask the trader how the terms of the sale of the digital IO and the purchase of the re-REMIC were negotiated; never reviewed the Bloomberg message reflecting the terms of the transaction; and did not determine whether the digital IO represented an entire tranche of a pool of collateral, thereby making it unique.

17. Deerfield Capital's accounting staff failed to document its analysis of the complex accounting issues raised by the transaction. Although Deerfield Capital's outside auditors had been consulted concerning previous efforts to conduct a transaction concerning the IO, Deerfield

Capital did not consult its outside auditor in connection with the December 2005 transaction and did not bring the transaction to the auditor's attention in connection with the audit of Deerfield Capital's accounts for the year ended December 31, 2005.

18. Valkner did not review the transaction after December 29. Although she did not sign the filings containing Deerfield Capital's financial statements, she signed management representation letters addressed to Deerfield Capital's outside auditors, in which she stated to the best of her knowledge, that Deerfield Capital's financial statements were presented in accordance with GAAP, for the audit of the year ended December 31, 2005, the year ended December 31, 2006 and the quarter ended March 31, 2006.

19. At the close of the quarter ended March 31, 2006, Deerfield Capital sold two additional digital IO securities in similar transactions. Deerfield Capital's new CFO did not undertake any independent review of the transactions, purportedly relying instead upon the work done by Valkner and others to ensure compliance with GAAP in connection with the December 29 transaction. Deerfield Capital did not inform its outside auditor of the transaction. In connection with the March 2006 transactions, Deerfield Capital recognized \$3.6 million in gains on the sales.

Impact on Deerfield Capital's Financial Statements

20. In connection with the December 2005 transactions, Deerfield Capital recognized a gain on sale of \$3.9 million and recorded a related expense of \$977,000 for an incentive fee paid to Deerfield Management. In connection with the March 2006 transactions, Deerfield Capital recognized a gain on sale of \$3.6 million and recorded an incentive fee expense of \$915 thousand; however, Deerfield Management did not ultimately collect that fee at the time of its year-end calculation, due to losses arising from the impairment of the re-REMICs later in 2006.

21. In its audited Statement of Operations included in its Form 10-K for the year ended December 31, 2005, Deerfield Capital represented that it had realized a net gain of \$5.372 million on the sale of available-for-sale securities, which was a component of \$5.435 million in other income and gain. Deerfield Capital failed to disclose that \$3.9 million of that gain represented the "sale" of the IO security and there was an agreement to purchase a newly created re-REMIC security that included the cash flows of the IO sold combined with cash flows from a PO security. Similarly, in the Form 10-Q for the three months ended March 31, 2006, Deerfield Capital represented that it had realized a gain of \$2.092 million on the sale of available-for-sale securities. Again, Deerfield Capital failed to disclose that \$3.6 million of that gain related to the sale of the digital IOs and that there was an agreement to purchase a newly created re-REMIC security that included the cash flows of those IOs.

22. Correcting the improper accounting requires that the gain on sale be excluded from, and that the incentive fee be added back to, the income statement. As a result of the accounting errors, Deerfield Capital overstated its net income for the fourth quarter of 2005 by \$2.9 million, or 15 percent, and for the first quarter of 2006 by \$2.7 million, or 14 percent. As a result of the

errors, Deerfield Capital also overstated its net income for the year ended December 31, 2005 by 6 percent.

Violations

23. As a result of the conduct described above, Deerfield Capital violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, and Valkner was a cause of Deerfield's violations of Section 13(a) of the Exchange Act and Rules 12b-20, and 13a-1 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to 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. Deerfield Capital violated those provisions by filing quarterly and annual reports that misstated its net income and gain on sale of available-for-sale securities and by failing to disclose that it was obligated to reacquire certain assets for which it had recognized revenue on a purported sale that should have been accounted for as a financing.

24. As a result of the conduct described above, Deerfield Capital violated Section 13(b)(2)(A) of the Exchange Act, and Valkner was a cause of Deerfield Capital's violations of 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. Because Deerfield Capital incorrectly recorded the transactions described above as sales, rather than financings, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

25. Lastly, as a result of the conduct described above, Deerfield Capital 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 generally accepted accounting principles. Deerfield Capital failed to implement internal accounting controls relating to its transactions in sales and purchases of re-securitizations sufficient to provide reasonable assurances that these accounts were accurately stated in accordance with generally accepted accounting principles.

IV.

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

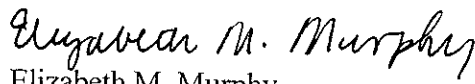
Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Deerfield Capital 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.

B. Pursuant to Section 21C of the Exchange Act, Respondent Valkner cease and desist from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

C. Respondent Deerfield Capital shall, within 15 days of the entry of this Order, pay disgorgement of \$977,000 and prejudgment interest of \$300,070.36 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, 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 Respondent Deerfield Capital 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 Gerald Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-6010.

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 2, 2011

In the Matter of

China 9D Construction Group,

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 China 9D Construction Group because it has not filed any periodic reports since the period ended September 30, 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 company. 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 company is suspended for the period from 9:30 a.m. EST on February 2, 2011, through 11:59 p.m. EST on February 15, 2011.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

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Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63822 / February 2, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3239 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14217

In the Matter of
ERIC A. HOLZER, CPA
Respondent.

ORDER OF FORTHWITH SUSPENSION
PURSUANT TO RULE 102(e)(2) OF THE
COMMISSION'S RULES OF PRACTICE

I.

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

II.

FINDINGS

The Commission finds that:

- A. Holzer was licensed to practice law in the State of New York on July 18, 2003.
- B. Holzer is a certified public accountant in the State of New York.
- C. On May 7, 2009, Holzer pleaded guilty before the United States District Court for the Southern District of New York in *United States v. Eric A. Holzer*, Case No.1:09-cr-470 (S.D.N.Y), to one count of conspiracy to commit securities fraud, in violation of 18 U.S.C. § 371, and one count of securities fraud, in violation of 15 U.S.C. §§ 78j(b) and 78ff, 17 C.F.R. § 240.10b-5 and 240.10b5-2, and 18 U.S.C. § 2. On October 2, 2009, a judgment in the criminal case was entered against Holzer on the basis of his plea of guilty. As a result, Holzer was

¹ Rule 102(e)(2) provides in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

sentenced to five (5) years of probation, ordered to pay an assessment of \$200 and a criminal fine of \$15,000, and ordered to forfeit over \$119,300, representing proceeds derived from his criminal offense.²

III.

ORDER IMPOSING SANCTIONS

In view of the foregoing, the Commission finds that Holzer has been convicted of a felony involving moral turpitude within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

² On December 29, 2009, disciplinary proceedings in New York by the First Department of the Appellate Division resulted in Holzer's disbarment due to his felony convictions.

*Commissioner Aguilar
Disapproved
Commissioner Faredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9180 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14218

In the Matter of

DON S. HERSHMAN,

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTION
8A OF THE SECURITIES ACT OF 1933,
MAKING FINDINGS, AND IMPOSING A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), against Don S. Hershman ("Hershman" or "Respondent").

II.

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

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

SUMMARY

1. Between 2005 and 2008, Wextrust Capital LLC and its affiliates ("Wextrust") raised approximately \$270 million from over 1,400 investors in at least 70 fraudulent private placement securities offerings for real estate, African diamond mining, commodities, and other ventures. On August 11, 2008, the Commission filed an emergency civil enforcement action against Wextrust and its principals in Federal District Court in the Southern District of New York in a case titled *SEC v. Byers, et al.*, No. 08-cv-7104 (S.D.N.Y.). Wextrust and its assets are now being administered by an equity receiver (the "Receiver") appointed in the case.
2. In 2005, the law firm of Much Shelist Denenberg Ament & Rubenstein, PC ("Much Shelist") began to provide real-estate related legal services to Wextrust. Soon thereafter, Hershman, who was one of Much Shelist's securities lawyers, became Wextrust's primary outside securities counsel. In that role he prepared or reviewed disclosure documents disseminated by Wextrust and its affiliates to potential investors in approximately 16 offerings that raised over \$127 million.
3. Over the course of his representation of Wextrust between 2005 and 2008, Hershman became increasingly aware of facts that he knew or should have known were material facts that were not disclosed in Wextrust offering documents. In 2006 and early 2007, Hershman learned that Wextrust engaged in the undisclosed over-raising of funds and had taken actions inconsistent with prior disclosures made to investors in an offering that he believed were sufficiently material to require Wextrust to offer rescission rights to investors. By late 2007, Hershman also learned that Joseph Shereshevsky ("Shereshevsky"), one of Wextrust's two principal executives, pleaded guilty to conspiracy to commit bank fraud in June 2003 and that he had lied to Hershman about his criminal conviction at the inception of the client relationship. By that time he also learned that a major investor had sued Wextrust for rescission of an offering he had worked on alleging material misrepresentations and omissions in the offering documents. In February of 2008, approximately two months after learning of Shereshevsky's fraud conviction, Hershman was alerted by Wextrust's CFO that Shereshevsky controlled Wextrust's bank accounts and that the CFO was having difficulty accessing those accounts to pay business expenses. Notwithstanding Hershman's knowledge of these facts, he continued to work or supervise work on private placement offerings for Wextrust that failed to disclose the principal's prior felony fraud conviction and Wextrust's prior over-raises. In April 2008, Hershman also worked on one offering

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.

that he knew would have the effect of diluting cash flow from investors in a prior offering that he had supervised. Because of that inconsistency, Hershman advised Wextrust that he did not condone the structure of the deal, but nonetheless agreed to advise Wextrust regarding the deal and did not insist on disclosure of the dilution to the prior investors.

RESPONDENT

4. **Hershman**, age 53, resides in Highland Park, Illinois. He joined the law firm of Much Shelist in 2000 as an equity partner and became a member of the management committee in 2005. From 2005 to August 2008, Hershman was a billing partner for Much Shelist's representation of Wextrust and received compensation based on those billings. During that time, Much Shelist was primary securities counsel to Wextrust.

OTHER RELEVANT ENTITIES

5. **Much Shelist** is a full-service law firm engaged primarily in real estate law with its principal place of business in Chicago, Illinois. The firm was founded in 1970, has approximately 85 attorneys, and maintains a second office in Irvine, California.

6. **Wextrust Capital, LLC** ("Wextrust Capital") was an Illinois limited liability company formed by Steven Byers in 2003. Wextrust Capital solicited investments through private placement offerings into a variety of investment vehicles through its affiliated broker-dealer, Wextrust Securities LLC, and managed those investments through other affiliates. Among the investment vehicles for which Wextrust Capital solicited investments were holding companies that Wextrust Capital formed for the purpose of holding equity interests in other companies. Wextrust Capital was headquartered in Chicago, Illinois and maintained offices all over the United States, including in New York, New York, as well as Israel and South Africa. From 2005, acting through Wextrust Securities LLC and affiliated entities, Wextrust Capital and its principals raised approximately \$270 million from approximately 1,400 investors throughout the United States and abroad. Altogether, since the formation of the Wextrust Securities in 2005, Wextrust Capital and its principals conducted approximately 70 private placement offerings and created approximately 150 entities in the form of limited liability companies or similar vehicles for the offerings.

7. **Steven Byers ("Byers")**, age 48, was a resident of Oakbrook, Illinois until his arrest in August 2008. He was the Chairman of Wextrust Capital and President and Chief Executive Officer of Wextrust Equity Partners LLC, the arm of Wextrust focusing on income-producing properties, and also was an owner and controlling person of Wextrust Securities LLC. Together with Shereshevsky, he controlled Wextrust. On April 13, 2010, Byers pleaded guilty to one count each of conspiracy to commit securities fraud and securities fraud.

8. **Shereshevsky**, age 53, resided in Norfolk, Virginia until his arrest in August 2008. Shereshevsky was Wextrust Capital's Chief Operating Officer, and had been a key person in building the private equity group, greatly increased Wextrust's access to capital and was instrumental in founding Wextrust Securities LLC and in Wextrust's expansion into diamond mining investments in Africa. In March 1993, Shereshevsky was arrested for, among other things,

bank fraud. In June 2003, he pleaded guilty in the Southern District of New York to one felony count of conspiracy to commit bank fraud.

BACKGROUND

9. Byers formed Wextrust Capital in 2003. Prior to that time, Byers had been in the real estate financing business, and in 2002 he began to engage in private placement securities offerings as a way to refinance his real estate deals. Shereshevsky, who had worked as a property manager for one of Byers' real estate deals, joined Byers at Wextrust Capital at around the time of its inception. Together, Byers and Shereshevsky controlled Wextrust.

10. Between 2005 and 2008, Wextrust raised approximately \$270 million from 1,400 investors in at least 70 fraudulent private placement securities offerings. Much Shelist had no association with Byers or Shereshevsky prior to Wextrust's introduction to Much Shelist in 2005. By the end of 2005, Hershman had become the primary billing partner for Wextrust securities matters and had overall responsibility for corporate securities work performed on its behalf until it was shut down in August 2008. Between 2005 and 2008, Hershman personally worked on or reviewed another attorney's work on 16 Wextrust private placement memoranda ("PPMs"), which allowed Wextrust to raise from investors more than \$127 million.

HERSHMAN BECOMES AWARE OF MISSTATEMENTS AND OMISSIONS IN WEXTRUST PRIVATE PLACEMENT MEMORANDA

Material, Undisclosed Modifications to the IDEX Offering

11. In December 2005, a Much Shelist attorney, under Hershman's supervision, began preparing offering documents for the IDEX offering. The purpose of the IDEX offering, dated January 16, 2006, was to raise \$23 million from investors in order to make a loan to and acquire a 40 percent equity interest in Pure Africa Minerals (Pty) ("PAM"), a South African holding company run by Byers and Shereshevsky, among others. The PPM represented that PAM, in turn, owned an equity stake in Vaticano Traders (Pty) Ltd. ("Vaticano"), a South African company engaged in the diamond-mining business. The PPM also represented that Vaticano owned certain mineral rights and permits with respect to three specific South African diamond mines.

12. In late 2005 and early 2006, while the attorney supervised by Hershman was preparing the IDEX offering documents, Hershman was made aware that documents evidencing both PAM's ownership of Vaticano and Vaticano's ownership of the mineral rights and mining permits could not be located. Hershman instructed Wextrust to disclose in the PPM that they "believed" the factual statements concerning ownership of Vaticano and the mineral rights and mining permits, but did not yet have confirming documentation as to such ownership. On January 19, 2006, Hershman learned from Shereshevsky that this disclosure was "becoming an issue with raising the money" from investors.

13. By February 15, 2006, Hershman received information that Shereshevsky had added to the IDEX structure two South African diamond mines, which were not identified in the original PPM sent to investors. Hershman learned that, consequently, some of the funds raised in

the IDEX offering were going to be used toward mining these two additional mines. At the same time, Hershman also learned that Wextrust had already raised \$13.5 million from investors for the IDEX offering.

14. On February 16, 2006, Hershman recommended that Wextrust describe the new mines in a one-page supplement to the IDEX PPM and an amendment to the operating agreement and set up a telephone number for investors to call with questions. Hershman also advised Wextrust management that “[a]n investor may possibly have a right of rescission based on these new mines, but let’s wait and see if anyone seems dissatisfied first.”

15. On February 24, 2006, Hershman learned from Wextrust management that Shereshevsky had “change[d] the [IDEX] deal completely.” Specifically, Hershman learned that money originally slated to be used to acquire the remaining interests in Vaticano and provide Vaticano with working capital was instead going to be used to purchase other mining properties and related equipment. On March 8, 2006 Hershman, through an attorney he supervised, again advised Wextrust to issue a supplement to the PPM and finally advised Wextrust to offer those IDEX investors who had already invested a right of rescission.

16. On March 23, 2006 – two months after the date of the original IDEX offering – Wextrust’s Chief Compliance Officer informed Hershman by email that the “cowboys” (that is, Wextrust management) intended to increase the IDEX offering from \$23 million to \$28 million, which would have the effect of diluting investors. By the end of April 2006 – four months after Much Shelist began work on the offering and two months after learning that Wextrust planned to increase the IDEX raise – the Much Shelist attorney supervised by Hershman was still drafting a supplement and rescission letter. The attorney and Hershman agreed that they would not finalize the rescission letter and PPM supplement until they were sure Wextrust had finished changing the terms of the IDEX deal, even though they believed the changes that had already occurred were likely material enough to warrant the offer of rescission rights and the offering was ongoing. On May 15, 2006, a Wextrust employee informed the Much Shelist attorney supervised by Hershman and another Much Shelist attorney in an email that the IDEX “rescission letter and amendment went out.”

17. Hershman knew that he and Much Shelist were listed as a notice party for IDEX and Wextrust in the IDEX operating agreement appended to the PPM.

18. Ultimately, Wextrust raised \$30,340,000 from investors for the offering although the PPM disclosed that the raise would be limited to \$23,000,000. The money raised in the IDEX offering was transferred to various accounts in Africa and has been dissipated.

19. In October 2007, Hershman learned that an investor in IDEX had filed a private action against Wextrust alleging fraud based on many of the same misrepresentations and omissions that Hershman had previously addressed in connection with the IDEX offering (e.g., misstatements concerning Vaticano’s ownership of diamond mines; modifications to the use of proceeds; and change in loan structure). The investor also sought rescission of its investment in IDEX. Upon learning of the allegations in the lawsuit, Hershman knew or should have known that

Wextrust management may never have sent to investors the rescission letter or PPM supplement that Hershman had earlier advised be issued.

Shereshevsky's Felony Conviction for Conspiracy to Commit Bank Fraud

20. In November 2007, Hershman learned from one of his partners handling another lawsuit alleging securities fraud against Wextrust that Shereshevsky had previously been convicted of conspiracy to commit bank fraud in 2003. Prior to commencing work for Wextrust, Hershman had asked Shereshevsky if he had ever been convicted of a crime, to which Shereshevsky responded that he had not. Even though Hershman knew that Shereshevsky had lied to him and was a convicted felon, he continued to prepare PPMs for Wextrust without insisting that Shereshevsky's conviction be disclosed.

21. Between the time Hershman learned of Shereshevsky's conviction in November 2007 and February 2008, Much Shelist prepared Wextrust offerings that permitted Wextrust to raise more than \$7.5 million from investors. Several of the PPMs for those offerings identified Shereshevsky as a key member of management and described him as "a principal and integral part of the management team," "a key asset in building the private equity group," and the person who "has brought focus and vision to the Manager's investment and merchant banking divisions." Those PPM's also described Shereshevsky's prior experience in the diamond business and noted that he "is a member of the Executive Board of Hampton Roads School in Norfolk, Virginia and a member of Congregation Bnai Israel." None of the PPMs disclosed Shereshevsky's criminal conviction or prior over-raises by Wextrust. Other PPMs failed to disclose Shereshevsky's role or conviction at all, although Hershman knew or should have known that Shereshevsky had control of Wextrust activities and also had control over the company's operating accounts.²

The Undisclosed Over-Raising in Connection with Offerings

22. On May 29, 2007, Hershman was informed that, as of that date, Wextrust raised \$9.2 million for an \$8 million private placement that Hershman prepared, known as Hamptons of Hinsdale. Hershman advised Wextrust's Chief Compliance Officer to "fix" the Hamptons of Hinsdale over-raise and to offer investors rescission rights if necessary, but he never followed up to make sure his advice was adhered to. By October 2007, when Hershman learned of the IDEX investor's rescission lawsuit, Hershman was on notice that Wextrust may have also conducted an undisclosed over-raise in connection with the IDEX offering.

² On February 8, 2008, Wextrust's CFO, who was Hershman's longtime acquaintance and who had been recommended for his position at Wextrust by Hershman, advised Hershman that he was concerned about signing a financial representation letter for the year 2006 because he was not an employee at the time, and that he had problems with Shereshevsky's control of the operating accounts and, even though he was CFO, he could not pay Wextrust's bills.

The Undisclosed Dilution of IDEX Investors

23. In early March 2008, after Hershman knew for certain of at least one prior Wextrust over-raise and had notice of the possible IDEX over-raise, the Wextrust CFO's concerns regarding Shereshevsky's control over the operating accounts, and Shereshevsky's undisclosed felony fraud conviction, Hershman was asked to advise Wextrust with respect to a \$25 million offering known as ATM II. After reviewing the draft offering documents that Wextrust provided, Hershman decided that he would not prepare, review or edit any of the offering documents for the ATM II transaction because he believed the structure of the transaction to be materially inconsistent with the structure of the IDEX transaction, which would adversely impact IDEX investors.

24. Specifically, Wextrust management determined to sell indirectly 10% of Wextrust's 60% equity share of PAM through the ATM II offering. In the IDEX transaction, IDEX investors received a 40% equity share of PAM in exchange for a loan made to PAM. Under the terms of the IDEX offering, Wextrust and its principals were only to be paid for certain loans they purported to make in connection with the entities involved after repayment in full of the loan made to PAM by the IDEX offering and the IDEX investors' capital contributions. However, the ATM II offering was structured in a way that a new loan to PAM would be made, which would be senior to the loan made by the IDEX offering, and the loans purportedly made to PAM by Wextrust during the IDEX offering would also be repaid before IDEX investors received payment on their capital contributions.

25. On March 18, 2008, Wextrust management forwarded to Hershman a copy of a letter from counsel for certain IDEX investors who had learned about the ATM II deal. The letter raised concerns about the potential dilution from the ATM II deal and requested relevant documents. Hershman advised Wextrust management that the proposed structure was not consistent with the terms of the IDEX transaction. Notwithstanding Hershman's legal advice and IDEX investors' concerns, Wextrust management decided to go forward with the proposed structure.

26. On April 17, 2008, Hershman executed an engagement letter in which Much Shelist agreed to represent ATM II in the transaction. The engagement letter stated that Much Shelist's "services will be limited to reviewing and editing the disclosure documentation prepared by employees of WexTrust Capital, including the Limited Liability Company Agreement of ATM and the subscription documentation, for purposes of compliance with U.S. securities laws." The engagement letter then specifically disclaimed responsibility for reviewing "the impact of the offering on governing documentation of PAM or the existing distribution agreement or the relationships among the various equity and debt holders of PAM." Hershman also supervised the preparation of ATM II's blue sky filings. Hershman's work on the ATM II transaction facilitated Wextrust in raising \$1,250,000 from investors for the ATM II offering. The raise for ATM II was stopped only by the August 11, 2008 emergency action filed by the Commission and the arrests of Byers and Shereshevsky.

Hershman's Role in Preparing Offering Documents

27. Between 2005 and 2008, Hershman personally worked on or reviewed another Much Shelist attorney's work on 16 Wextrust private placements, which allowed Wextrust to raise from investors more than \$127 million. At least six of those transactions were prepared by Hershman and another Much Shelist attorney in late 2007 and 2008, which permitted Wextrust to raise over \$7.5 million from investors after Hershman knew that Shereshevsky had been convicted of felony conspiracy to commit bank fraud and that Wextrust had engaged in at least one undisclosed over-raising of funds. Much Shelist was identified as notice party for Wextrust or its affiliate in some of those offerings. Hershman also facilitated the ATM II offering even though Wextrust rejected his legal advice that it was materially inconsistent with the terms of the IDEX offering and would adversely affect IDEX investors in a material way. Hershman was paid \$25,291 in fees for his work on Wextrust matters after the time he knew of Shereshevsky's felony conviction.

LEGAL CONCLUSIONS

28. Sections 17(a)(2) and 17(a)(3) of the Securities Act make it unlawful for any person in the offer or sale of any securities to obtain money or property by means of any material misrepresentations or omissions, or to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon the purchaser. *Ira Weiss*, Securities Act Rel. No. 8641 (Dec. 2, 2005) at 18. "[T]o fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'" *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (citation omitted).

29. Proof of scienter is not required to establish violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. Negligence alone is sufficient. *Aaron v. SEC*, 446 U.S. 680, 697 & 701-02 (1980). Negligence is defined as the failure to exercise reasonable care. *Weiss* at 19.

30. In view of Shereshevsky's central role in managing Wextrust and the positive description of his business and civic accomplishments in Wextrust PPMs, his prior conviction for conspiracy to commit bank fraud in June 2003 was a material fact that Wextrust should have disclosed to investors. *SEC v. Scott*, 565 F. Supp. 1513, 1527 (S.D.N.Y. 1983) (principal's prior fraud conviction was material information that should have been disclosed to investors). Failure to disclose past securities over-raises by Wextrust and the potential for dilution of investors is also a fact that a reasonable investor investing in Wextrust securities offerings would most likely find to be significant in making an investment decision.

31. Section 8A(a) of the Securities Act provides that the Commission may issue a cease-and-desist order against a person who is "a cause of [another person's] violation, due to an act or omission the person knew or should have known would contribute to such violation" Negligence alone is sufficient to establish causing liability for non-scienter violations. *KPMG, LLP v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

32. Section 8A(e) of the Securities Act authorizes the Commission to order disgorgement in a cease-and-desist proceeding instituted under Section 8A(a) of the Securities Act.

33. After learning of (i) Shereshevsky's fraud conviction, (ii) that Shereshevsky had lied to him about his prior conviction, (iii) at least one prior undisclosed Wextrust over-raise and the possibility of an undisclosed over-raise in connection with the IDEX offering, and (iv) concerns raised by Wextrust's CFO regarding Shereshevsky's control over the Wextrust operating accounts, Hershman knew or should have known that one or more of those facts were material facts that should have been disclosed in the Wextrust PPMs that he prepared or reviewed in late 2007 and 2008. Yet Hershman did not even request that Wextrust include such material facts in its private placement memoranda. Moreover, when confronted with ATM II offering that Hershman knew was inconsistent with the prior IDEX offering he had supervised and that would harm IDEX investors, Hershman nonetheless agreed to advise Wextrust on disclosures for the offering and to supervise Blue Sky laws filings to facilitate the offering. By virtue of his conduct, Hershman was a cause of Wextrust's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent Hershman cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

B. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of \$25,291 and prejudgment interest of \$4,042.10 to the Receiver appointed in *SEC v. Byers, et al.*, 08-cv-7104 (S.D.N.Y.). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to "Timothy J. Coleman, as Wextrust Receiver", c/o Freshfields Bruckhaus Deringer US LLP, 701 Pennsylvania Avenue, NW, Suite 600, Washington, DC 20004-2692; and (C) submitted under cover letter that identifies Don Hershman as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Andrew M. Calamari, Division of Enforcement, Securities and Exchange Commission, 3 World Financial

Center, New York, NY 10281. In accordance with Rule 1102 of the Commission's Rules of Practice [17 C.F.R. 201.1102], the procedures set forth herein shall govern the distribution of any funds paid pursuant to this 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. 63824 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14220

	:	
	:	
	:	
In the Matter of	:	ORDER INSTITUTING ADMINISTRATIVE
	:	PROCEEDINGS PURSUANT TO RULE
ROGER AUGUST KIMMEL, JR., ESQ.,	:	102(e) OF THE COMMISSION'S RULES OF
	:	PRACTICE, MAKING FINDINGS, AND
Respondent.	:	IMPOSING REMEDIAL SANCTIONS
	:	
	:	
	:	

I.

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

II.

In anticipation of the institution of these proceedings, Kimmel 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

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

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

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, paragraph 2 below, which are admitted, Kimmel consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Kimmel, age 67, is and has been an attorney licensed to practice law in the State of Ohio. From at least March 2008 through July 2008, Kimmel acted as an attorney for Petroleum Unlimited, LLC, and Petroleum Unlimited II, LLC (collectively "Petroleum Unlimited").
2. On January 12, 2011, a final judgment was entered against Kimmel, permanently enjoining him from future violations of Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Roger August Kimmel, Jr., et al., Civil Action Number 9:11-CV-80038-MARRA, in the United States District Court for the Southern District of Florida.
3. The Commission's complaint alleges that, among other things, in connection with the offer and sale of Petroleum Unlimited's securities, Kimmel misused investor funds, misrepresented the company's use of offering proceeds and the annual returns investors could earn by investing in Petroleum Unlimited, and failed to disclose exorbitant sales commissions.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that Kimmel is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.

Elizabeth M. Murphy
Secretary


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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 242 and 249

[Release No. 34-63825; File No. S7-06-11]

RIN: 3235-AK93

Registration and Regulation of Security-Based Swap Execution Facilities

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; proposed interpretation.

SUMMARY: In accordance with Section 763 ("Section 763") 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 SB SEF under the Securities Exchange Act of 1934 ("Exchange Act") that is designed to create a registration framework for security-based swap execution facilities ("SB SEFs"); establish rules with respect to the Dodd-Frank Act's requirement that a SB SEF must comply with the fourteen enumerated core principles ("Core Principles") and enforce compliance with those principles; and implement a process for a SB SEF to submit to the Commission proposed changes to the SB SEF's rules. The Commission also is proposing an interpretation of the definition of "security-based swap execution facility" set forth in Section 3(a)(77) of the Exchange Act to provide guidance on the characteristics of those systems or platforms that would satisfy the statutory definition. In addition, the Commission is proposing to amend Rule 3a-1 under the Exchange Act to exempt a registered SB SEF from the Exchange Act's definition of "exchange" and to add Rule 15a-12 under the Exchange Act to exempt, subject to certain conditions, a registered SB SEF from regulation as a broker pursuant to Section 15(b) of the Exchange Act.

DATES: Comments should be submitted on or before April 4, 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/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-06-11 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 S7-06-11. 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: Nancy J. Burke-Sanow, Assistant Director, at (202) 551-5621; David Liu, Senior Special Counsel, at (312) 353-6265; Constance Kiggins, Special Counsel, (202) 551-5701; Molly Kim, Special Counsel, at (202) 551-5644; Leah Mesfin,

Special Counsel, at (202) 551-5655; Susie Cho, Special Counsel, at (202) 551-5639; Michou Nguyen, Special Counsel, (202) 551-5634; Heidi Pilpel, Special Counsel, (202) 551-5666; Steven Varholik, Special Counsel, at (202) 551-5615; Sarah Schandler, Special Counsel, 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 SB SEF under the Exchange Act governing the registration and regulation of SB SEFs, an interpretation with respect to the definition of a SB SEF and new Form SB SEF for applicants to register with the Commission as SB SEFs. The Commission also is proposing certain exemptions to facilitate the trading of security-based swaps (“SB swaps”) on SB SEFs.

I. Introduction

On July 21, 2010, the President signed the Dodd-Frank Act into law.¹ The Dodd-Frank Act was enacted, among other things, to promote the financial stability of the United States by improving accountability and transparency of the nation’s 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 of the OTC derivatives market. The Dodd-Frank Act is intended to strengthen the existing regulatory structure concerning, and to provide the Commission and the CFTC with effective regulatory tools to oversee, the OTC swaps markets, which have grown exponentially in recent years and

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.

are capable of affecting significant sectors of the U.S. economy.

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 with respect to transactions in SB swaps regulated by the Commission: (1) transactions in SB 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;⁴

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 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” to include transactions and entities that have been structured to evade Title VII of the Dodd-Frank Act. Section 761(b) of the Dodd-Frank Act provides that the Commission may 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 the 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 sought comment from interested parties. See Securities Exchange Act Release Nos. 63452 (December 7, 2010), 75 FR 80174 (December 21, 2010) (File No. S7-39-10) (proposed rulemaking regarding definitions contained in Title VII of the Dodd-Frank Act relating to participants). The Commission also will propose rules regarding definitions contained in Title VII of the Dodd-Frank Act relating to products in a separate proposed rulemaking. See also 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).

⁴ See Pub. L. No. 111-203, § 763(a) (adding Section 3C(a)(1) of the Exchange Act).

(2) if the SB swap is subject to the clearing requirement, the transaction must be executed on an exchange or on a SB SEF registered under Section 3D of the Exchange Act or a SB SEF exempt from registration under Section 3D(e) of the Exchange Act, unless no SB SEF or exchange makes such SB swap available for trading or the SB swap transaction is subject to the clearing exception in Section 3C(g) of the Exchange Act,⁵ and (3) transactions in SB swaps (whether cleared or uncleared) must be reported to a registered security-based swap data repository (“SDR”) or the Commission.⁶

II. Regulatory Framework of Security-Based Swap Execution Facilities

Currently, SB swaps trade in the OTC market, rather than on regulated markets. Although some SB swaps have moved to centralized clearing, prior to the enactment of the Dodd-Frank Act, centralized clearing of SB swaps was not required. The current market for SB swaps is opaque, with little, if any, pre-trade transparency (the ability of market participants to see trading interest prior to a trade being executed) or post-trade transparency (the ability of market participants to see transaction information after a trade is executed). A key goal of the Dodd-Frank Act is to bring trading of SB swaps onto regulated markets,⁷ as reflected in the statutory requirement that, subject to certain exceptions, any SB swap subject to mandatory

⁵ See Pub. L. No. 111-203, § 763(a) (adding Section 3C(h) of the Exchange Act). See also Pub. L. No. 111-203, § 761(a) (adding Section 3(a)(77) of the Exchange Act), defining the term “security-based swap execution facility.” The Dodd-Frank Act amends the CEA to provide for a similar regulatory framework with respect to transactions in swaps regulated by the CFTC.

⁶ See Pub. L. No. 111-203, § 761(a)(75) (adding Section 3(a)(75) of the Exchange Act) (defining the term “security-based swap data repository”). The registration of an SDR and the reporting of SB swaps are the subject of separate Commission rulemakings. See Securities Exchange Act Release Nos. 63347 (November 19, 2010), 75 FR 77306 (December 10, 2010) (File No. S7-35-10) (“SDR Release”) and 63346 (November 19, 2010), 75 FR 75208 (December 2, 2010) (File No. S7-34-10) (“Reporting and Dissemination Release”).

⁷ See Pub. L. No. 111-203, preamble.

clearing must be traded on a SB SEF or an exchange, unless no SB SEF or exchange makes such SB swap available for trading.

Section 763 of the Dodd-Frank Act amends the Exchange Act by adding various new statutory provisions to govern the regulation of SB SEFs.⁸ Section 3C(h) of the Exchange Act specifies that transactions in SB swaps that are subject to the clearing requirement of Section 3C(a)(1) of the Exchange Act must be executed on an exchange or on a SB SEF registered with the Commission (or a SB SEF exempt from registration), unless no exchange or SB SEF makes the SB swap available to trade (referred to as the “mandatory trade execution requirement”) or the SB swap transaction is subject to the clearing exception in Section 3C(g) of the Exchange Act (“end-user exception”).⁹ Further, Section 3D(a)(1) of the Exchange Act states that no person may operate a facility for the trading or processing of SB swaps, unless the facility is registered as a SB SEF or as a national securities exchange under that section.¹⁰ Under Section 3D(b) of the Exchange Act, a SB SEF registered with the Commission may make SB swaps available for trading and facilitate trade processing of SB swaps.¹¹ Section 3D(c) of the Exchange Act requires a national securities exchange, to the extent it also operates a SB SEF and uses the same electronic trade execution system for listing and executing trades in SB swaps, to identify

⁸ See Pub. L. No. 111-203, § 763 (adding Sections 3C and 3D of the Exchange Act).

⁹ See Pub. L. No. 111-203, § 763 (adding Section 3C(h) of the Exchange Act).

¹⁰ See Pub. L. No. 111-203, § 763(a) (adding Section 3D(a)(1) of the Exchange Act). The Commission views this requirement as applying only to facilities that meet the definition of “security-based swap execution facility” in Section 3(a)(77) under the Exchange Act. SB swaps that are not subject to the mandatory trade execution requirement would not have to be traded on a registered SB SEF and could be traded in the over-the-counter (“OTC”) market for SB swaps.

¹¹ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(b) of the Exchange Act).

whether electronic trading of SB swaps is taking place on or through the exchange or the SB SEF.¹²

Section 3D(d) of the Exchange Act specifies that to be registered and maintain registration, a SB SEF must comply with fourteen Core Principles enumerated therein and any requirement that the Commission may impose by rule or regulation.¹³ The Core Principles applicable to SB SEFs are captioned: (1) Compliance with Core Principles; (2) Compliance with Rules; (3) Security-Based Swaps Not Readily Susceptible to Manipulation; (4) Monitoring of Trading and Trade Processing; (5) Ability to Obtain Information; (6) Financial Integrity of Transactions; (7) Emergency Authority; (8) Timely Publication of Trading Information; (9) Recordkeeping and Reporting; (10) Antitrust Considerations; (11) Conflicts of Interest; (12) Financial Resources; (13) System Safeguards; and (14) Designation of Chief Compliance Officer.¹⁴ As a result, a registered SB SEF would have certain regulatory obligations with respect to overseeing its market and the participants that trade on its facility. Further, Section 3D(f) of the Exchange Act states that the Commission shall prescribe rules governing the regulation of SB SEFs.¹⁵ Finally, Section 3(a)(77) of the Exchange Act defines a SB SEF as a trading system or platform in which multiple participants have the ability to execute or trade SB 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: (1) facilitates the execution of SB swaps between persons; and (2) is not a national securities exchange.¹⁶

¹² See Pub. L. No. 111-203, § 763(c) (adding Section 3D(c) of the Exchange Act).

¹³ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(1)(A) of the Exchange Act).

¹⁴ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(1)-(14) of the Exchange Act).

¹⁵ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(f) of the Exchange Act).

¹⁶ See Pub. L. No. 111-203, § 761(a) (adding Section 3(a)(77) of the Exchange Act).

As regulated markets for the trading of SB swaps, SB SEFs, as well as exchanges that post or trade SB swaps (“SBS exchanges”), are intended to play an important role in enhancing the transparency and oversight of the market for SB swaps. SB SEFs should help further the statutory objective of greater transparency and a more competitive environment for the trading of SB swaps by providing a venue for multiple parties to execute trades in SB swaps and also by serving as a conduit for information regarding trading interest in SB swaps. As a result of the Dodd-Frank Act’s provisions relating to SB SEFs, the Commission would have access to information on the trading of SB swaps that occurs on SB SEFs and information regarding trading by their participants. In addition, because SB SEFs would have certain regulatory obligations arising from their Core Principles, such as monitoring trading, assuring the ability to obtain information, and establishing and enforcing rules and procedures to ensure the financial integrity of SB swaps entered on or through the SB SEF, these facilities can play an important role in helping to oversee the market for SB swaps on an ongoing basis and allowing regulators to quickly assess information regarding the potential for systemic risk across trading venues.

The Commission is mindful that any rules that the Commission may adopt regarding the regulation of SB SEFs could impact the incentives for existing or prospective platforms for the trading of SB swaps to enter or withdraw from this market. On the other hand, the rules to be adopted by the Commission for the trading of SB swaps should be sufficient to fulfill the objectives of the Dodd-Frank Act to promote financial stability and transparency. The Commission also is mindful that, both over time and as a result of Commission proposals to implement the Dodd-Frank Act, the further development of the SB swap market may alter some of the specific calculus for future regulation of SB SEFs.

The Commission notes that the CFTC is proposing rules relating to swap execution facilities ("SEFs") as required under Section 733 of the Dodd-Frank Act.¹⁷ Because there are differences between the markets and products that the Commission and the CFTC currently regulate, the approach that each agency may take regarding the regulation of SB SEFs and SEFs, respectively, also may differ in various respects. The Commission recognizes that commenters may respond to the Commission's proposals by referring to the CFTC's proposals and welcomes commenters' views and suggestions on the impact of any differences between the Commission and CFTC approaches to the regulation of SB SEFs and SEFs. The Commission is particularly interested in whether its proposed rulemaking would result in any duplicative or inconsistent efforts on the part of market participants subject to both regulatory regimes or would result in gaps between those regimes.

Further, the Commission is aware that regulators in other countries are considering reform of their swaps and derivatives markets and are interested in achieving a consistent approach to swaps regulation between the United States, Europe and other jurisdictions to mitigate the risk of regulatory arbitrage.¹⁸ Although the Commission must be guided by the requirements of the Dodd-Frank Act in crafting proposed rules applicable to markets that trade SB swaps and the participants in those markets, the Commission recognizes that the particular rules that it may adopt under the Dodd-Frank Act may impact the incentives of market participants with respect to where they choose to engage in the trading of SB swaps.

¹⁷ See Pub. L. No. 111-203, § 733 (adding Section 5h of the CEA). See also 76 FR 1214 (January 7, 2011) ("Notice of proposed SEF rulemaking by the CFTC").

¹⁸ See, e.g., Committee of European Securities Regulators ("CESR"), CESR Technical Advice to the European Commission in the context of the MiFID Review and Responses to the European Commission for Additional Information, dated October 13, 2010, available at http://www.cesr-eu.org/index.php?page=contenu_groups&id=61&docmore=1.

Commenters are urged to consider generally the role that regulation may play in fostering or limiting the development of the market for SB 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 establish a framework for the trading of SB swaps. In addition, commenters are urged to consider the effect of the Commission's proposals relating to SB SEFs on the global swaps and derivatives markets and to offer specific comments regarding how the proposals compare with the existing or proposed regulations of other jurisdictions.

III. The Definition of Security-Based Swap Execution Facilities

Since the enactment of the Dodd-Frank Act in July 2010, the Commission has engaged in a number of outreach programs relating to the legislation's rulemaking mandates, including trading of SB swaps on regulated markets.¹⁹ On September 15, 2010, the staff of the Commission and of the CFTC conducted a joint roundtable to discuss issues related to the formation and regulation of SEFs and SB SEFs ("Roundtable").²⁰ Topics discussed at the Roundtable included the scope of the definition of a SEF and SB SEF; registration of these facilities; products that would trade on a SEF and SB SEF; block trades; access to SEFs and SB SEFs; and cross-market issues.²¹ The purpose of the Roundtable was to provide a forum for the

¹⁹ See, e.g., Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, Transparency, Public Input on SEC Regulatory Initiatives under the Dodd-Frank Act Title VII - Wall Street Transparency and Accountability, Mandatory Exchange Trading and Swap Execution Facilities, available at <http://www.sec.gov/spotlight/dodd-frank.shtml>.

²⁰ See Securities Exchange Release No. 62864 (September 8, 2010), 75 FR 55574 (September 13, 2010) (File No. 4-612). Webcast available at <http://www.sec.gov/news/openmeetings/2010/jac091510.shtml>.

²¹ See Press Release issued by the Commission on September 8, 2010, "SEC, CFTC To Host Joint September Roundtables On Swap and Security-Based Swap Matters" (File No. 2010-166), available at <http://www.sec.gov/news/press/2010/2010-166.htm>.

discussion of these issues and to assist SEC and CFTC staff as they developed proposed rules to meet the Dodd-Frank Act's mandate to bring the trading of swaps and SB swaps subject to the mandatory clearing requirement onto organized markets. Panelists at the Roundtable provided comments on their experience with the current market structure for the trading of swaps and SB swaps and offered their views and suggestions on ways that that structure could change as a result of the legislation. Pursuant to the Commission's outreach, a range of individuals and entities, including swap dealers, brokers, end-users, academics and others, have expressed their views on a variety of topics, such as the scope of activities or the nature of platforms that should fall within the statutory definition of "security-based swap execution facility."²²

Many letters from market participants advocated for a flexible interpretation of the statutory definition of SB SEF.²³ In their letters, they argued that the definition of SB SEF should permit many different types of existing and new trading and execution platforms.²⁴ Certain market participants noted that the SB swap market is more customized and illiquid than the cash equities market and argued that a broad range of trading models would be necessary to

²² See, e.g., <http://www.sec.gov/spotlight/dodd-frank.shtml>.

²³ See, e.g., letter from Ben Macdonald, Global Head Fixed Income, Bloomberg LP, to Commission, dated September 22, 2010 ("Bloomberg Letter"), at 2; letter from Richard H. Baker, President and CEO, Managed Funds Association, to Elizabeth M. Murphy, Secretary, Commission, dated September 22, 2010 ("MFA Letter"), at 16; letter from Ernest C. Goodrich, Jr., Managing Director – Legal Department, and Marcelo Riffaud, Managing Director – Legal Department, Deutsche Bank AG, to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, Commission, dated October 6, 2010 ("Deutsche Bank Letter"), at 5-6 and 8-9; and letter from Larry Tabb, CEO and Founder, Andy Nybo, Head of Derivatives, and Kevin C. McPartland, Senior Analyst, TABB Group, to Gary Gensler, Chairman, CFTC, and Mary Schapiro, Chairman, Commission, dated August 23, 2010 ("TABB Letter"), at 2.

²⁴ See, e.g., Bloomberg Letter, *id.*, at 2; MFA Letter, *id.*, at 16; and Deutsche Bank Letter, *id.*, at 7.

address the SB swap market's unique characteristics and to allow this market to develop properly.²⁵

Although many commenters who expressed a view regarding the definition of SB SEF favored allowing multiple platforms,²⁶ some commenters expressed concern about some types of platforms that potentially could meet the definition of SB SEF. One commenter believed that allowing multiple request for quote ("RFQ") platforms,²⁷ without a price mechanism that aggregates prices across platforms, to meet the definition of SB SEF, could lead to a fragmented market, which could discourage competition.²⁸ Another commenter suggested that permitting an RFQ platform to be treated as a SB SEF could be viewed as preserving the status quo of a dealer-dominated market and believed that the Dodd-Frank Act envisioned that SB swaps would be traded on a facility akin to a limit order book platform.²⁹

The Commission also received other specific views about platforms that commenters believed should or should not be included in the definition of SB SEF. For example, one commenter believed that platforms that would not trade or execute SB swap transactions, such as

²⁵ See, e.g., Bloomberg Letter, supra note 23, at 2, and Deutsche Bank Letter, supra note 23, at 6-7. See also infra, Section III.B for a discussion of the Commission's interpretation of the definition of SB SEF.

²⁶ See supra note 23 and accompanying text.

²⁷ In referring to a RFQ platform, the Commission means a trading platform where a customer who wishes to execute a SB swap disseminates a request for quote to one or more dealers and one or more of those dealers respond to the request with an executable quote.

²⁸ See, e.g., Commentary by S. "Vish" Viswanathan, Professor, Fuqua School of Business, Duke University, at the Roundtable. Webcast available at <http://www.sec.gov/news/openmeetings/2010/jac091510.shtml>.

²⁹ See Commentary by Heather Slavkin, Senior Legal Policy Advisor for the Office of Investment, AFL-CIO, at the Roundtable. Webcast available at <http://www.sec.gov/news/openmeetings/2010/jac091510.shtml>. See also infra, Section III.B discussing the Commission's interpretation taking into account concerns raised by commenters.

pure trade processing facilities, would not meet the statutory definition of SB SEF.³⁰ A market participant, however, stated that in its view the statutory definition of SB SEF would encompass pure trade processing facilities.³¹

The information presented at the Roundtable and received from the public has helped to inform the proposals relating to SB SEFs that are part of this rulemaking. The Commission is mindful that there exists a wide range of views on the part of market participants and others about the nature of the activities or systems that would constitute, and the scope of activities permitted by, a SB SEF and therefore encourages interested persons to provide their views and suggestions, as well as any materials or data to support their positions, on this aspect of the proposed rulemaking. The Commission believes that the prudent course is to take where appropriate a deliberate and attentive approach to its regulation of SB SEFs that is informed by the state of development of SB swap trading on regulated markets. The Commission emphasizes, however, that any actions it may take now or in the future would be designed to further the overall objectives of the Dodd-Frank Act.

A. Current SB Swap Market

1. Trading Models

Unlike the markets for cash equity securities and listed options, the market for SB swaps currently is characterized by bilateral negotiation in the OTC swap market; is largely decentralized; many instruments are not standardized; and many SB swaps are not centrally

³⁰ See letter from Mark D. Young, Skadden, Arps, Slate, Meagher & Flom LLP, to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, Commission, dated September 22, 2010, at 3.

³¹ See Meetings with SEC Officials: Memorandum from the Division of Trading and Markets regarding an August 25, 2010 Meeting with representatives of MarkitSERV, dated September 2, 2010, MarkitSERV PowerPoint Presentation, dated August 25, 2010 at p. 5-6, available at <http://www.sec.gov/comments/s7-16-10/s71610-96.pdf>.

cleared. The lack of uniform rules concerning the trading of SB swaps and the one-to-one nature of trade negotiation in SB swaps has resulted in the formation of distinct types of venues for the trading of these securities, ranging from bilateral negotiations carried out over the telephone, to single-dealer RFQ platforms, to multi-dealer RFQ platforms, to central limit order books outside the United States, and others, as more fully described below. The use of electronic media to execute transactions in SB swaps varies greatly across trading venues, with some venues being highly electronic whereas others rely almost exclusively on non-electronic means such as the telephone. The reasons for use of, or lack of use of, electronic media vary from such factors as user preference to limitations in the existing infrastructure of certain trading platforms. The description below of the ways in which SB swaps may be traded is based in part on discussions with market participants. The Commission solicits comments on the accuracy of this description.

The Commission uses the term “bilateral negotiation” to refer to the model whereby one party uses the telephone, email or other communications to contact directly a potential counterparty to negotiate a SB swap. Once the terms are agreed, the SB swap transaction is executed and the terms are memorialized.³² In a bilateral negotiation, there may be no pre-trade or post-trade transparency available to the marketplace because only the two parties to the transaction are aware of the terms of the negotiation and the final terms of the agreement. Further, no terms of the proposed transaction are firm until the transaction is executed. However, reputational costs generally serve as a deterrent to either party’s failing to honor any quoted terms. Dealer to customer bilateral negotiation currently is used for all SB swap asset

³² For further discussion, see, e.g., Securities Exchange Act Release No. 63727 (January 14, 2011), 76 FR 3859 (January 21, 2011) (proposing rules for the trade acknowledgement and verification of security-based swaps).

classes, and particularly for trading in less liquid SB swaps, in situations where the parties prefer a privately negotiated transaction, such as in executing block trades, or in other circumstances in which it is not cost effective for a party to the trade to use one of the execution methods described below.

Another model for the trading of SB swaps is the single-dealer RFQ electronic trading platform. In a single-dealer RFQ platform, a dealer may post indicative quotes for SB swaps in various SB swap asset classes that the dealer is willing to trade. Only the dealer's approved customers would have access to the platform. When a customer wishes to transact in a SB swap, the customer requests an executable quote, the dealer provides one, and if customer accepts the dealer's quote, the transaction is executed electronically. If the dealer repeatedly responds to requests for executable quotes with quotes that are significantly less favorable than the dealer's indicative quotes posted on the single-dealer electronic trading platform, volume on the platform presumably would diminish and participants may no longer transact there. This type of platform generally provides pre-trade transparency in the form of indicative quotes on a pricing screen, but only from one dealer to its customer. Currently, there is no post-trade reporting of transactions on single-dealer platforms and thus there is no post-trade transparency.

A variant of the single-dealer model is an aggregator-type platform that combines two or more single-dealer RFQ platforms. In such a platform, a customer who has access to the platform, which is determined solely at the discretion of its operator and of the dealers involved, may see indicative quotes from multiple dealers at once instead of seeing quotes only from one dealer as in the single-dealer RFQ platform. Although a participant can simultaneously view quotes from multiple dealers, the participant can request a firm quote from only one dealer at a time. One feature of the aggregated single-dealer platform as compared to the bilateral

negotiation and single-dealer models described above is the ability of a participant in the aggregated single-dealer platform to see indicative quotes from multiple dealers. However, customers are not afforded an opportunity to send RFQs to multiple dealers at the same time to promote competitive pricing. Also, like the single-dealer electronic platform, there is no post-trade reporting of transactions and thus there is no post-trade transparency.

A third model is the multi-dealer RFQ electronic trading platform.³³ In a multi-dealer RFQ system, a requester can send an RFQ to solicit quotes on a certain SB swap from multiple dealers at the same time. Currently, dealers on a multi-dealer RFQ platform generally require the platform to set limits on the number of dealers to whom a customer may send an RFQ, and also may limit which dealers may participate on the platform. These platforms are sometimes owned by dealers themselves. After the RFQ is submitted, the recipients have a prescribed amount of time in which to respond to the RFQ with a quote. Responses to the RFQ are firm. The requestor then has the opportunity to review the responses and accept the best quote. A multi-dealer RFQ platform provides a certain degree of pre-trade transparency, depending on its characteristics. But to the extent that a requester is restricted by platform rules to soliciting quotes from a limited number of dealers, the customer's pre-trade transparency is restricted to that number of quotes it receives in response to its RFQ. In some instances requestors may prefer to limit the number of recipients of an RFQ as a way to protect proprietary trading strategies as dissemination of their interest to multiple dealers may increase hedging costs to

³³ The single-dealer RFQ platform is an example of a system that permits customers to submit an RFQ to a single dealer, which is distinct from a multi-dealer RFQ platform that permits customers to solicit quotes from multiple dealers simultaneously instead of one dealer. The multi-dealer RFQ platform differs from a single-dealer aggregator platform because a participant in the aggregated single-dealer platform may only send a request to one dealer at a time and thus would not have the ability to interact with the bids or offers of multiple dealers simultaneously.

dealers, and thus costs to the requestors as reflected in the prices from the dealers. Pre-trade transparency may also exist through the platform's dissemination of composite indicative quotes to all participants prior to trades. Post-trade transparency may exist if the platform chooses to disseminate information regarding executed transactions.

A fourth model for the trading of SB swaps is a limit order book system or similar system, which the Commission understands is not yet in operation for the trading of SB swaps in the United States but exists for the trading of SB swaps in Europe. Today, securities and futures exchanges in the United States display a limit order book in which firm bids and offers are posted for all participants to see, with the identity of the parties withheld until a transaction occurs. Bids and offers are then matched based on price-time priority or other established parameters and trades are executed accordingly. The quotes on a limit order book system are firm. A limit order book system may be a more suitable model for the trading of more liquid, rather than less liquid, SB swaps. In general, a limit order book system also provides greater pre-trade transparency than the three platforms described above because all participants can view bids and offers before placing their bids and offers. However, broadly communicating trading interest, particularly about a large trade, may increase hedging costs, and thus costs to investors as reflected in the prices from the dealers. The system can also provide post-trade transparency, to the extent that participants can see the terms of executed transactions.

A fifth type of trading, which the Commission herein refers to as "brokerage trading," is used by brokers to execute SB swap trades on behalf of customers, often in larger sized transactions. In such a system, a broker receives a request from a customer (which may be a dealer) who seeks to execute a specific type of SB swap. The broker then interacts with other customers to fill the request and execute the transaction. The mode of interaction can vary

depending on the size of the trade and the type of SB swap being traded. In some cases, the interaction is done purely by voice over the telephone, while in other cases, the interaction is electronic or a hybrid of voice and an electronic system. The level of automation and use of electronic means also vary depending on the technological state and functionality of the broker's platform.³⁴ This model often is used by dealers that seek to transact with other dealers through the use of an interdealer broker as an intermediary. In this model, there may be pre-trade transparency to the extent that participants are able to see bids and offers of other participants and post-trade transparency to the extent that participants can see the terms of executed transactions.

The five foregoing examples represent broadly the various types of models for the trading of OTC swaps in existence today. These examples may not represent every single method in existence today and the discussion above is intended to give an overview of the models without providing the nuances of each particular type.

2. The SB Swap Market and the Commission's Approach to SB SEF

Definitions

In the Commission's view, the diverse nature of these examples demonstrates the extent to which, when compared with the equities markets, certain aspects of the SB swap market are

³⁴ The Commission understands that a small portion of the brokerage trading in the United States is currently highly automated and has characteristics of a limit order book. However, while depth of the order book may be displayed, generally there may be only one bid or offer, and sometimes only one side of the market would be displayed (*i.e.*, a bid without an offer and vice versa). Because the volume in some SB swaps may be low, the electronic systems maintained by wholesale brokers would not necessarily include a matching engine that would provide for price-time priority or other execution parameters, unlike other types of electronic limit order books. Although the wholesale brokers' systems are electronic, the customer would need to perform some steps manually (*e.g.*, hit the bid or lift the offer) to execute a trade.

still evolving.³⁵ In considering ways in which the Commission could approach the definition of SB SEF, the Commission has sought to facilitate competition and innovations in the SB swap market that could be used to promote more efficient trading in organized, transparent and regulated trading venues. The Commission does not believe it should simply overlay the same regulatory structure that is currently in place for equities, given important differences in the nature and maturity of the SB swap and equities markets. However, the Commission does believe that certain elements of equity market structure may be directly relevant to the SB swap market.

Furthermore, rather than proposing a rule that would establish a prescribed configuration for SB SEFs that would meet the statutory definition of SB SEF, the Commission proposes to provide baseline principles interpreting the definition of SB SEF, consistent with the requirements of the Exchange Act, as amended by the Dodd-Frank Act, which any entity would need to be able to meet to register as a SB SEF. Such an approach is designed to allow flexibility to those trading venues that seek to register with the Commission as a SB SEF and to permit the continued development of organized markets for the trading of SB swaps. This more flexible approach also would allow the Commission to monitor the market for SB swaps and propose adjustments, as necessary, to any interpretation that it may adopt as this market sector continues to evolve.

³⁵ For example, data from the Depository Trust and Clearing Corporation covering the period from March 22, 2010 to June 20, 2010 for single name credit default swaps revealed the following: out of 998 types of swaps (i.e., a swap based on one reference entity), only 55 had 10 or more trades per day (34 trades being the highest), and 827 of the swaps had 5 or fewer trades per day (531 of those only had 2 or fewer trades per day). In the data set, "trades per day" includes all tenors (e.g., duration or expiry) in swaps of the same reference entity. See http://www.dtcc.com/downloads/products/derivserv/CDS_Snapshot_Analysis_Sep17-2010.pdf; see also http://www.dtcc.com/products/derivserv/data_table_snap0002.php and http://www.dtcc.com/products/derivserv/data_table_snapshot.php.

However, the Commission recognizes that, consistent with the Dodd-Frank Act, the interpretation of the definition of SB SEF should: (1) encourage the migration of trading SB swaps from the OTC market to SB SEFs (or exchanges), (2) provide a meaningful distinction between a SB SEF and an OTC trading venue, (3) promote further transparency of the SB swap market, and (4) to facilitate competition and innovation in the SB swap markets that could be used to promote more efficient trading in organized, transparent, and regulated trading venues. In addition, the interpretation of the definition of SB SEF should complement other aspects of proposed SB swap regulations, including those related to post trade transparency, mandatory clearing, and the general requirement that SB swaps that are subject to mandatory clearing only be traded on an exchange or SB SEF, unless no exchange or SB SEF makes the SB swap available to trade.

B. Scope of SB SEF Definition

As noted above, Section 3(a)(77) of the Exchange Act defines a SB SEF as a trading system or platform in which multiple participants have the ability to execute or trade SB 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: (1) facilitates the execution of SB swaps between persons; and (2) is not a national securities exchange.³⁶

A key issue noted at the Roundtable and raised by market participants generally regarding Dodd-Frank Act implementation is the scope of the definition of “security-based swap

³⁶ As discussed *infra* Section XXI, an entity that meets the definition of SB SEF would be required to register as a SB SEF or a national securities exchange (unless exempted under Section 3D(e) of the Exchange Act if the Commission finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the CFTC). A registered SB SEF would be required to satisfy all 14 Core Principles and any rules promulgated by the Commission, including proposed Rule 811(a)(3), which provides for certain requirements relating trading on a SB SEF. See Pub. L. No. 111-203, § 763(c) (adding Section 3D(a)(1) and (d)(1) of the Exchange Act).

execution facility.”³⁷ SB swap industry participants have expressed an interest in, and offered their views on, the parameters of the definition of SB SEF.³⁸ Such participants asserted that the interpretation of the definition of SB SEF is a significant issue for the SB swap industry because, under the mandatory trade execution requirement in Section 3C(h) of the Exchange Act, a SB swap subject to mandatory clearing must be executed on a SB SEF or on an exchange, if made available for trading. The discussion below sets forth the Commission’s preliminary view as to the meaning of the various elements of this definition.

The “multiple participant to multiple participant” requirement in the definition of SB SEF prescribes that “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.”³⁹ Consistent with this requirement, the Commission proposes to interpret the definition of SB SEF to mean a system or platform that allows more than one participant to interact with the trading interest of more than one other participant on that system or platform. The Commission notes that this definition can be satisfied by various types of platforms, but some platforms that are currently used to trade SB swaps in the OTC market would not meet this definition, and would not be considered SB SEFs. As noted above, the Commission is aware that the movement of SB swaps trading onto regulated platforms is still in an emergent stage. Therefore, in considering ways in which the Commission could approach the definition of SB SEF, the Commission has sought to facilitate competition and innovations in the SB swaps market that could be used to promote more efficient trading in organized, transparent and regulated trading venues to support the Dodd-Frank Act’s goal of moving the trading of SB swaps onto regulated markets.

³⁷ See, e.g., Bloomberg Letter, *supra* note 23, at 2, and MFA Letter, *supra* note 23, at 16.

³⁸ See *supra* notes 23 to 25.

³⁹ See Pub. L. No. 111-203, § 763(a) (adding Section 3(77) of the Exchange Act).

Under this proposed interpretation, if a system or platform were to allow an individual participant (of which there must be more than one on the system, but which do not need to be acting simultaneously) to send, at the same time, a single RFQ to all other liquidity providing participants on that system or platform and view responses from those participants, the Commission believes that such a model would satisfy the requirements of the statutory definition, even if the quote requesting participants are acting at different times. A key element to this model is that the SB SEF would not be able to limit the number of liquidity providing participants from whom a participant could request a quote on the SB SEF.⁴⁰

The Commission further believes that the requirements of the statutory definition would be met if the system or platform not only provided the quote requesting participant with the ability to send a single RFQ to all liquidity providing participants, but also provided the quote requesting participant with the ability to choose to send an RFQ to fewer than all liquidity providing participants. In the Commission's view, a system or platform that affords a quote requesting participant the ability to send an RFQ to all participants, but also permits the quote requesting participant to choose to send an RFQ to fewer participants, would satisfy the statutory definition because multiple participants would have the ability to execute or trade SB swaps by accepting bids or offers made by multiple participants. The person exercising investment discretion for the transaction, whether it is the participant itself or the participant's customer, would be the person that would have the ability to choose to send the RFQ to less than all

⁴⁰ See infra Section VIII.C.

participants, as they would be in the best position to determine the impact on their interest of a broad or narrow dissemination of their RFQ.⁴¹

Under the proposed interpretation of the definition of SB SEF, a SB SEF would be able to offer functionality to a participant (or a participant's customer) enabling that participant to choose to send a single RFQ to any number of specific liquidity providing participants on the SB SEF, including just a single liquidity provider. The Commission requests comment on whether in addition to providing this flexibility to investors initiating RFQs, the interpretation should also set a floor for the minimum number of liquidity providers that must be included in an RFQ (and, if so, what that minimum number should be). Commenters should be mindful that in proposing its interpretation of the definition of SB SEF, the Commission is trying to balance the above-stated goal of encouraging SB swap trading to move onto regulated markets with the goal of promoting greater transparency in the trading of SB swaps.

On the one hand, providing investors as much choice as possible in determining how to route an RFQ on a SB SEF may incentivize investors to trade on a SB SEF when they otherwise might not have made that choice. Since those investors that have a fiduciary duty must seek best execution for a transaction, they may have a natural incentive to route to multiple dealers. However, this incentive may be impacted by the liquidity characteristics of the SB swap. Market participants, including dealers and buy-side customers, have raised concerns regarding pre-trade transparency of SB swap trades, particularly block trades. They believe that if other market participants know the terms of a trade prior to the time it is executed, those other market participants could attempt to profit from the information about the trade to the detriment of the

⁴¹ Regardless of the number of participants to which a RFQ was sent, the response(s) to that RFQ would be required to be included in the composite indicative quote of the SB SEF. See infra note 152 and accompanying text.

initiator of the trade.⁴² Therefore, particularly for illiquid SB swaps, an investor may determine that it is in its best interest not to broadly project its trading intention, and may choose to send a RFQ to one dealer.⁴³ Other investors could still benefit by the request because the response to that RFQ would become part of the composite indicative quote of that SB SEF.⁴⁴ Providing investors the choice to send a RFQ to only one dealer on a SB SEF – as long as they have the ability to send it to more than one if they chose to – may encourage investors to execute trades on a SB SEF even with respect to SB swaps that are not required to be traded on a SB SEF or an exchange, thus supporting the development of trading on regulated platforms and venues in the United States, rather than in other jurisdictions.

On the other hand, requiring that all RFQs on a SB SEF be sent to more than one dealer could force competition among dealers more than if RFQs to a single dealer were permitted. This competition may lead to lower spreads as dealers compete with each other on price. Further, this competition may provide for a more robust composite indicative quote because a greater number of responses would be incorporated into the composite. In addition, requiring that RFQs be sent to more than one dealer provides for the possibility that a response from a dealer other than the one with whom the investor may have “pre-arranged” the transaction will result in a better price. However, market participants have expressed a concern that requiring a broad level of pre-trade transparency, particularly for illiquid products, may not lead to better prices and in certain circumstances may lead to worse prices provided by dealers if dealer hedging is made more difficult after the intent to trade has been projected to the entire market.

⁴² See discussion in Section VIII.C and D infra.

⁴³ See Reporting and Dissemination Release, supra note 6, at 89-93.

⁴⁴ See discussion of proposed Rule 811(d)(5) in Section VIII.C infra.

In addition, the Commission proposes to interpret the statutory requirement that “multiple participants have the ability to execute or trade SB swaps by accepting bids and offers made by multiple participants in the facility or system” to require a SB SEF to provide at least a basic functionality to allow any participant on the SB SEF the ability to make and display executable bids or offers accessible to all other participants on the SB SEF, if the participant chooses to do so. The Commission preliminarily believes that such a requirement would allow for increased price transparency beyond what would be found in the bilateral OTC market, if a market participant chooses to utilize the functionality to display a bid or offer.

Under the proposed interpretation of the definition of SB SEF (either with or without the additional requirement for a minimum number of liquidity providers to be included in every RFQ), the traditional bilateral negotiation model, as described above, would not fall within the definition of SB SEF because there would be only one party able to seek a quote and only one party that is able to provide a quote in response. The Commission believes that the inclusion of the phrase “through any means of interstate commerce” in the definition of SB SEF would not, by itself, support the proposition that bilateral negotiation would satisfy the definition’s terms; the trading system or platform would still need to meet the other requirements of the definition, specifically, the requirement that multiple participants have the ability to execute or trade SB swaps by accepting bids and offers made by multiple participants in the facility or system (“multiple participant to multiple participant requirement”).

Likewise, a platform where there is a single dealer interacting with multiple customers on the other side of the transaction would not appear to meet the “multiple participant to multiple participant” requirement because the dealer is only one person. This would be true for

aggregated single-dealer platforms as well, because a participant on such a platform may only submit one request at a time and receive only one response at a time, on a dealer-by-dealer basis.

The Commission proposes that the definition of SB SEF cannot be satisfied by the simple aggregation of trading interest across trading systems or platforms to meet the “multiple participant to multiple participant” requirement. That is, each trading method – when viewed in isolation – would need to individually meet the “multiple participant to multiple participant” requirement on its own. Thus, an entity that relies on a bilateral negotiation system with one participant on each end of the telephone or similar communication system, but with several such conversations occurring simultaneously, could not claim to meet the definition of SB SEF by asserting that when those conversations are viewed in the aggregate, *i.e.*, bilateral negotiation between persons A and B to facilitate one transaction, and bilateral negotiation between persons C and D, to facilitate a separate transaction, that the “multiple participant to multiple participant” requirement is met.⁴⁵ Two independent single-dealer platforms also may not be construed in the aggregate in order to meet the “multiple participant to multiple participant” requirement. In each of these situations, there is no opportunity for interaction among participants, except on a “one participant to one participant” basis.

However, a system or platform that provides for an auction for a class of SB swaps to be held at a prescribed time and that allows multiple participants to interact with each other, with trades executed pursuant to a pre-determined algorithm, could meet the proposed interpretation of the definition of SB SEF. In addition, the Commission believes that a limit order book system as described above for the trading of SB swaps could satisfy the proposed interpretation of the

⁴⁵ However, as discussed further below in the discussion of the application of the definition of SB SEF to wholesale brokers, if person A negotiates with persons B, C and D as part of the same transaction, the “multiple participant to multiple participant” requirements may be able to be met. See *infra* note 46 and accompanying text.

definition of SB SEF. Such a model generally would allow interaction between multiple (i.e., two or more) firm orders or bids and offers. Moreover, to satisfy the definition of SB SEF, a system or platform would not need to be limited to only one type of trading model. An entity that wishes to register as a SB SEF could operate different trading models for different SB swap products, as long as each trading system or platform on its own meets the interpretation of the definition of SB SEF that the Commission may adopt. For example, a SB SEF could operate both a multi-dealer RFQ mechanism for the trading of less liquid SB swaps and a limit order book for the trading of more liquid SB swaps.

The Commission has considered whether brokerage trading, as described above, would satisfy its proposed interpretation of the definition of SB SEF. On the one hand, brokerage trading relies to a certain degree on “voice” communication, such as telephonic communication between the broker and its customers. On the other hand, the wholesale broker⁴⁶ acts as an intermediary between various potential participants to a SB swap transaction, and may utilize electronic systems to display trading interest with which various participants could interact to transact in SB swaps. In some respects, the wholesale broker’s role is similar to that of a floor broker on an exchange, in which the floor broker may use voice communication to find trading interest on the floor that can interact with an order from its customer. If after the wholesale broker receives a request from a customer (of which there must be more than one, but which do not need to be acting simultaneously) to execute a trade in a SB swap, and the broker then submits that request to all participants on the system or platform (or to less than all participants, if the customer has chosen to have the request sent to less than all participants), the Commission

⁴⁶ For purposes of this proposing release, the term “wholesale brokers” generally refers to brokers that intermediate transactions in SB swaps between dealers or between dealers and end users.

preliminarily believes that such a model could satisfy the Commission's proposed interpretation of the definition of SB SEF. Thus, the brokerage trading model may be able to satisfy the Commission's proposed interpretation of the definition of SB SEF to the extent that multiple participants would have access to the system or platform and their trading interest could interact with bids and offers of multiple other participants in that system or platform. Unless explicitly requested by the customer, for any given transaction if a wholesale broker typically acts only as the intermediary between a given customer and a single counterparty to facilitate the negotiation of a bilateral contract, the Commission does not believe this wholesale broker would meet the proposed interpretation of the definition of SB SEF. Because of the different variations of the wholesale broker system, however, each system would have to be evaluated on its own merits to determine whether it would meet the Commission's proposed interpretation of the definition of SB SEF.

The Commission's proposed interpretation of the definition of SB SEF would result in permitting to be registered as SB SEFs systems or platforms for the trading of SB swaps with a variety of features, and not just those systems or platforms with exchange-like features (for example, systems requiring all trading interest to be firm and displayed to all participants in the market). The concern with taking the latter approach is that the market for many SB swaps is fairly illiquid.⁴⁷ However, in the context of SB swaps that are subject to the mandatory clearing requirement, the Exchange Act requires that the trading of SB swaps must occur on a SB SEF or on an exchange, if the SB swap is made available for trading (unless certain exceptions apply). Thus, requiring every registered SB SEF to operate like a national securities exchange could result in (1) cleared SB swaps not being made available to trade on an exchange or SB SEF, with

⁴⁷ See supra note 35.

the result that SB swaps would continue to trade in the OTC SB swap market; or (2) if SB swaps subject to mandatory clearing are made available to trade on an exchange or SB SEF, the continued development of the SB swap market could be hindered, if participants are unwilling to display two-sided firm quotes to participants or if the requirement to do so results in bid-offer spreads that are so wide as to not be economical). If the definition of SB SEF is too narrowly construed, this could provide a disincentive for SB swap trading activity to move from the OTC swap market to regulated markets. A broader interpretation of the definition of SB SEF could have the beneficial result of increasing the proportion of trading occurring on regulated markets. Conversely, if the definition of SB SEF is too broadly construed, the Commission's regulatory scheme may not adequately advance the Dodd-Frank Act's goal of greater transparency. The Commission's proposed interpretation of the definition of SB SEF is intended to balance these concerns, promoting transparency as well as providing incentives for market participants to trade SB swaps on regulated markets pursuant to Commission rules and oversight, rather than in the OTC swap market.

The Commission notes that no matter what other functionality a SB SEF puts in place (for example, a multi-dealer electronic RFQ mechanism), it also would be required to provide a basic functionality to allow any participant on the SB SEF the ability to make and display executable bids or offers accessible to all other participants on the SB SEF, if the market participant chooses to do so.

Considering the early stage of development of the regulatory framework for the SB swap market and the existing structure of the SB swap market, the Commission is mindful that its interpretation of the definition of SB SEF, and the rules it is proposing herein to implement the Dodd-Frank Act, could have unforeseen consequences, either beneficial or undesirable, with

respect to the shape that this market will take. In the Commission's view, it is important that the regulatory structure will provide incentives for the trading of SB swaps on regulated markets that are designed to foster greater transparency and competition that are subject to Commission oversight, while at the same time allow for the continued efficient innovation and evolution of the SB swap market. The Commission therefore is seeking where appropriate to take a deliberate and attentive approach to the regulation of SB SEFs that is informed by the state of development of the trading of SB swaps on regulated markets.

C. Request for Comments

The Commission seeks commenters' views and suggestions on its proposed interpretation of the definition of SB SEF. Comment is requested on whether the Commission's proposed interpretation, which would require an RFQ to be sent to all participants but would allow the quote requesting participant to query less than all participants, is appropriate, or whether it is too narrow or too broad. Are there other interpretations of the statutory definition that would promote price transparency and competition, as well as incenting market participants to trade on SB SEFs rather than in the OTC market? If so, please explain. Does the proposed ability of the quote requesting participant to choose to send a RFQ to less than all participants, raise any concerns? Should the decision to exercise the ability to choose to send a RFQ to less than all participants be required on a transaction-by-transaction basis? Why or why not? When should the opt-out feature be permitted other than on a transaction-by-transaction basis? What would be the potential benefits or costs of allowing an RFQ to be submitted to only one participant? What would be the potential benefits or costs of requiring that an RFQ be sent to more than one participant? If the Commission were to require that an RFQ be sent to more than one participant, how many should be the minimum? Should the Commission require that an RFQ be sent to two

participants? Five participants (which is the number proposed by the CFTC)?⁴⁸ Or some other number of participants? Which approach – allowing a RFQ to be sent to one participant or requiring a minimum number greater than one - would better promote transparency? Which approach would encourage greater trading of SB swaps on SB SEFs? What impact, if any, would the various approaches have on market participants' incentives to trade within the United States or in other jurisdictions? How should the Commission weigh the possibility that trading may move to other jurisdictions in determining how best to regulate markets within the United States? What would be the costs and benefits to such an approach? What if only a small number of dealers were willing to provide quotes on the platform or in a particular SB swap?

Should the proposed interpretation that affords the ability to opt to have a RFQ sent to less than all participants be limited to block trades? Should a proposed interpretation that affords the ability to opt to have a RFQ sent to one participant be limited to block trades? What would be the benefits and costs of allowing the opt-out flexibility, to any number of participants, for block trades? For non-block trades? Are there factors that would cause a different result for block trades versus non-block trades? Would the flexibility for participants to choose to send a RFQ to less than all participants, including to just one participant, help to address concerns about the impact of pre-trade transparency on dealers' incentives or ability to provide competitive prices, as discussed more fully in Section VIII.C? If so, how so? If not, why not?

The Commission also is interested in learning commenters' views on whether the market for SB swaps would be enhanced or adversely affected by its proposed interpretation of the definition of SB SEF and, if so, in what ways.

⁴⁸ See Notice of proposed SEF rulemaking by the CFTC, supra note 17 (requiring that RFQs be disseminated to at least five participants).

Should there be a requirement that the execution of trades or the submission of bids and offers be done electronically?

Would the proposed requirement that an SB SEF provide functionality to allow any participant on an SB SEF to make and display executable bids or offers accessible to all market participants on the SB SEF, if the market participants choose to do so, be beneficial? What, if any, impact would requiring this functionality have on access to the SB SEF, or liquidity of the SB swaps traded on the SB SEF? Should the proposed requirement be modified? If so, how? What would be the advantages and disadvantages of such a proposal? Do commenters believe that market participants would utilize this functionality? Should the Commission require any particular method of displaying such bids or offers? For example, should the Commission require that the SB SEF post all of these executable bids and offers on a centralized screen visible by all participants? What would be the advantages and disadvantages of having such a centralized screen? What other method could be utilized to display such bids and offers?

In addition, the Commission requests comment on the consequences of its proposed interpretation of the definition of SB SEF on existing platforms that may seek to register as a SB SEF and on those platforms that would not be able to meet the proposed interpretation of the definition of SB SEF. What kinds of changes would existing platforms need to make to their current structure to fall within the proposed interpretation of the definition of SB SEF? Are there existing platforms that would not be able to restructure to meet the proposed interpretation, e.g., single-dealer RFQ platforms? If so, what impact, if any, would that outcome have on the market for SB swaps? Are single-dealer platforms likely to become obsolete as trading of certain SB swaps moves to SB SEFs? Or, are such platforms likely to continue to exist to support the OTC market? What impact would the proposed interpretation have on competition among existing

trading platforms and liquidity in SB swaps as trading of certain SB swaps moves to SB SEFs?

Are new platforms likely to emerge to trade SB swaps?

The Commission is interested in learning commenters' views on the effect on the SB swap market if certain trading platforms would not meet the proposed interpretation of the definition of SB SEF and would not be able to register as a SB SEF, and therefore no longer would be able to trade SB swaps that are subject to mandatory clearing and are made available to trade on a SB SEF or an exchange. Are there any types of trading venues so critical to the proper functioning of the SB swap market that the Commission should consider expanding the proposed interpretation of the definition of SB SEF so that such entities could qualify as SB SEFs? If so, what trading platforms are they and what kinds of conditions should they be subject to? Should any such expansion of the proposed interpretation of the definition of SB SEF to cover such platforms be temporary and, if so, for how long? What would be the impact of such action on any platform that could meet an unexpanded definition of SB SEF? Market participants have expressed concern about the trading of illiquid SB swaps once platforms are configured to meet the statutory definition of SB SEF, particularly in light of the mandatory trade execution requirement. The Commission requests comment on the effect of its proposed interpretation of the definition of SB SEF on the trading of illiquid SB swaps. Would a multi-dealer RFQ system as discussed above sufficiently accommodate the trading of illiquid SB swaps? If not, what other models could meet the statutory definition of SB SEF and accommodate the trading of illiquid SB swaps? Would an interpretation of the definition of SB SEF that would allow an investor to choose to send an RFQ to one participant effectively accommodate the trading of illiquid SB swaps? Would an interpretation of the definition of SB SEF that would require that an RFQ be sent to more than one participant effectively accommodate the trading of illiquid SB swaps? In

responding to these questions, the Commission requests that commenters take into account the Commission's discussion of SB swaps that are made available to trade in Section VIII.B below.

The discussion above contains several examples of trading models that the Commission believes would meet the statutory definition of SB SEF. Are there other trading models not discussed above that would meet the statutory definition of SB SEF? The discussion above also contains several examples of trading models that the Commission believes would not meet the statutory definition of SB SEF. Are there other models that should be excluded from the proposed interpretation?

The Commission seeks commenters' views on the role of wholesale brokers in the SB swap market and its view that trading of SB swaps by such brokers potentially could satisfy the proposed interpretation of the definition of SB SEF. As noted above, the Commission has identified bilateral negotiation, e.g., a trade occurring between two parties via the telephone, as a model that would not meet its proposed interpretation of the definition of a SB SEF. The Commission understands that wholesale brokers often act as intermediaries in executing SB swap transactions and may engage in bilateral negotiation when they attempt to complete an order. The Commission further understands that the orders that wholesale brokers attempt to fill may be large and that, as a result, they may interact with multiple participants in attempting to execute the transactions. The Commission also understands that these brokers may also maintain electronic systems for the display of trading interest that their customers can access. Do commenters agree that bilateral negotiation by wholesale brokers, by itself, should not meet the proposed interpretation of the definition of SB SEF? Is the Commission's view correct that there are ways in which wholesale brokers could restructure their operations to meet the proposed interpretation of the definition of SB SEF? How would such platforms or systems be structured

to meet the proposed interpretation? What would be the impact on the SB swap market of any restructuring of a wholesale broker's business to meet the Commission's proposed interpretation of the definition of SB SEF, particularly in light of the fact that trades in SB swaps today frequently occur through bilateral negotiation? For those wholesale brokers that currently effect transactions in SB swaps, would the modifications that a wholesale brokerage firm would be required to make to satisfy the proposed interpretation of the definition of SB SEF, the proposed rules implementing the Core Principles, and the proposed registration requirements be too costly or otherwise impracticable to meet so that the firm would find it difficult to register as a SB SEF? The Commission recognizes that wholesale brokerage activities differ from dealer to customer activities in effecting SB swap transactions. Certain proposed requirements discussed below, such as impartial access, may affect wholesale brokers differently than SB SEFs that are not operated by such brokers. Comment is requested on any such different impact on wholesale brokers that intend to operate SB SEFs, including the costs and benefits of such impact. Should the Commission view wholesale brokers' SB SEF operations differently than the operations of other SB SEFs? If so, how so?

Another example of a trading platform that could meet the proposed interpretation of the definition of SB SEF would include a multi-dealer RFQ model. Do commenters agree that the definition of SB SEF should cover these types of trading platforms? If so, why? If not, why not?

Market participants also have expressed concern about any proposed interpretation of the definition of SB SEF that would result in others discerning their proprietary trading strategies. What would be the impact of the Commission's proposed interpretation of the definition of SB SEF on these concerns? Would one or more of the models discussed above that would meet the

proposed interpretation of the definition of SB SEF provide an adequate level of comfort for these market participants? If not, is there a model that would meet the statutory definition of a SB SEF and yet account for these market participants' concerns?

As noted above, the Commission recognizes that the regulatory framework for the SB swap market is still in its early stages of development. What would be the impact on innovation in the SB swap market as a result of the proposed interpretation of the definition of SB SEF?

For example, under the proposed interpretation of the definition of a SB SEF, the SB SEF must provide a mechanism for the dissemination of firm quotes, if any, submitted by participants in the SB SEF. This functionality would allow a "limit order-book" model to emerge in parallel with other trading models on the SB SEF, including RFQ mechanisms, provided that each model meets all SB SEF requirements discussed above. The proposed interpretation is based on the premise that allowing more than one type of trading model to qualify as a SB SEF would, among other things, provide investors with more choices as well as encourage more types of SB swaps to trade on venues regulated by the Commission. Is there any scenario where this flexibility could impact competition or innovation because dealers may have their own preferences for one model over another? If so, under what scenario could this occur, and what consequences could result? For example, would the concentration of trading in the SB swap market raise concerns that, and provide incentives for, market participants that have a significant portion of the trading volume for certain types of SB swaps in one type of market structure to resist trading those SB swaps in a market structure that might otherwise be more efficient for that particular product?

The Commission also is interested in learning whether its proposed interpretation of the definition of SB SEF would influence market participants' decisions regarding the jurisdiction in which to execute their SB swap trades. Would the proposed interpretation affect a market

participant's decision as to the jurisdiction in which to execute SB swaps transactions? If so, how? What other factors might also influence that decision, and how would those factors weigh against this factor? The Commission seeks commenters' views on whether, the ways in which, and to whom any migration to a different jurisdiction would be beneficial or adverse.

Commenters are urged, when considering all questions regarding the Commission's proposed interpretation of the definition of SB SEF, to take into account the rules being proposed by the Commission to implement the Core Principles, particularly the rules regarding the treatment and interaction of trading interest on a SB SEF, as discussed below.⁴⁹ The 14 Core Principles set forth in Section 3D(d) of the Exchange Act are integral to the regulation of a SB SEF. The Commission, in Sections VIII to XXII of this release, is proposing various rules to implement these Core Principles, as well as proposed registration requirements. The Commission also is interested in commenters' views on whether the Commission's proposed interpretation of the definition of SB SEF, along with its proposed rules implementing the Core Principles and proposed registration requirements, in the aggregate, are too permissive, are appropriate, or are too burdensome at this stage of development of the SB swap market. If commenters believe that the proposals in the aggregate are too permissive, the Commission is interested in being informed of ways in which they could be enhanced. If commenters believe that the proposals in the aggregate are too burdensome, the Commission is interested in being informed of ways in which they could be modified.

The Commission is interested in learning commenters' views on whether the combination of the proposed interpretation of the definition of SB SEF, its proposed rules implementing the Core Principles, and its proposed registration requirements would be too onerous and thus would

⁴⁹ See *infra* Section VIII (discussing Core Principle 2 and the requirements relating to a SB SEF's trading rules).

make it impractical or economically infeasible for entities that currently trade SB swaps to modify their procedures, personnel, systems or platform in order to operate as a SB SEF. If this is the case, the Commission seeks commenters views on ways that its proposed interpretation of the definition of SB SEF, its proposed rules implementing the Core Principles, or its proposed registration requirements could be modified so that entities that currently trade SB swaps could continue to do so and at the same time the statutory requirements of the Dodd-Frank Act relating to SB SEFs would be met. In particular, the Commission requests comment on the question of whether it should adopt a phased approach to the implementation and/or application of the proposed rules, whereby certain provisions would become operational only when certain designated timing, volume, liquidity, or other thresholds were met.⁵⁰ The Commission seeks commenters' views on the steps it could take to facilitate the transition to a more regulatory environment for those entities that currently trade SB swaps and expect to register as SB SEFs.⁵¹

IV. Exemption from the Definition of Exchange for Security-Based Swap Execution Facilities

An entity that meets the definition of SB SEF in Section 3(a)(77) of the Exchange Act may also meet the definition of "exchange" set forth in Section 3(a)(1) of the Exchange Act,⁵² certain of the terms of which have been interpreted by the Commission in Rule 3b-16 of the

⁵⁰ See *infra* the discussion in Section XXV regarding a phased approach to implementation.

⁵¹ See *infra* Section XXI.A.2 seeking commenters' views on a possible phased-in approach to any rules that the Commission may adopt with respect to SB SEFs.

⁵² 15 U.S.C. 78c(a)(1). The term "exchange" means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.

Exchange Act.⁵³ The Commission believes that Congress did not intend that entities that meet the definition of SB SEF in Section 3(a)(77) of the Exchange Act and that comply with Section 3D of the Exchange Act and the rules and regulations promulgated by the Commission (including the requirement to register as a SB SEF) also would be subject to various requirements applicable to exchanges, including registration as a national securities exchange.⁵⁴

Section 3(a)(77) of the Exchange Act defines a SB SEF as a trading system or platform in which multiple participants have the ability to execute or trade SB 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: (1) facilitates the execution of SB swaps between persons; and (2) is not a national securities exchange (emphasis added).⁵⁵ Further, Section 3C(h) of the Exchange Act provides that transactions involving SB swaps subject to the clearing requirement be executed on either (1) an exchange or (2) a SB SEF registered under Section 3D of the Exchange Act or exempt from registration (unless no exchange or SB SEF makes the SB

⁵³ 17 CFR 240.3b-16 defines the phrase “market place or facilities for bringing together purchasers or sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange” to mean an organization, association or group of persons that (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of the trade.

⁵⁴ See, e.g., Section 6 of the Exchange Act, 15 U.S.C. 78f, which, among other things, requires a national securities exchange to enforce compliance by its members and their associated persons with the Exchange Act and rules and regulations thereunder, as well as with the exchange’s rules. National securities exchanges are self-regulatory organizations (“SROs”) for purposes of the Exchange Act and are subject to the requirements of Sections 17 and 19 of the Exchange Act, 15 U.S.C. 78q and 78s. Section 17(a)(1) requires national securities exchanges to make and keep records for prescribed periods, and to furnish such records to the Commission as well as any related reports. Section 19(b) requires, among other things, SROs to file proposed rule changes with the Commission.

⁵⁵ See Pub. L. No. 111-203, § 761(a) (adding Section 3a(77) of the Exchange Act).

swap available to trade or the SB swap transaction is subject to a clearing exception).⁵⁶ Finally, Section 3D(a)(1) of the Exchange Act provides that no person may operate a facility for the trading or processing of SB swaps, unless the facility is registered as a SB SEF or as a national securities exchange.⁵⁷ The Commission interprets these provisions to mean that an entity that is registered as a SB SEF cannot also be a national securities exchange; that an exchange and a SB SEF registered under Section 3D of the Exchange Act (or exempt from such registration) are separate categories of regulated entities for the trading of SB swaps; and that an entity registered as a SB SEF would not also be required to register as a national securities exchange.

Section 36 of the Exchange Act⁵⁸ gives the Commission broad authority to exempt any person, security, or transaction from any provision of the Exchange Act and any rule or regulation thereunder. Such an exemption may be subject to conditions. Using this authority, the Commission is proposing to amend Rule 3a1-1 of the Exchange Act⁵⁹ by adding paragraph (a)(4) to exempt any SB SEF from the definition of “exchange,” if such SB SEF provides a marketplace solely for the trading of SB swaps (and no other security) and complies with the provisions of proposed Regulation SB SEF.⁶⁰ The effect of this exemption would be that an entity that registers as a SB SEF would not also have to register as a national securities exchange.

⁵⁶ See Pub. L. No. 111-203, § 763(a) (adding Section 3C(h) of the Exchange Act). The Commission notes that in this section Congress chose to use the term “exchange” as opposed to “national securities exchange.” An exchange only becomes a “national securities exchange” upon registration with the Commission pursuant to Section 6 of the Exchange Act.

⁵⁷ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(a)(1) of the Exchange Act).

⁵⁸ 15 U.S.C. 78mm.

⁵⁹ 17 CFR 240.3a1-1.

⁶⁰ See proposed Rule 3a1-1(a)(4).

The Commission preliminarily believes that this proposed exemption is necessary and appropriate in the public interest and is consistent with the protection of investors because it would effectuate the intent of the Dodd-Frank Act, as expressed in Sections 3(a)(77), 3C(h) and 3D(a)(1) of the Exchange Act, and it would eliminate what the Commission believes would be a largely duplicative oversight of SB SEFs. The Commission believes that Congress specifically provided a comprehensive regulatory framework for SB SEFs in the Exchange Act, as amended by the Dodd-Frank Act, and therefore that such entities that are registered as SB SEFs should not also be required to register and be regulated as national securities exchanges. The Commission notes that a registered SB SEF that chose to provide a marketplace for the trading of any security other than a SB swap would not be in compliance with the exemption in proposed Rule 3a1-1(a)(4). Also, as the SB swaps markets continue to evolve, the Commission will continue to assess the appropriateness of, and/or take action with respect to, the proposed exemption from the definition of exchange.

The Commission requests comment on the proposed exemption in Rule 3a1-1(a)(4). Is the exemption necessary or appropriate? Are the conditions to the proposed exemption appropriate or should there be any additional conditions? What are the benefits or drawbacks of the proposed exemption?

The definition of “security-based swap execution facility” and the definition of “exchange” (certain terms of which have been interpreted by Rule 3b-16 under the Exchange Act) are similar in that they both include the concept of multiple participants and multiple buyers and sellers, respectively. However, these definitions are not identical. It is possible that an entity that trades SB swaps would meet the criteria of Rule 3b-16 but not the definition of SB SEF contained in Section 3(a)(77) of the Exchange Act. If such an entity trades SB swaps that

are subject to mandatory clearing and that are made available to trade on an exchange or SB SEF, it would be required to register as a national securities exchange, absent a limited volume exemption pursuant to Section 5 of the Exchange Act.⁶¹ Should the Commission permit such a platform to register as a SB SEF pursuant to Section 3D(a)(1) of the Exchange Act?⁶² Should the Commission instead provide an exemption from the definition of exchange for such an entity? If so, why, and what should be the conditions to any such exemption? What would be the benefits or drawbacks of any such exemption?

V. Conditional Exemption from Regulation as Brokers for Security-Based Swap Execution Facilities

An entity that meets the definition of “security-based swap execution facility” in Section 3(a)(77) of the Exchange Act also would meet the definition of “broker” set forth in Section

⁶¹ The trading of a SB swap on an ATS when that SB swap is subject to mandatory clearing and is made available to trade on a SB SEF or a national securities exchange would not satisfy the requirement of Section 3C(h) of the Exchange Act. Section 3C(h) of the Exchange Act states that, with respect to transactions involving SB swaps subject to the clearing requirement of subsection (a)(1) of Section 3C of the Exchange Act, the counterparties shall (A) execute the transaction on an exchange; or (B) execute the transaction on a SB SEF registered under Section 3D of the Exchange Act or a SB SEF that is exempt from registration under section 3D(e) of the Exchange Act. Although, as noted above, Section 3C(h) uses the term “exchange” as opposed to “national securities exchange,” an ATS would not satisfy this requirement because an ATS is exempt from the definition of exchange pursuant to Rule 3a1-1 under the Exchange Act.

⁶² Section 3D(a)(1) of the Exchange Act states that “no person may operate a facility for the trading or processing of security-based swaps, unless the facility is registered as a security-based swap execution facility or as a national securities exchange under this section.” Section 3(a)(77) of the Exchange Act defines “security-based swap execution facility” to mean a trading system or platform in which multiple participants have the ability to execute or trade SB 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 SB swaps between persons; and (B) is not a national securities exchange. The Commission interprets these two provisions, taken together, to require registration as a SB SEF or a national securities exchange for any entity that meets the definition of SB SEF in Section 3(a)(77) of the Exchange Act.

3(a)(4) of the Exchange Act.⁶³ The term “broker” is generally defined to mean any person engaged in the business of effecting transactions in securities for the account of others.⁶⁴ A SB SEF is defined as a trading system or platform in which multiple participants have the ability to execute or trade SB 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 SB swaps between persons; and (B) is not a national securities exchange.⁶⁵ A SB SEF, by facilitating the execution of SB swaps between persons, also would be engaged in the business of effecting transactions in securities for the account of others and therefore would meet the statutory definition of “broker.” Absent an exception or exemption, a SB SEF that effects transactions in SB swaps would be required to register as a broker pursuant to Sections 15(a)(1) and (b) of the Exchange Act⁶⁶ and to comply with the reporting and other requirements applicable to brokers under the Exchange Act and rules and regulations thereunder.

As the Commission noted in its discussion regarding the exemption from the definition of “exchange” for SB SEFs, the Exchange Act, as amended by the Dodd-Frank Act, sets forth a comprehensive regulatory framework for SB SEFs. The Commission believes that this framework indicates that Congress did not intend for entities that meet the definition of SB SEF in Section 3(a)(77) of the Exchange Act and that comply with Section 3D of the Exchange Act

⁶³ 15 U.S.C. 78c(a)(4).

⁶⁴ *Id.* The term “security” in Section 3(a)(10) of the Exchange Act includes a “security-based swap.” See 15 U.S.C. 78c(a)(10).

⁶⁵ See Pub. L. No. 111-203, § 761(a) (adding Section 3(a)(77) of the Exchange Act).

⁶⁶ 15 U.S.C. 78o(a)(1) and (b). Section 15(a)(1) generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission. Section 15(b) generally provides the manner of registration of brokers and dealers and other requirements applicable to registered brokers and dealers.

and the rules and regulations thereunder (including the registration as a SB SEF) also to be subject to all of the requirements set forth in the Exchange Act and the rules and regulations thereunder applicable to brokers.⁶⁷ As discussed above, the Exchange Act, as amended, establishes the statutory structure for SB SEFs to register with the Commission and for the Commission to adopt rules and regulations that require these entities to comply with the Core Principles and enforce compliance with those Core Principles and any rules or regulations that the Commission may adopt.

Section 36 of the Exchange Act gives the Commission broad authority to exempt any person, security, or transaction from provisions of the Exchange Act and the rules thereunder.⁶⁸ Such an exemption may be subject to conditions.⁶⁹ Using this authority, as well as its authority to establish procedures regarding the registration of brokers, the Commission is proposing Rule 15a-12 under the Exchange Act to allow a SB SEF that is a broker solely due to its activity with respect to SB swaps executed on or through the SB SEF to satisfy the requirement to register as a broker by registering as a SB SEF. Such person, however, must not engage in any activity that would require registration as a broker other than facilitating the trading of SB swaps on or

⁶⁷ Brokers and dealers must comply with the Exchange Act provisions and rules and regulations thereunder applicable to them. See, e.g., Section 15 of the Exchange Act, 15 U.S.C. 78o, and rules and regulations thereunder. For example, brokers and dealers must comply with a number of regulations that govern their conduct, such as rules relating to customer confirmations and disclosure of credit terms in margin transactions. See 17 CFR 240.10b-10 and 17 CFR 240.10b-16. They also must comply with a number of financial responsibility regulations, such as the net capital and customer protection rules. See 17 CFR 240.15c3-1 and 17 CFR 240.15c3-3. Among other things, registered brokers and dealers also must make and keep current books and records relating to their business and detailing, among other things, securities transactions, money balances, and securities positions; keep records for required periods and furnish copies of those records to the Commission on request; and file certain financial reports with the Commission. See 17 CFR 240.17a-3, 17 CFR 240.17a-4, and 17 CFR 240.17a-5.

⁶⁸ 15 U.S.C. 78mm.

⁶⁹ See id.

through the SB SEF in a manner consistent with Regulation SB SEF. For example, acting as an agent to a counterparty to a SB swap trade or acting in a discretionary manner with respect to the execution of a SB swap trade would indicate that such person may be acting as a broker and, if the person is acting as a broker, it would be required to register as such, unless an exemption or exception from registration was available. If an entity, such as an inter-dealer broker, for example, elects not to separate its inter-dealer broker from its SB SEF or create a subsidiary for its SB SEF, and instead chooses to operate the SB SEF as the same entity as the broker, the inter-dealer broker would not qualify for the exemption.

In addition, the Commission is proposing to conditionally exempt any SB SEF from the Exchange Act and the rules and regulations thereunder applicable to brokers, except Exchange Act Sections 15(b)(4), 15(b)(6), and 17(b).⁷⁰ Under the proposed Rule, three key provisions of the Exchange Act that serve as the basis for Commission examination and enforcement of the federal securities laws with respect to a registered broker would continue to apply to a SB SEF that relies on the exemption in proposed Rule 15a-12. Section 17(b) of the Exchange Act⁷¹ authorizes the Commission to conduct reasonable periodic, special, or other examinations, of “[a]ll records” maintained by entities described in Section 17(a),⁷² including registered brokers.⁷³ These examinations may be conducted “at any time, or from time to time,” as the Commission “deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Exchange Act].”⁷⁴ Proposed Rule 15a-12 also

⁷⁰ See proposed Rule 15a-12(c).

⁷¹ 15 U.S.C. 78q(b). See also 15 U.S.C. 78m(h)(4).

⁷² 15 U.S.C. 78q(a).

⁷³ 15 U.S.C. 78q(b).

⁷⁴ Id.

would not exempt a broker that registers as a SB SEF from the statutory disqualification provisions in Sections 15(b)(4) and (6) of the Exchange Act, both with respect to itself and with respect to its associated persons.⁷⁵ Further, pursuant to proposed Rule 15a-12(d), a broker registered under Section 15a-12(a) of the Exchange Act that does not engage in any activity other than the facilitating and trading of SB swaps on or through the SB SEF in a manner consistent with Regulation SB SEF would be exempt from the Securities Investor Protection Act (“SIPA”), including membership in the Securities Investor Protection Corporation.⁷⁶

The Commission believes that the exemption in proposed Rule 15a-12 under the Exchange Act is necessary and appropriate in the public interest and consistent with the protection of investors because it would eliminate what the Commission believes would be unnecessary additional regulation of SB SEFs. Because SB SEFs would be required to register as such under Section 3D of the Exchange Act, it would be unnecessary for them also to be subject to statutory and regulatory provisions governing brokers, subject to certain exceptions set forth in the proposed rule. The Commission believes that Congress specifically provided a comprehensive regulatory framework for SB SEFs in the Exchange Act, as amended by the Dodd-Frank Act, and therefore that such entities generally should not also be regulated as brokers where such regulation would be duplicative and unnecessary. As such, the Commission preliminarily believes that the broker registration and oversight process can be accomplished largely through the entity’s registration as a SB SEF. In this regard, the Commission also

⁷⁵ 15 U.S.C. 78o(b)(4) and (6). See also 15 U.S.C. 78c(a)(18) (defining “person associated with a broker or dealer” or “associated person of a broker or dealer”).

⁷⁶ Section 36 of the Exchange Act gives the Commission broad authority to exempt any person, security, or transaction from any of the provisions of the Exchange Act. This authority would include the ability of the Commission to grant an exemption under Section 36 from certain requirements of SIPA. See Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59366, n. 31 (November 3, 1998).

believes that it would be unnecessary and inconsistent with the comprehensive regulatory framework for SB SEFs to require a SB SEF, which would not be a custodian of customer funds or securities and would not otherwise operate as a broker, to comply with SIPA. SIPA is a comprehensive regulatory scheme for the orderly liquidation of failed broker-dealers and the return of customer property. If additional regulation is developed for brokers, any application of such regulation to SB SEFs would be proposed by rule. Any order, such as a suspension of the registration or trading of a security pursuant to Sections 12(j) or 12(k) of the Exchange Act,⁷⁷ if applicable to a SB SEF, would specify that it would be applicable to a SB SEF.

The Commission notes that it is not exempting SB SEFs from registration as brokers; rather, it is proposing to eliminate an additive layer of regulation that the Commission believes is not necessary in light of its regulatory oversight of SB SEFs. The Commission does not believe, however, that it would be in the public interest to exempt SB SEFs from the examination requirements of Section 17(b) of the Exchange Act, the statutory disqualification provisions of Sections 15(b)(4) and (6) of the Exchange Act.

The Commission requests comment on all aspects of its proposed rule. Specifically, the Commission requests comment on the scope, form, and conditions of the proposed exemption. Is the exemption necessary? Should the Commission add additional conditions to its exemption, including requiring compliance with any other statutory provisions or any other rules or regulations applicable to brokers? If so, which ones, and why? Should the Commission exempt SB SEFs from the provisions of SIPA? If not, why not?

The Commission seeks comment on whether there is a need for SB SEFs to become members of a national securities association. Would it be beneficial to require SB SEFs to

⁷⁷ 15 U.S.C. 781(j) and (k).

become members of a national securities association to provide an additional level of regulatory oversight in addition to oversight by the Commission? Why or why not? Should the proposed exemption include a condition requiring SB SEFs to comply with Section 15(b)(8) under the Exchange Act,⁷⁸ which requires a registered broker to be a member of a registered national securities association unless such broker effects transactions solely on a national securities exchange of which it is a member? What would be the advantages or disadvantages of such membership?

As noted above, the proposed Rule would not apply in those instances when the SB SEF is engaging in activity that is not solely related to the execution of SB swaps on or through the facility, *e.g.*, when the broker provides services such as acting as an agent to a counterparty to an SB swap trade or acts in a discretionary manner with respect to the execution of SB swap trades. In such instances, should the broker be required to comply with all Exchange Act and Commission requirements relating to brokers? If so, how would the broker be able to separate its brokerage function from its activities as a SB SEF? What potential conflict concerns would be raised, if any, if an entity that was engaged in brokerage activity in SB swaps on a SB SEF were affiliated with that SB SEF, or if an entity were engaging in brokerage activity in SB swaps on a SB SEF in the same legal entity that operates the SB SEF? If commenters believe that such activity would raise concerns, should the Commission require the entity's brokerage activities and its SB SEF activities to be conducted on separate legal entities? Or, should the Commission impose requirements on the ability of a broker to be affiliated with a SB SEF? If so, what conditions should the Commission impose, and how would they address any potential conflict concerns?

⁷⁸ 15 U.S.C. 78o(b)(8).

Are there any potential conflict concerns raised if a wholesale broker is affiliated with a SB SEF, or is operating in the same legal entity as a SB SEF? If so, what are those concerns, and what are commenters views on whether and how such concerns should be addressed?

What would be the effect of having SB SEFs join a registered securities association without having a comparable SRO for security-based swap dealers (“SB swap dealers”) or major security-based swap participants (“major SB swap participants”)? Because SB SEFs would be subject to regulatory obligations, should the Commission provide guidance on the acceptable scope of any outsourcing of regulatory matters that the SB SEF could undertake?

VI. Access to Security-Based Swap Execution Facilities

The Dodd-Frank Act does not define the categories of market participants that may have access to trading on a registered SB SEF or the terms of such access. For the purposes of providing guidance on this issue and to ensure that SB SEFs grant access to their markets in a manner that is consistent with the Core Principles in Section 3D of the Exchange Act, the Commission is proposing Rule 809 and 811(b). Proposed Rule 809 would set forth the categories of persons that would be permitted to have direct access to trading on a registered SB SEF as a participant and also the terms and conditions that the SB SEF would need to adopt for granting such access.⁷⁹ Proposed Rule 811(b) would elaborate on the standards for providing impartial access.⁸⁰ The purpose of the proposed rules is to ensure that access to SB SEFs is granted in a manner that strikes an appropriate balance between the statutory requirements of impartial access (Core Principle 2) and financial integrity of transactions (Core Principle 6) for SB SEFs.

⁷⁹ See proposed Rule 809.

⁸⁰ See proposed Rule 811(b).

The Commission understands that, currently, trades in SB swaps occur among dealers on OTC inter-dealer markets, and between dealers and end-user customers on single- or multi-dealer OTC dealer-to-customer markets or through bilateral negotiations. In addition, trading of SB swaps in these OTC markets is dominated by a small number of large swap dealers.⁸¹ When a small group of market participants dominates much of the trading in SB swaps, and exerts control over access to the SB swaps market, it raises concerns about open access and competition. If SB SEFs are controlled by a small group of dealers who also dominate trading in the market for SB swaps, the dealers may have economic incentives to exert undue influence to restrict the level of access to SB SEFs and thus impede competition by other market participants in order to increase their ability to maintain higher profit margins.⁸² At the same time, in the absence of clearing or other financial safeguards, counterparties assess the degree of credit risk posed by each other, and enter into SB swap transactions only with other persons deemed to have an acceptable level of credit risk. Therefore, in the OTC market for SB swaps, open access and

⁸¹ See Office of the Comptroller of the Currency (“OCC”), 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....”). Several commenters on proposed Regulation MC, however, took issue with this statistic because the OCC data included information about U.S. dealers only. See, e.g., Letter from Barry L. Zubrow, Executive Vice President & Chief Risk Officer, JP Morgan Chase & Co., to Elizabeth M. Murphy, Secretary, Commission, and David A. Stawick, Secretary, CFTC, dated November 17, 2010.

⁸² In addition, these market participants might be motivated to restrict the scope of SB swaps that are made available for trading at SB SEFs if there is a strong economic incentive to keep such SB swaps in the OTC market. Conflicts of interest concerns relating to SB SEFs are discussed in greater depth in the release proposing Regulation MC, which recently was published by the Commission as part of a rulemaking mandated by Section 765 of the Dodd-Frank Act. See Securities Exchange Act Release No. 63107 (October 14, 2010), 75 FR 65882 (October 26, 2010) (“Regulation MC Proposing Release”). Section 765 of the Dodd-Frank Act requires the Commission to adopt rules to mitigate specified conflicts of interest relating to SB SEFs, security-based swap clearing agencies, and SBS exchanges.

containing counterparty credit risk may be viewed as competing and potentially conflicting goals.

The Dodd-Frank Act addresses these competing concerns in several ways. Section 3C(a)(1) of the Exchange Act requires the mandatory clearing of SB swaps that the Commission determines must be cleared.⁸³ With respect to trading on SB SEFs, the Dodd-Frank Act requires SB SEFs to establish rules for both impartial access to their markets and the financial integrity of transactions on their markets, including with respect to clearance and settlement. Specifically, Core Principle 2 requires SB SEFs to provide market participants with impartial access to the market.⁸⁴ Under Core Principle 6, SB SEFs are required to establish and enforce rules and procedures for ensuring the financial integrity of SB swaps entered on or through the facilities of the SB SEF, including the clearance and settlement of SB swaps pursuant to Section 3C(a)(1) of the Exchange Act.⁸⁵ The Commission does not believe that the requirement for impartial access to a SB SEF under Core Principle 2 means that it must allow unfettered access to any and all persons. Rather, the requirements of Core Principle 6 that SB SEFs ensure the financial integrity of transactions on their markets, particularly with respect to the mandatory clearing requirement, permit SB SEF to have minimum standards for access to their markets, though such access must be provided on an impartial basis.

⁸³ See Pub. L. No. 111-203, § 763(a) (adding Section 3C(a)(1) of the Exchange Act). Section 3C(a)(1) makes it unlawful for a person to engage in a SB swap unless the SB swap is submitted for clearing to a registered clearing agency, if the SB swap is required to be cleared.

⁸⁴ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2) of the Exchange Act).

⁸⁵ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(6) of the Exchange Act). Section 3C(a)(1) makes it unlawful for a person to engage in a SB swap unless the SB swap is submitted for clearing to a registered clearing agency, if the SB swap is required to be cleared. See Pub. L. No. 111-203, § 763(a) (adding Section 3C(a)(1) of the Exchange Act).

In recognition of the challenges in striking the balance between impartial access and financial integrity goals of the Dodd-Frank Act, and in view of the current dominance of trading in SB swaps in the OTC market by a small number of dealers, the Commission is proposing Rule 809 and Rule 811(b) to establish certain baseline principles for granting access to SB SEFs in compliance with the requirements of both Core Principles 2 and 6. Specifically, proposed Rule 809(a) through (c) and proposed Rule 811(b) would require that SB SEFs enact and apply objective standards for access to their markets, in compliance with the impartial access requirement of Core Principle 2. Proposed Rule 809(a) and (c)(1) through (4) would establish certain minimum, objective standards for SB SEF participants, in compliance with the financial integrity of transactions requirements of Core Principle 6.

A. Impartial Access

Proposed Rule 809(a) would provide that only registered SB swap dealers, major SB swap participants, or brokers (as defined in section 3(a)(4) of the Exchange Act), or eligible contract participants⁸⁶ would be eligible to become participants in a SB SEF. Proposed Rule 809(b) would require a SB SEF to permit all eligible persons that meet the requirements for becoming a participant under Rule 809(a) and the SB SEF's rules to become participants in the SB SEF, consistent with the requirements for impartial access in Core Principle 2 and proposed Rule 811(b).⁸⁷ Proposed Rule 809(b) would, however, permit a SB SEF to choose to not permit any eligible contract participants that are not registered with the Commission as a SB swap

⁸⁶ The term "eligible contract participant" is defined in Section 3(a)(65) of the Exchange Act as having the same meaning as in Section 1a of the CEA (7 U.S.C. 1a). As discussed above, this term may be further defined by the Commission and the CFTC pursuant to various sections of the Dodd-Frank Act. See *supra* note 3.

⁸⁷ Core Principle 2 requires a SB SEF to establish and enforce compliance with rules relating to any limitation on access to the facility and to provide market participants with impartial access to the market. See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2) of the Exchange Act).

dealer, major SB swap participant, or broker (as defined in section 3(a)(4) of the Act⁸⁸) (“non-registered ECP”), to become participants in the SB SEF. Thus, under the proposed rule, while a SB SEF could choose to not allow any non-registered ECPs to become participants, if the SB SEF chose to permit such non-registered ECPs to become participants in the SB SEF, it could not selectively prohibit certain non-registered ECPs from becoming participants if they otherwise satisfied the SB SEF’s requirements. In effect, proposed Rule 809(b) would limit the discretion involved in admitting participants to a SB SEF because it would impose an affirmative requirement on SB SEFs to grant qualified persons access to their markets as participants.⁸⁹

Proposed Rule 809(c) would require a SB SEF to establish rules setting forth requirements for eligible persons to become participants in the SB SEF consistent with the SB SEF’s obligations under the Exchange Act and the rules thereunder, and includes certain enumerated minimum standards.⁹⁰ Proposed Rule 809(c), by requiring a SB SEF to codify its standards for becoming a participant in its market, would make the process of admitting participants transparent and rules-based, and thereby more objective. In addition, such rules would have to be consistent with proposed Rule 811(b), which would require every SB SEF to establish fair, objective, and not unreasonably discriminatory standards for granting impartial access to trading on the facility.⁹¹ Proposed Rule 811(b) would require that a SB SEF may not

⁸⁸ 15 U.S.C. 78c(a)(4).

⁸⁹ This proposed requirement is analogous to the fair access requirement for national securities exchanges under Section 6(b)(2) of the Exchange Act, which also imposes an affirmative duty to admit qualified broker-dealers as members. See 15 U.S.C. 78f(b)(2). “The rules of the exchange [must] provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange....”

⁹⁰ See proposed Rule 809(c)(1)-(4) and infra notes 105-109 and accompanying text for a discussion of those proposed provisions.

⁹¹ See proposed Rule 811(b)(1).

unreasonably prohibit or limit any person with respect to access to the services offered by the SB SEF by applying those standards in an unfair or unreasonably discriminatory manner:⁹²

Proposed Rule 811(b)(3) also would require every SB SEF to make and keep records of all grants, denials, or limitations of access and to report that information on proposed Form SB SEF⁹³ and in the annual compliance report of the Chief Compliance Officer (“CCO”) pursuant to proposed Rule 823(c).

As was the case when the Commission adopted Regulation ATS,⁹⁴ these provisions are based on the principle that qualified market participants should have fair access to the nation’s securities markets. Under the proposal, a SB SEF would have flexibility in establishing standards for impartial access so long as those standards are fair and objective and do not unreasonably discriminate, and the SB SEF does not apply the standards in an unfair or unreasonably discriminatory manner. For example, a SB SEF could establish objective minimum capital or credit requirements for participants, as long as they were not designed to, and did not have the effect of, unreasonably discriminating among persons seeking access to the SB SEF.⁹⁵ Similarly, a SB SEF could reasonably deny access to participants based on an unfavorable disciplinary history. Provided that these or other standards are objective and applied consistently to all potential participants, a SB SEF could be considered to be granting or denying access fairly. A denial of access might be unreasonable, however, if it were based solely, for

⁹² See proposed Rule 811(b)(2).

⁹³ The Commission is proposing that SB SEFs register on Form SB SEF. See *infra* Section XXII for a discussion of proposed Form SB SEF.

⁹⁴ 17 CFR 242.300 *et seq.* See Securities Exchange Act Release No. 40760, (December 8, 1998), 63 FR 70844 (“ATS Adopting Release”) at notes 245 to 256.

⁹⁵ See *infra* Section XII for a discussion of the ability of a SB SEF to impose higher capital requirements.

example, on the business activities of a prospective participant that are unrelated to trading on the SB SEF.⁹⁶

The Commission believes that impartial access to SB SEFs would work in conjunction with rules proposed by the Commission to mitigate conflicts of interest that could arise when a small number of market participants, including their related persons, exercise control or undue influence over a SB SEF either through ownership of voting interests or participation in the governance of the SB SEF.⁹⁷ The Commission requests comment, however, on the extent to which both types of rules are necessary to ensure fair access to SB SEFs.

B. Financial Integrity

As noted above, proposed Rule 809(a) would permit only persons that are registered with the Commission as SB swap dealers, major SB swap participants, or brokers, or persons that are eligible contract participants (as defined in section 3(a)(65) of the Act) to become participants of a SB SEF.⁹⁸ Permitting registered SB swap dealers, major SB swap participants, and brokers to become participants would support the SB SEF's duty to ensure the financial integrity of transactions, including the clearance and settlement of SB swaps, under Core Principle 6.⁹⁹ Registered SB swap dealers, major SB swap participants, and brokers are all subject to, or would be subject to, minimum financial responsibility requirements (including margin and net capital

⁹⁶ The Commission also discussed fair access at length in the ATS Adopting Release. See supra note 94 at note 245.

⁹⁷ See Regulation MC Proposing Release, supra note 82.

⁹⁸ See proposed Rule 809(a). The term "participant," when used with respect to a SB SEF, would mean a person that is permitted to directly effect transactions on the SB SEF. See proposed Rule 800.

⁹⁹ Core Principle 6 requires SB SEFs to establish and enforce rules and procedures for ensuring the financial integrity of SB swaps entered on or through the facilities of the SB SEF, including the clearance and settlement of SB swaps pursuant to Section 3C(a)(1) of the Exchange Act. See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(6) of the Exchange Act).

requirements) and business conduct requirements as a result of their registered status under the Exchange Act, which the Commission believes would serve as a useful baseline for ensuring the financial integrity of their transactions entered on SB SEFs.¹⁰⁰ Moreover, the Commission notes that these registered persons are subject to Commission oversight for compliance with those requirements.¹⁰¹

At the same time, proposed Rule 809(a) also would permit a SB SEF to choose to allow non-registered ECPs to become participants in the SB SEF. If a SB SEF chooses to permit non-registered ECPs to become participants, the SB SEF would be responsible for establishing risk management controls and supervisory procedures reasonably designed to manage financial, regulatory, and other risks associated with the eligible contract participants' access under proposed Rule 809(d).

Proposed Rule 809(d) would require SB SEFs that provide direct access to non-registered ECPs as participants to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other

¹⁰⁰ The Exchange Act requires registered SB swap dealers and major SB swap participants to comply with certain minimum financial responsibility and business conduct requirements. See Pub. L. No. 111-203, § 764(a) (adding Sections 15F(e) and (h) of the Exchange Act). The financial responsibility and business conduct requirements applicable to registered SB swap dealers and major SB swap participants will be the subject of a separate rulemaking. Likewise, the Exchange Act requires registered brokers to comply with certain financial responsibility and business conduct obligations under Section 15(c) of the Exchange Act and the rules and regulation thereunder. See 15 U.S.C. 78o(c), and Rules 15c1-2, 15c1-3, 15c2-1, 15c2-5, and 15c3-1 under the Exchange Act, 17 CFR 240.15c1-2, 15c1-3, 15c2-1, 15c2-5, and 15c3-1.

¹⁰¹ The Commission's regulatory and oversight authority includes and would include requirements to keep books and records open to the inspection and examination authority of the Commission. See Section 15F(f) of the Exchange Act, , Pub. L. No. 111-203, § 764 (adding Section 15F(f) of the Exchange Act) and Section 17(b) of the Exchange Act, 15 U.S.C. 78q(b).

risks of direct access by eligible contract participants.¹⁰² The SB SEF'S risk management controls and supervisory procedures for granting access to non-registered ECPs would be required to be reasonably designed to ensure compliance with all regulatory requirements. The proposed requirements for SB SEFs in proposed Rule 809(d) are based on similar requirements in Rule 15c3-5(b) and (c)(2) under the Exchange Act for ATs that provide access to their markets to non-broker-dealers.¹⁰³

Allowing eligible contract participants to be direct participants in a SB SEF would be consistent with the way the OTC SB swaps market operates today. The Commission preliminarily believes that it is reasonable and appropriate to require the SB SEF that provides direct access to non-registered ECPs to undertake certain responsibilities to manage the risk of those market participants accessing their market. This proposed requirement would support the SB SEF's compliance with the financial integrity of transaction requirement of Core Principle 6. Participants that are SB swap dealers, major SB swap participants, and brokers that are participants of the SB SEFs would be required to be registered with the Commission and be subject to certain margin, net capital, and other financial requirements that, by virtue of their registration, are designed to curtail the market risk imposed by their trading activities. In contrast, non-registered ECPs would not have corresponding requirements under the Exchange Act. The proposed requirements of Rule 809(d) are designed to reduce the risks associated with non-registered ECPs that have direct access to SB SEFs by requiring SB SEFs that choose to allow non-registered ECPs to be participants to establish, document and maintain risk management controls and supervisory procedures. Since non-registered ECPs are not subject to capital and other financial requirements, there is a concern that, in the absence of requiring risk

¹⁰² See proposed Rule 809(d)(1).

¹⁰³ See 17 CFR 240.15c3-5(c).

management controls and supervisory procedures, they could enter into trades that exceed appropriate credit or capital limits for their risk capacity. The Commission preliminarily believes that the SB SEF is best positioned to implement the proposed controls and procedures.

The Commission preliminarily believes that proposed Rules 809(a) and (d) would ensure that access to SB SEFs is sufficiently broad, while at the same time imposing certain thresholds and conditions for such access to ensure the financial integrity of transactions on the SB SEF. The Commission preliminarily believes that the proposed limit on eligible persons that may become participants in SB SEFs under proposed Rule 809(a) should not have the effect of preventing interested market participants from trading SB swaps. The Commission notes, for example, that many dealers would likely meet the definition of SB swap dealer, and thereby would be able to have direct access to trading SB swaps on SB SEFs once they are registered. Many other market participants would qualify for direct access by meeting the definition of “eligible contract participant” in Section 3(a)(65) of the Act. The Commission notes that, although SB SEFs are not required to provide access to their markets to non-registered ECPs as participants, if a SB SEF should provide access to non-registered ECPs to its markets as participants, it would be required to provide such access impartially consistent with proposed Rule 811(b). In addition, the Commission notes that eligible contract participants that are not participants could access a SB SEF indirectly through a participant.¹⁰⁴ Therefore, the

¹⁰⁴ Under the Dodd-Frank Act, transactions in SB swaps with a market participant that is not an eligible contract participant must be effected on a national securities exchange registered under Section 6(b) of the Exchange Act. See Pub. L. No. 111-203, § 763(e) (adding Section 6(l) of the Exchange Act). In addition, the offer and sale of SB swaps to market participants that are not eligible contract participants would have to be pursuant to an effective registration statement under Section 6 of the Securities Act of 1933. See 15 U.S.C. 77f.

Commission preliminarily believes that proposed Rule 809(a) would not have an adverse effect on access to trading SB swaps on a SB SEF.

To help ensure that access to SB SEFs is granted in a manner that would enable the SB SEF to carry out its responsibilities under Core Principle 6, proposed Rule 809(c)(1) and (2) also would require SB SEFs to have rules to require a participant to, at a minimum: (1) be a member of, or have an arrangement with a member of, a registered clearing agency to clear trades in SB swaps that are subject to mandatory clearing pursuant to Section 3C(a)(1) of the Act and entered into by the participant on the SB SEF; and (2)(i) to meet the minimum financial responsibility requirements¹⁰⁵ and recordkeeping and reporting requirements¹⁰⁶ imposed by the Commission by virtue of its registration as a SB swap dealer, major SB swap participant, or broker, or (ii) in the case of an eligible contract participant, meet the recordkeeping and reporting requirements that the SB SEF shall establish pursuant to proposed Rule 813.

Requiring SB SEFs to put in place rules that require its participants to be a clearing member of, or have arrangements with a clearing member of, a registered clearing agency to clear trades in SB swaps that are subject to mandatory clearing and entered by the participant

¹⁰⁵ See Pub. L. No. 111-203, § 764(a) (adding Sections 15F(e) of the Exchange Act) and Section 15(c) of the Exchange Act, 15 U.S.C. 78o(c). For registered brokers, see also Rule 15c3-1 under the Exchange Act. The financial responsibility requirements applicable to registered SB swap dealers and major SB swap participants will be the subject of a separate rulemaking.

¹⁰⁶ The Exchange Act requires registered SB swap dealers and major SB swap participants to keep books and records of activities related to their business and provide certain reports of those activities. See Pub. L. No. 111-203, § 764(a) (adding Section 15F(f) of the Exchange Act). The rules relating to the recordkeeping and reporting requirements of these entities will be the subject of a separate Commission rulemaking. Likewise, the Exchange Act and rules and regulations thereunder require registered brokers to keep books and records of activities related to their business and provide certain reports of those activities. See Section 17(a) of the Exchange Act, 15 U.S.C. 78q(a), and see, e.g., Rules 17a-3 through 17a-5 under the Exchange Act, 17 CFR 240.17a-3 through 240.17a-5.

and, in the case of registered SB swap dealers, major SB swap participants, or brokers, to meet the minimum financial responsibility requirements imposed by the Commission should strengthen the financial integrity of SB swap transactions that occur on the SB SEFs by reducing the counterparty credit risks associated with SB swap transactions, consistent with Core Principle 6.¹⁰⁷ Furthermore, the requirement for participants to meet the minimum recordkeeping and reporting requirements imposed by the Commission by virtue of their registration or, in the case of non-registered ECPs, those requirements imposed by the SB SEF, would enable a SB SEF to obtain the necessary information to perform their functions under Section 3D of the Exchange Act, consistent with Core Principle 5, and to enforce its rules and procedures for ensuring the financial integrity of SB swaps entered on the SB SEF, consistent with Core Principle 6.¹⁰⁸ The recordkeeping and reporting requirements also should foster a SB SEF's ability to comply with its obligations to capture information that may be used in establishing whether rule violations have occurred under Core Principle 2 and to monitor trading in SB swaps under Core Principle 4.¹⁰⁹

Proposed Rules 809(c)(3) and (4) would require SB SEFs to have rules to require a participant to, at a minimum: (1) agree to comply with the rules, policies, and procedures of the SB SEF, and (2) consent to disciplinary procedures of the SB SEF for violations of its rules. The Commission notes that the cooperation of participants is critical to the SB SEF's ability to comply with several Core Principles in Section 3D of the Exchange Act, particularly Core Principles 2 (Compliance with Rules), 4 (Monitoring of Trading and Trade Processing), and 6

¹⁰⁷ See supra note 99.

¹⁰⁸ See Pub. L. No. 111-203, § 763(c) (adding Sections 3D(d)(5) and (6) of the Exchange Act).

¹⁰⁹ See Pub. L. No. 111-203, § 763(c) (adding Sections 3D(d)(2)(B)(ii) and 3D(d)(4)(B)).

(Financial Integrity of Transactions). For this reason, the Commission believes that it is important for SB SEFs to have rules conditioning access to their markets on a participant's compliance with the SB SEF's rules and its consent to the disciplinary procedures of the SB SEF.

The Commission requests comments on all aspects of the proposed rules relating to access on SB SEFs. The Commission also requests comments on whether proposed Rule 809 incorporates the appropriate categories of persons to be allowed direct access to SB SEFs. If not, how should the categories of such persons be altered? Should certain proposed participants be excluded from having direct access to a SB SEF? If so, which ones and why? Should other categories of persons also be allowed to have direct access to a SB SEF? If so, which ones, and why? Are there any concerns with allowing non-regulated entities to directly access a SB SEF? What would be the benefits of allowing such access? The Commission understands that it is the current practice for customers to engage in transactions with dealers without intermediation. How would the requirements of proposed Rule 809 affect that practice? Please describe any such effects. What would be the result of the proposed rule?

What are the benefits and drawbacks of the proposal for SB SEFs to provide direct access to all persons that meet the requirements for becoming a participant in their rules? Are there other alternatives that the Commission should consider to achieve the goal of having impartial access to SB SEFs, consistent with Core Principle 2? If so, please explain.

Proposed Rule 809(b) would allow a SB SEF to choose not to permit non-registered ECPs to become participants. How, if at all, would this proposed provision affect access to SB SEFs? Should the Commission allow SB SEFs to have the discretion to choose whether or not to permit non-registered ECPs to become participants? Or should the Commission mandate

whether or not to require SB SEFs to allow non-registered ECPs to become participants? If the latter, should the Commission require SB SEFs to allow, or prohibit, non-registered ECPs from becoming participants? What would be the effect on access of a mandate for either option? Are SB SEFs that are capable of establishing the risk management controls and supervisory procedures required in proposed Rule 809(d) likely to exclude non-registered ECPs from becoming participants to reduce competition on their markets? Would having the flexibility to exclude non-registered ECPs from becoming participants advance the market entry of smaller SB SEFs that do not have the resources to comply with proposed Rule 809(d),¹¹⁰ thus increasing opportunities for competition across SB SEFs?

Are the proposed minimum standards for participants of a SB SEF, as set forth in proposed Rule 809(c), necessary and appropriate? If not, why not? Do the qualifications for being a participant in proposed Rule 809(c)(1) and (2) adequately address the financial integrity requirements of Core Principle 6? Do the requirements of proposed Rule 809(c)(2) also foster the ability of SB SEFs to comply with their obligations under Core Principles 2, 4, and 5? What other qualifications should participants in a SB SEF be required to meet as a threshold matter? Are there other minimum standards that the Commission should consider requiring?

Are the requirements in proposed Rule 809(d) pertaining to risk management controls and supervisory procedures for SB SEFs that provide direct access to non-registered ECPs necessary or appropriate? If so, why? If not, why not and what would be a better alternative for addressing risks, if any, associated with providing access to non-registered ECPs?

¹¹⁰ Proposed Rule 809(d) would require a SB SEF that choose to permit non-registered ECPs to have access as participants to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity and to ensure compliance with all regulatory requirements.

The Commission recently adopted new Rule 15c3-5 to require broker-dealers to have certain risk management controls for direct and indirect access to trading on national securities exchanges and ATSS.¹¹¹ Specifically, Rule 15c3-5 imposes requirements on broker-dealers that have direct access to trading on national securities exchanges and ATSS and to broker-dealer operators of ATSS that provide direct access to non-broker-dealers. Proposed Rule 809(d) would incorporate a requirement to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of their business activity that is generally based upon the requirements of Rule 15c3-5(b) and (c)(2) as they apply to ATSS. However, proposed Rule 809 would not prescribe the specific components for the required risk management controls and supervisory procedures that are contained in Rule 15c3-5(c) or the other requirements in Rule 15c3-5(d) and (e). Should proposed Rule 809(d) provide more specific requirements as to the risk management controls and supervisory procedures that should apply to SB SEFs that provide access to non-registered ECPs as participants? If so, would some or all of the requirements of Rule 15c3-5(c) be appropriate for SB SEFs?¹¹² Please specify and explain why. If not, why not and what would be

¹¹¹ See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2011) (File No. S7-03-10) (adopting release for Rule 15c3-5, which governs the terms for sponsored access or direct access on national securities exchanges and alternative trading systems).

¹¹² Rule 15c3-5(c) requires the financial risk management controls and supervisory procedures to be reasonably designed to: (i) prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds and, where appropriate, more finely-tuned by sector, security, or otherwise by rejecting orders if such orders would exceed the applicable credit or capital thresholds; and (ii) prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders; (iii) prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis or if restricted from trading those securities; (iv) restrict access to trading systems and technology that provide access to permit access to persons and accounts that are pre-approved and authorized; and (v) assure that

a better alternative for SB SEFs in this context? Would the remaining requirements of Rule 15c3-5, in paragraphs (d) and (e), be appropriate to apply to SB SEFs that provide access to non-registered ECPs as participants?¹¹³ At this time, the Commission is not proposing to adopt rules relating to direct or indirect access to SB SEFs for SB swap dealers, major SB swap participants, or brokers.¹¹⁴ Should the Commission adopt rules for risk management controls and supervisory procedures for SB swap dealers, major SB swap participants, brokers and any other participant with direct access to trading or that may provide indirect access to trading, on a SB SEF as a participant? If so, would the terms of Rule 15c3-5 be an appropriate guideline for such rules? Please explain why or why not. If so, should the Commission apply some or all of the requirements of Rule 15c3-5 to SB swap dealers, major SB swap participants, and brokers that are participants in a SB SEF? If only some of the requirements of Rule 15c3-5 should apply, which ones should apply and why? Should the Commission apply requirements similar to those in Rule 15c3-5 only when SB swap dealers, major SB swap participants, and brokers that are participants in a SB SEF provide indirect access to the SB SEF to non-participants? Or, should the risk management controls and procedures required in Rule 15c3-5 also apply to their own transactions as participants of a SB SEF (as they do for the broker-dealers with direct access

appropriate surveillance personnel receive immediate post-trade execution reports that result from market access. See 17 CFR 240.15c3-5(c).

¹¹³ Rule 15c3-5(d) requires the financial and regulatory risk management controls and supervisory procedures to be under the direct and exclusive control of the broker or dealer subject to the requirements of the rule, except under certain proscribed circumstances. Rule 15c3-5(e) imposes certain requirements pertaining to regularly reviewing the effectiveness of the risk management controls and supervisory procedures required by the rule and for promptly addressing any issues. See Rule 15c3-5(d) and (e), 17 CFR 242.15c3-5(d) and (e).

¹¹⁴ The Commission notes that participants that provide sponsored access to SB SEFs would be required to register with the Commission as a broker under Section 15(a)(1) and (b) of the Exchange Act.

under Rule 15c3-5)? Why or why not? Or, are the terms of Rule 15c3-5 inappropriate for SB swap dealers, major SB swap participants, brokers, or other persons that are participants of a SB SEF? If so, why and what terms would be a better alternative to address the risks associated with direct access or sponsored access to SB SEFs? What other terms and conditions should the Commission consider to mitigate the risks associated with access to SB SEFs?

What would be the likely impact of having a rule like Rule 15c3-5 apply to SB swap dealers, major SB swap participants, and brokers that are participants in SB SEFs? How would current practices for trading SB swaps be affected by applying a rule like Rule 15c3-5 to participants in SB SEFs? How might the evolution of the SB swaps market over time be affected by such a rule? Would it promote or impede the establishment of SB SEFs?

VII. Core Principle 1 – Compliance with Core Principles

Section 3D(d)(1) of the Exchange Act (Core Principle 1) requires a SB SEF, to be registered and maintain registration as a SB SEF with the Commission, to comply with: (i) the Core Principles described in Section 3D(d) of the Exchange Act; and (ii) any requirement that the Commission may impose by rule or regulation.¹¹⁵ The Commission proposes to implement the requirements of Section 3D(d)(1) of the Exchange Act in proposed Rule 810(a) of Regulation SB SEF.

The Commission proposes in Rule 810(b) to require a SB SEF to have rules for the maintenance of certain standards of fairness in dealings with participants on their markets. The proposed requirements in Rule 810(b) are derived from similar requirements that national securities exchanges are subject to under Section 6(b) of the Exchange Act.¹¹⁶ The Commission preliminarily believes that the analogous requirements incorporated into proposed Rule 810(b)

¹¹⁵ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(1) of the Exchange Act).

¹¹⁶ 15 U.S.C. 78f(b).

are appropriate because SB SEFs, like national securities exchanges, are subject to statutory requirements to establish and enforce trading and participation rules that will deter abuses and provide impartial access to their markets.¹¹⁷

Proposed Rule 810(b)(1) would require a SB SEF to establish rules that provide for the equitable allocation of reasonable dues, fees, and other charges among its participants and any other users of its system.¹¹⁸ This requirement is comparable to a similar requirement for national securities exchanges in Section 6(b)(4) of the Exchange Act.¹¹⁹ SB SEFs, like exchanges, presumably would assess dues, fees, or other charges on the various market participants that trade on their markets. The purpose of this proposed requirement is to ensure that SB SEFs apply those dues, fees and other charges among participants and any other users of their systems in ways that are fair and equitable, and not in ways that inequitably favor, or discriminate against, one or more classes of such persons. Thus, proposed Rule 810(b)(1) would support the requirement in Core Principle 2 and the proposed rules thereunder that SB SEFs must provide for impartial access to their markets by ensuring that each market participant's access to the SB SEF is not limited by an inequitable distribution of dues, fees, or other charges assessed by the SB SEF.¹²⁰ In this regard, proposed Rule 810(b)(1) also is designed to promote fair competition on SB SEFs.

Proposed Rule 810(b)(2) would require a SB SEF to establish rules and systems that are not designed to permit unfair discrimination among participants and any other persons using its

¹¹⁷ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2)(B) of the Exchange Act).

¹¹⁸ See proposed Rule 810(b)(1).

¹¹⁹ Section 6(b)(4) of the Exchange Act requires the rules of the exchange to provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities. 15 U.S.C. 78f(b)(4).

¹²⁰ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2) of the Exchange Act) and proposed Rule 811(b).

system. This proposed requirement is comparable to one of the requirements for national securities exchanges contained in Section 6(b)(5) of the Exchange Act.¹²¹ In practical terms, the proposal would compel SB SEFs to design their rules and systems in ways that would treat the various market participants in the SB SEF similarly, unless appropriate considerations, consistent with the goals of the Exchange Act, provide a justification for treating some market participants differently. Like proposed Rule 810(b)(1), proposed Rule 810(b)(2) is designed to support the impartial access requirements of Core Principle 2 and promote fair competition on SB SEFs.

Proposed Rule 810(b)(3) would require a SB SEF to establish rules that promote just and equitable principles of trade.¹²² This proposed requirement is comparable to a similar requirement for national securities exchanges contained in Section 6(b)(5) of the Exchange Act.¹²³ The purpose of proposed Rule 810(b)(3) is to require SB SEFs to design their rules in a manner that advances the goals of the Exchange Act of promoting fair and competitive markets for SB swaps. SB SEFs, by establishing rules for trading and monitoring trading among buyers and sellers of SB swaps on their systems, could play a significant role in the development of regulated markets for SB swaps, which in turn would help reduce incidents of systemic risk.

Finally, proposed Rule 810(b)(4) would require a SB SEF to adopt rules that, in general, would provide a fair procedure for disciplining participants for violations of the rules of the SB SEF.¹²⁴ This proposed requirement is analogous to a similar requirement for national securities

¹²¹ Section 6(b)(5) of the Exchange Act provides, in part, that the rules of the exchange must not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. 15 U.S.C. 78f(b)(5).

¹²² See proposed Rule 810(b)(3).

¹²³ Section 6(b)(5) of the Exchange Act provides, in part, that the rules of the exchange must be designed to promote just and equitable principles of trade. 15 U.S.C. 78f(b)(5).

¹²⁴ See proposed Rule 810(b)(4).

exchanges in Section 6(b)(7) of the Exchange Act.¹²⁵ A SB SEF is required, pursuant to Section 3D(d)(2) of the Exchange Act, to enforce compliance with any of its rules.¹²⁶ SB SEFs may choose to enforce rules on their markets by applying penalties and taking other disciplinary actions against participants for violations of their rules. Proposed Rule 810(b)(4) is designed to ensure that, when the SB SEF pursues disciplinary action against a participant for violations of the SB SEF's rules, the participant is afforded a fair process.

While the Commission intends for a SB SEF to retain flexibility in establishing its disciplinary procedures, the Commission anticipates that such rules would have to comply with rules recently proposed under Regulation MC,¹²⁷ should those rules be adopted by the Commission. Proposed Rule 702(h) under Regulation MC would require any disciplinary process of a SB SEF to preclude any group or class of participants from dominating or exercising disproportionate influence on the disciplinary process. In other words, to the extent that there is more than one type of group or class of persons that are participants in a SB SEF, the composition of any disciplinary panel or other disciplinary body should not allow one group or class to have representation that is out of proportion in comparison to other groups or classes of persons that are participants in the SB SEF. In addition, any panel or other body that is responsible for disciplinary decisions, and any appellate body for the reviewing of disciplinary decisions, would have to include at least one independent director.¹²⁸ The Commission preliminarily believes that proposed Rule 810(b)(4) under Regulation SB SEF would supplement

¹²⁵ Section 6(b)(7) of the Exchange Act requires the rules of the exchange to provide a fair procedure for the disciplining of members and persons associated with members. 15 U.S.C. 78f(b)(7).

¹²⁶ 15 U.S.C. 78c-4(d)(2).

¹²⁷ See Regulation MC Proposing Release, supra note 82.

¹²⁸ See proposed Rule 702(h) under Regulation MC, Regulation MC Proposing Release, supra note 82.

and enhance the proposed requirements of Regulation MC, although the Commission requests comment on the extent to which both sets of rules are necessary to mitigate potential conflicts of interest with respect to the SB SEF's disciplinary process.¹²⁹

Proposed Rule 810(c) would prohibit a SB SEF from using any confidential information it collects or receives, from or on behalf of any person, for non-regulatory purposes. The purpose of proposed Rule 810(c) is to prevent the SB SEF from taking commercial advantage of any confidential information that it receives in connection with its regulatory responsibilities.

The Commission requests comments on all aspects of the proposed Rule 810 implementing Core Principle 1. Are the provisions of proposed Rule 810 appropriate and sufficiently clear? If not, why not and are there preferable alternatives? What are the benefits and drawbacks of imposing on SB SEFs proposed requirements that are comparable to those statutory provisions that are applicable to national securities exchanges under the Exchange Act?

Is the Commission's proposed rule that would require a SB SEF's rules to provide for fees, dues, and other charges that are reasonable and equitably allocated among participants and any other persons using its system appropriate and sufficiently clear? Is this requirement necessary? If not, why not and are there preferable alternatives to help support the statutory goal of impartial access? Are there circumstances under which it would not be appropriate to require the SB SEF to allocate fees, dues, and other charges equitably? In what instances might a SB SEF seek to differentiate among its users with respect to fees, dues, and other charges, including discounts and rebates? Should any of those instances be permitted or restricted?

Is the Commission's proposed rule requiring a SB SEF to establish rules and systems that are not designed to permit unfair discrimination among participants and any other persons using

¹²⁹ For a discussion of further proposals to mitigate conflicts of interest related to SB SEFs, see infra Section XVII.

its system appropriate and sufficiently clear? If not, what additional guidelines should the Commission consider for determining when a rule or system would create unfair discrimination among users of the SB SEF's system? What, if any, existing aspects of the current market for SB swaps may lead to unfair discrimination among market participants?

Is the Commission's proposed rule requiring a SB SEF to establish rules to promote just and equitable principles of trade appropriate and sufficiently clear? Are there any specific rules or practices that the Commission should require SB SEFs to adopt for this purpose? If so, what rules or practices, existing or otherwise, should the Commission require? Should the Commission provide guidance on the types of rules that it believes would promote just and equitable principles of trade?

Are there any other requirements that the Commission should impose on a SB SEF to promote fair markets and competition? What factors would most promote fair markets and competition in trading SB swaps, in particular?

Is the proposed requirement that a SB SEF establish a fair procedure for disciplining participants for violations of the rules of the SB SEF appropriate and sufficiently clear? Are there any standards that the Commission should require, at a minimum, for such fair procedures? Is it sufficiently clear how SB SEFs could comply with this requirement in light of the requirements of proposed Rule 702(h) in Regulation MC, which would require the SB SEF to preclude any group or class of participants from dominating or exercising disproportionate influence on the SB SEF's disciplinary process and to have at least one independent director on any disciplinary panel? If not, in what way is the interaction of proposed Rule 810(b)(4) of Regulation SB SEF and proposed Rule 702(h) of Regulation MC unclear and what steps could the Commission take to improve these provisions? Should the Commission provide further

guidance on how SB SEFs could establish disciplinary procedures that would comply with the requirements of proposed Rule 810(b)(4) in Regulation SB SEF? Are there additional measures that the Commission should take to foster the independence of the SB SEF's disciplinary process, such as requiring any appeals of disciplinary actions to be considered by the SB SEF's independent directors?

Proposed Rule 810(c) would prohibit SB SEFs from using for non-regulatory purposes any confidential information they collect or receive in connection with their regulatory obligations. Would this proposed rule provide sufficient protection from the improper use of sensitive information by a SB SEF? If not, what other measures should the Commission considering requiring SB SEFs to implement to protect the confidentiality of the non-public information that they collect or receive? Please provide specific suggestions and explain how such suggestions would better address the need to keep non-public information confidential.

VIII. Core Principle 2 – Compliance with Security-Based Swap Execution Facility Rules

Section 3D(d)(2) of the Exchange Act (Core Principle 2) states that a SB SEF shall: (A) establish and enforce compliance with any rule established by such SB SEF, including (i) the terms and conditions of the SB swaps traded or processed on or through the facility and (ii) any limitation on access to the facility; (B) establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means (i) to provide market participants with impartial access to the market and (ii) to capture information that may be used in establishing whether rule violations have occurred; and (C) establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the

facility, including block trades.¹³⁰ The Commission is proposing to implement these statutory requirements in proposed Rule 811(a) of Regulation SB SEF.

The Commission believes that the primary issues raised by this Core Principle relate to the rules that a SB SEF must establish and enforce regarding access, the SB swaps that could trade on the system, and surveillance, investigation and enforcement of participants' activities on the SB SEF. In proposing Rule 811(a) of Regulation SB SEF to implement this Core Principle, the Commission has been informed by its experience with regulating both national securities exchanges and ATSS, while recognizing that differences exist between the cash equities and listed options markets and the market for SB swaps.

Much as Sections 6 and 19 of the Exchange Act¹³¹ require that national securities exchanges have rules, among other things, to govern trading, membership, and discipline of its members, the Commission preliminarily believes that, pursuant to Section 3D(d)(2) of the Exchange Act, SB SEFs should have similar rules. In this way, participants would be fully informed of the rules governing various aspects of the operation of the SB SEF and the requirements governing trading on the system, and would recognize that there would be consequences if they fail to comply with those rules. Below is a discussion of the rules that, in the Commission's view, would need to be developed and implemented by SB SEFs to comply with Core Principle 2. These proposed rules are not meant to be an exhaustive list, and the Commission believes that a SB SEF would need to evaluate its own market to determine the measures that are necessary to implement the Core Principles.

A. Denials or Limitations on Access

¹³⁰ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2) of the Exchange Act).

¹³¹ See, e.g., Sections 6(b) and 19(g) of Exchange Act, 15 U.S.C. 78f(b) and 78s(g).

Core Principle 2 is in part concerned with limitations on access and mandates that SB SEFs provide impartial access to their markets.¹³² The Commission discusses the substantive issues relating to access, and the rules it is proposing relating to access, in Section VI above.¹³³ The Commission believes that one of the most important requirements of Core Principle 2 concerns the SB SEF's rules regarding impartial access to the facility. The Commission discusses the procedural rules it is proposing in connection with the Core Principle 2 requirement for impartial access below. As the Commission noted in the Regulation MC Proposing Release, participants of a SB SEF might seek to limit the number of direct participants of the SB SEF to limit competition and increase the opportunity for higher profit margins.¹³⁴

The Commission is proposing several procedural rules in support of the proposed requirements for impartial access discussed above in Section VI. First, proposed Rule 811(b)(3) would require every SB SEF to make and keep records of all grants of access, including, for all participants, the reasons for granting such access, and all denials or limitations of access, including, for each applicant, the reasons for denying or limiting access. The purpose of proposed Rule 811(b)(3) is to ensure that Commission staff would have the ability to examine such records upon request, pursuant to the requirements of proposed Rule 814 of Regulation SB

¹³² See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2)(A)(ii) and 3D(d)(2)(B) of the Exchange Act).

¹³³ See supra Section VI, notes 79 to 114.

¹³⁴ See Regulation MC Proposing Release, supra note 82. See also infra Section VI. As discussed further in Section XVII below, the Commission proposed a number of requirements in Regulation MC designed to mitigate potential conflicts of interest relating to SB SEFs, as discussed in the Regulation MC Proposing Release. The additional rules the Commission is proposing herein relating to impartial access are designed to work together with proposed Regulation MC to help mitigate potential conflicts of interest, as identified in the Regulation MC Proposing Release. In addition, as discussed in Section XVII, the Commission is proposing governance rules that also are designed to help mitigate potential conflicts of interest relating to SB SEFs.

SEF.¹³⁵ In addition, proposed Rule 811(b)(4) would require each SB SEF to file notice with the Commission (by filing an annual amendment to proposed Form SB SEF¹³⁶ and in the compliance report required of the CCO pursuant to Core Principle 14 and proposed Rule 823 of Regulation SB SEF), if the SB SEF prohibits or limits access to the facility for any participant, or if the SB SEF denies access to an applicant.¹³⁷ In its notice, a SB SEF should inform the Commission of the reasons for its denial of access and provide the Commission with the contact information of the aggrieved participant or applicant.¹³⁸ Together, these requirements, which would provide the Commission with information about, or access to information about, any instances when the SB SEF has denied access to a participant or an applicant to become a participant, should help the Commission carry out its oversight of SB SEFs. This ability is particularly important given the identified potential conflict of interest concerns with respect to access to a SB SEF.¹³⁹

Further, under proposed Rule 811(b)(5), a SB SEF would be required to establish a fair process for the review of any prohibition or limitation on access with respect to a participant or any refusal to grant access with respect to an applicant.¹⁴⁰ Fair access to trading venues for SB swaps, and consequently a fair review process, is important, especially when a SB SEF may be

¹³⁵ See *infra* Section VI discussing proposed Rule 814 regarding the Commission's ability to obtain information.

¹³⁶ See *infra* Section XXII discussing proposed Form SB SEF. The Commission notes that proposed Form SB SEF would be a publicly available document, and so such notice would be publicly available.

¹³⁷ See *infra* Sections XXIII and XXI for a discussion of Form SB SEF and the responsibilities of the CCO, respectively.

¹³⁸ The Commission could bring an enforcement action if it believed that a SB SEF had denied or limited access in contravention of the Exchange Act and the rules thereunder.

¹³⁹ See Regulation MC Proposing Release, *supra* note 82.

¹⁴⁰ See proposed Rule 811(b)(5). Such a process is required for all national securities exchanges and for ATSS that have exceeded certain volume thresholds. See Sections 6(c) and 19(e) of the Exchange Act (15 U.S.C. 78f(c) and 78s(e)) and Rule 301(b)(5) (17 CFR 242.301(b)(5)) of Regulation ATS.

the only venue for the trading of a particular SB swap. The Commission believes that for any such review process by a SB SEF to be fair, at a minimum, those persons involved in the decision to prohibit, limit, or deny a participant's or applicant's access to the SB SEF should not be involved in the review of whether such prohibition, limitation, or denial was appropriate. Otherwise, the purpose of the review process could be undermined. The SB SEF's Board should consider the most appropriate body to conduct the internal review process, whether that body is the Board itself, a committee that is delegated this function by the Board, or some other appropriate body.

The Commission requests comment on all aspects of its proposal regarding denials or limitations of access. Is the proposed rule requiring a SB SEF to notify the Commission annually of any prohibition, limitation, or denial of access to its services appropriate and sufficiently clear? Would this be useful information for market participants and the public? Should the Commission require notice more often than annually? Would the proposal assist in mitigating conflicts of interest on the part of a SB SEF? If so, how so? If not, why not?

Is the Commission's proposed rule regarding a SB SEF's review of its denials of access appropriate and sufficiently clear? If not, why not and what would be a better approach? Are there any measures that the Commission could require that would result in a more meaningful internal review process? For example, should the Commission explicitly require that the Board or the regulatory oversight committee ("ROC") review all denials of or limitations on access?¹⁴¹ Would such a proposal be useful? If so, within what time frame should the review be completed? Are there any other requirements the Commission should impose?

¹⁴¹ The Commission proposed in Regulation MC to require a SB SEF to have a ROC, and that the ROC be composed of independent directors. See Regulation MC Proposing Release, supra note 82.

B. Swap Review Committee

Proposed Rule 811(c) would require a SB SEF to establish and enforce compliance with rules concerning the terms and conditions of the SB swaps traded on the facility. To carry out this requirement, a SB SEF would be required to establish a swap review committee¹⁴² to determine the SB swaps that trade on the SB SEF, as well as the SB swaps that should no longer trade on the SB SEF. The proposed rule would require that the composition of the swap review committee provide for the fair representation of participants in the SB SEF and other market participants. Specifically, the proposed rule would require that each class of participant and other market participants (such as the customers of participants, including end-users and buy-side firms) would have the right to participate in the swap review committee. The proposed rule also would provide that the members of the swap review committee be chosen so that no single class of participant or category of market participant would predominate. The rules of the SB SEF also would be required to stipulate the method by which such representation would be chosen by the Board of the SB SEF.¹⁴³ Having a compositionally balanced committee should help to assure that the process of determining those SB swaps that should trade (or no longer should trade) would be fair and that various classes of participants in the SB SEF, as well as other market participants, would have a voice in those decisions.

Proposed Rule 811(c)(3) would require the SB SEF to establish criteria to be used by the swap review committee in determining which SB swaps should be traded on the SB SEF. The Commission preliminarily believes that this would allow the most flexibility by permitting a SB

¹⁴² The swap review committee would not be required to be a committee of the Board under the Commission's proposed rule, although a SB SEF may choose to allow or require members of its Board to serve on the swap review committee, as the SB SEF would determine.

¹⁴³ See proposed Rule 811(c)(2).

SEF to choose whatever criteria it believes are important in determining which SB swaps to trade, thereby encouraging as much trading of SB swaps on SB SEFs as possible.

The Dodd-Frank Act requires that transactions involving SB swaps subject to the clearing requirement of subsection (a)(1) of Section 3C of the Exchange Act be executed on an exchange or on a registered SB SEF unless no exchange or SB SEF makes the SB swap available to trade.¹⁴⁴ Consequently, once a SB swap is “made available to trade” on an exchange or a SB SEF (and is required to be cleared), it can no longer trade in the OTC market, making the determination of what it means for a SB swap to be “made available to trade,” as well as the decision as to who makes such a determination, central to the implementation of Title VII of the Dodd-Frank Act. The Commission has received comments that the scope of those SB swaps that are made available for trading would be important in this market because of the mandatory trade execution requirement and the nature of the SB swap market,¹⁴⁵ which is relatively illiquid and

¹⁴⁴ See Section 3C(h) of the Exchange Act. The requirement in Section 3C(h) of the Exchange Act that a SB swap that is made available to trade on an exchange or a SB SEF shall be traded on an exchange or SB SEF (and not in the OTC market) only applies to SB swaps subject to mandatory clearing. Section 3C(h) of the Exchange Act generally states that, with respect to transactions involving SB swaps subject to the clearing requirement of paragraph (a)(1) of Section 3C, counterparties shall: (1) execute the transaction on an exchange; or (2) execute the transaction on a registered SB SEF or a SB SEF that is exempt from registration. However, these requirements shall not apply if no exchange or SB SEF makes the SB swap available to trade or for SB swap transactions subject to the clearing exception in paragraph (g) of Section 3C.

In a separate proposed rulemaking, the Commission, among other matters, is seeking comment generally on how the factors identified in the statute relating to the mandatory clearing requirement should be applied in making determinations as to whether particular SB swaps are or should be required to be cleared. See Securities Exchange Act Release No. 63557 (December 15, 2010), 75 FR 82490 (December 30, 2010) (File No. S7-44-10).

¹⁴⁵ See, e.g., Commentary by Yves P. Denizé, Director & Associate General Counsel, TIAA-CREF, at the Roundtable. Webcast available at <http://www.sec.gov/news/openmeetings/2010/jac091510.shtml>.

has a smaller number of market participants in comparison to the cash equities and listed options markets.¹⁴⁶

In the Regulation MC Proposing Release, the Commission identified conflicts of interest that could arise when a small number of market participants exercise control or undue influence over a SB SEF.¹⁴⁷ When trading of SB swaps is dominated by a small number of participants, those participants may have competitive incentives to, among other things, limit the number of SB swaps that are made available for trading by a SB SEF to keep those SB swaps trading in the OTC market. This could be true even for SB swaps that would have sufficient trading activity to trade on a SB SEF.¹⁴⁸ On the other hand, once the determination has been made that a SB swap that is subject to mandatory clearing is available to trade on an exchange or a SB SEF, then such SB swap can no longer trade in the OTC market, even if trading of the SB swap on the exchange or SB SEF were virtually nonexistent. Thus, a determination by even one SB SEF or national securities exchange that a SB swap was available to trade on the exchange or SB SEF could have unintended consequences for the trading of such SB swap.

In light of these competing incentives stated above, the Commission preliminarily believes that it would be appropriate that the decision as to when a SB swap would be considered to be “made available to trade” on an exchange or a SB SEF pursuant to Section 3C(h) of the Exchange Act should be made pursuant to objective measures established by the Commission, rather than by one or a group of SB SEFs. Such objective measures could provide that a SB swap that is subject to mandatory clearing would be “made available to trade” unless the SB

¹⁴⁶ The market for SB swaps today is concentrated in the hands of a few dealers. See supra note 81, stating that five large commercial banks represent 97% of the total banking industry notional amounts.

¹⁴⁷ See Regulation MC Proposing Release, supra note 82, 75 FR at 65890.

¹⁴⁸ Id.

swap fails to meet a threshold test that the Commission may adopt or, conversely, that no SB swap would be “made available to trade” unless the SB swap passed a threshold test that the Commission may adopt. In either case, under this approach the Commission would in effect interpret the phrase “made available to trade” in Section 3C(h) of the Exchange Act as meaning something more than the decision to simply trade, or essentially list, a SB swap on a SB SEF or an exchange.¹⁴⁹ This approach would have the further effect of permitting SB swaps to be made subject to mandatory clearing independently of whether they are required to be traded exclusively on SB SEFs and exchanges, because there would not be an automatic requirement that SB swaps subject to mandatory clearing trade only on a SB SEF or exchange simply because they are listed on one.

The Commission does not, however, have sufficient data at this time to propose the objective standards pursuant to which a determination whether a SB swap is “made available to trade” would be made. The Commission preliminarily anticipates that it will separately address how to determine when a particular SB swap would be considered to be “made available for trading” on an exchange or SB SEF pursuant to the directive of Section 3C(h) of the Exchange Act. We solicit comment in this release, however, on how the Commission should craft an objective standard for whether a SB swap is “made available to trade.” For example, an objective determination could be based on a formula measuring the percentage of trading in a particular SB swap that was taking place on exchanges and SB SEFs compared to the aggregate

¹⁴⁹ Pursuant to proposed Rule 811(c), the swap review committee of each SB SEF would be responsible for determining which SB swaps the SB SEF permits to be traded on the SB SEF. Under the proposed approach, however, this decision would not be the same as a determination that such SB swap had been made available for trading within the meaning of Section 3C(h) of the Exchange Act. The swap review committee’s decision, therefore, would not in and of itself be the sole determinant of when a SB swap could no longer trade in the OTC market.

percentage of trading that was taking place in the SB swap on exchanges and SB SEFs, and in the OTC market.¹⁵⁰ Alternatively, such a determination could be based on overall volume in the SB swap, wherever executed. In addition, such a test could require that a baseline trading threshold for each SB swap be met. For example, such a threshold could be that, within a given measurement period, a minimum number of transactions in the SB swap be executed or that a minimum notional value in the SB swap be traded. There may be instances when, because of a low total number of transactions in a SB swap, it may not be appropriate to determine that such SB swap should be made available to trade.

It also may be appropriate to utilize objective measures to determine when a SB swap should no longer be considered to be made available for trading. If it were determined that a SB swap should no longer be considered to be made available for trading because, for example, among other objective measures very little trading in such SB swap on SB SEFs has occurred over a specified time period, such SB swap would be able to trade in the OTC market, as well as on exchanges and SB SEFs.

Proposed Rule 811(c)(4) would require the swap review committee to periodically review each SB swap trading on the SB SEF to determine whether the trading characteristics of each such SB swap justify a change to the trading platform being used for that particular SB swap. In making such a determination, the swap review committee would need to consider whether (1) the liquidity in each SB swap is at an appropriate level for the SB swap's trading platform on which it trades; and (2) such SB swap would be more suited for trading on a different type of platform, including a platform that provides for increased price transparency for participants entering

¹⁵⁰ Because all SB swap transactions would be required to be reported to a registered SDR, whether they occur on an exchange, a SB SEF, or in the OTC market, the Commission would have access to complete information on trading volume regarding each SB swap.

quotes, orders, or other trading interest. The first review could not be earlier than 120 days after the initiation of trading for a given SB swap.

Proposed Rule 811(c)(4) is designed to ensure that SB swaps that are trading on the SB SEF are trading on an appropriate platform. For example, if a SB swap is trading in an RFQ mechanism but trading in the SB swap becomes sufficiently liquid, the SB SEF should consider moving the SB swap to a platform with greater transparency. There could be reasons why the SB SEF prefers not to do so, e.g., because the predominant dealers on the market prefer to continue trading the SB swap in the RFQ platform that does not have the same degree of transparency and thus competition, as a limit order book. Having such decisions made by the swap review committee, and reported promptly to the CCO and annually to the ROC and the Board (as discussed in the next paragraph), appear to lessen any undue influence that any one class of participants may have in keeping the SB swap trading on a platform that does not afford the appropriate level of price transparency for that SB swap.

Proposed Rule 811(c)(5) would require the swap review committee to report decisions on each SB swap promptly to the CCO and annually to the ROC. This would include initial decisions on trading SB swaps as well as ongoing determinations pursuant to the reviews of the swap review committee. This would help ensure that the CCO is kept apprised of changes in the trading of SB swaps so that trading can be properly monitored.

The Commission requests comment on all aspects of the rules relating to the swap review committee and its responsibilities. Is the Commission's proposed rule concerning the composition of the swap review committee appropriate and sufficiently clear? Should the Commission's rule contain more detail about the requirements for the composition of the

committee? If so, what should those requirements be? Should the Commission require independent director representation on the swap review committee?

Is the Commission's proposed Rule 811(c)(3) concerning how the SB SEF should determine whether to trade a SB swap appropriate and sufficiently clear? Should the Commission include any particular factors that the SB SEF should consider, and, if so, what should those factors be and why?

As discussed above, under the proposal the Commission would interpret the phrase "made available to trade" in Section 3C(h) of the Exchange Act as meaning something more than the decision to simply trade, or essentially list, a SB swap on a SB SEF or an exchange. The Commission requests comment on whether commenters agree with this approach, or if, instead, we should consider a SB swap to be "made available to trade" if it is listed on an exchange or a SB SEF in compliance with applicable rules and regulations. What are the advantages and disadvantages of such an approach? Would the approach be more or less simple and cost-effective than the proposal, which would involve the Commission in determining whether a SB swap is "available to trade" and distinguishes this from the determination under proposed Rule 811(c)(3) of whether a SB swap should be traded or listed on a SB SEF? Does the review under proposed Rule 811(c)(3) accomplish many or all of the Commission's regulatory objectives? Would an approach that deems a SB swap "available to trade" if it is listed be more or less susceptible to manipulation or gaming than the proposed approach? Would an approach that deems a SB swap "available to trade" if it is listed generally result in more or less trading of SB swaps on exchanges or SB SEFs? If the Commission were to take the position that listing of a SB swap on an exchange or a SB SEF is the same as "made available to trade," could the Commission's potential concerns about permitting SB SEFs and exchanges to determine whether

a SB swap is "available to trade" be addressed through an exemptive process that could consider potential adverse effects or unintended consequences as to particular SB swaps? Are the Commission's potential concerns about permitting SB SEFs and exchanges to determine whether a SB swap is "available to trade" affected by the types of trading permitted on a SB SEF, such as the ability to send an RFQ to only one or few other participants? If the Commission were to take the position that listing of a SB swap on an exchange or SB SEF is the same as "made available to trade," the Commission could subject SB swaps to mandatory clearing independently of whether such SB swaps are required to be traded on SB SEFs or exchanges by, for example, using an exemptive process or specifying, at the time the mandatory clearing determination is made, that a SB swap is not "available to trade" unless certain criteria are met. What would be the advantages and disadvantages of such an approach compared to the Commission's proposal?

The Commission requests comment on whether it would be appropriate for the decision as to when a SB swap would be considered to be "made available to trade" on an exchange or a SB SEF pursuant to Section 3C(h) of the Exchange Act to be made pursuant to objective measures established by the Commission, rather than by one or a group of SB SEFs. If not, why not? If not, is there another method that commenters would suggest, other than having the determination made by SB SEFs? If so, what is that method?

The Commission requests comment on the manner in which the determination to make a particular SB swap available for trading would be made. What would be an appropriate method or standards to determine whether a SB swap should be made available for trading? Should the test be based on the aggregate amount of trading in the SB swap on exchanges and SB SEFs and in the OTC market, or on overall volume, wherever the SB swap may be executed? What would be an appropriate volume threshold for each alternative, and why? Should a volume threshold

vary by asset class? Is one test more appropriate for some asset classes and the other test more appropriate for others? If so, why, and what is the appropriate volume threshold for each asset class with each test? What would be the appropriate measurement period for a volume threshold and why? On what other characteristics could the test be based? Frequency of trading? The number of SB SEFs on which the SB swap is also trading?

Should there be some minimum level of liquidity in both the OTC market and on SB SEFs and exchanges in connection with the determination that a SB swap has been made available to trade? If so, what is the appropriate level of liquidity? What is a baseline threshold that SB swaps made available to trade should meet? Should it be based on the number of transactions, the notional value for a given SB swap, or both, over a set time period? Or, is there another baseline threshold that the Commission should consider? If so, what is it? Over what time period should the activity be measured?

What would be an appropriate test to determine that a SB swap should no longer be considered to be made available for trading? Because such a SB swap would not be trading in the OTC market, a volume test similar to one of the suggested tests above to determine whether a SB swap should be considered to be made available for trading - comparing the aggregate percentage of trading on exchanges and SB SEFs to overall trading - may not be feasible. How little trading on SB SEFs should be taking place before the Commission determines that the SB swap should be permitted to trade again in the OTC market (because it is no longer considered to be "made available for trading")? Is there a specific number of trades that would make it appropriate to determine that a SB swap is no longer considered to be made available for trading? If so, what should that number be? Or, should a test be based on a percentage trading volume comparison of trading activity in a SB swap to a time period prior to when it was

considered to be made available to trade? What period of time would be appropriate to determine if a pattern of lack of trading has set in? Should such a determination be based on a test based on something other than trading volume? If so, what should such a test be? How should the Commission take into account the possibility that market participants might engage in gaming behavior to affect the outcome of a test based on trading frequency or volume?

Should the presumption be that no SB swap is deemed made available to trade unless it meets the threshold established by any test that the Commission may adopt, or should the presumption be that all SB swaps are deemed available to trade unless they fail to meet the threshold established by any such test? What would be the costs and benefits of each approach?

Has the Commission correctly identified the potential conflicts with SB SEFs that could arise in decisions to make a SB swap available to trade? Would the proposal the Commission has outlined here help to mitigate those conflicts? If not, why not?

How, if at all, would having the determination about what SB swaps are made available for trading be made pursuant to an objective formula, as the Commission is considering to propose, rather than allowing each SB SEF to make the determination, impact the incentives for creating a SB SEF? Would the proposal have the effect of chilling the creation of SB SEFs because trading could simply continue in the OTC market until trading meets the objective test? If so, how should the determination of what is made available to trade be made? How should the Commission guard against the concern that, if a distinction is not made between "listing" or "trading" of a SB swap, and "making available to trade," OTC trading could effectively be cut off in SB swaps that were made available to trade, even if market participants believe that they would benefit from continued OTC trading? Is this concern mitigated if the Commission adopts an interpretation of the definition of SB SEF that permits an RFQ to be sent to only one other

participant? Why or why not? Under such approach, would there still remain benefits for the OTC trading of certain types of SB swaps by market participants? If so, what would be these benefits and under which circumstances, and for what types of SB swaps, would this be the case? How should those benefits, if any, be weighed with the Dodd-Frank Act's goal of moving trading in SB swaps onto regulated markets?

Would the idea of looking at volume trading on SB SEFs and SBS exchanges versus trading in the OTC market be subject to gaming? For example, would it be possible for firms to avoid having SB swaps designated as made available to trade, for example, by suppressing SB SEF trading volume by posting inferior quotes on SB SEFs while continuing to offer the identical product in the OTC market at a better price? If so, what impact would such behavior have on the SB swap market? If so, how could the Commission guard against such behavior?

If the Commission has not adopted a standard for determining when a SB swap is made available to trade by the time a SB swap is determined to be subject to mandatory clearing, what action, if any, should the Commission take to clarify the impact of a SB SEF or exchange listing a SB swap for trading on its market? Would it be necessary or appropriate for the Commission to clarify the meaning of "made available to trade" in these circumstances and, if so, what type of clarification should the Commission provide? Commenters should address the impact, if any, of any action or inaction by the Commission in these circumstances on market participants and on the trading of SB swaps, including the impact of any clarifications that commenters may propose.

Is the Commission's proposed Rule 811(c)(4) requiring review by the swap review committee of the liquidity of SB swaps, and its potential requirement for an SB SEF to move trading of the SB swap to a different type of platform operated by the SB SEF that would provide

for greater pre-trade price transparency, once certain volume thresholds are met, sufficiently clear? Is it necessary for a swap review committee to review SB swaps trading on limit order book platforms, as well as multiple dealer RFQ platforms? If not, why not? Should the Commission establish a trading activity threshold that, if exceeded, would require a SB SEF to move the trading of SB swaps to a limit order book platform? If so, what would be the appropriate factors and threshold? For example, should such factors include the liquidity of the SB swap? If so, how should such liquidity be measured (e.g., average daily trading volume, frequency of trades, size of trades)? What would be an appropriate measurement period for any such threshold(s)? Should a threshold vary depending on the type of SB swap? Should a threshold be relative (e.g., based on a specified percentage of overall volume) or absolute (e.g., based on a specific number of trades in a given measurement period)? What are the benefits and drawbacks of mandating a trading activity threshold that, if exceeded, would require a SB SEF to move the trading of SB swaps to a limit order book platform?

C. Trading Procedures

Proposed Rule 811(d) would require every SB SEF to establish and enforce rules governing the procedures for trading on the SB SEF, including but not limited to: doing business on the SB SEF; types of orders or other trading interest available; the manner in which trading interest would be handled on the SB SEF, including a proposed requirement that the rules provide for the fair treatment of all trading interest; the manner in which price transparency for participants entering orders, requests for quotations, responses, quotations, or other trading interest into the system would be promoted; the manner in which trading interest, including orders, requests for quotations, responses, quotations, and transaction data, would be disseminated, including whether dissemination would be only to participants of the SB SEF or

more broadly, and whether or not for a fee; prohibited trading practices; the handling of clearly erroneous trades; trading halts; the manner in which block trades would be handled, if different from the handling of non-block trades; and any other rules concerning trading on the facility. The Commission believes that it is important for a SB SEF to have rules concerning doing business on the SB SEF because such rules would provide participants with a uniform set of expectations for how the SB SEF would operate.

The Commission expects that such rules would include information as basic as the hours the SB SEF is available for trading, as well as rules concerning the manner in which trading interest would be handled by the SB SEF. Such rules also would help to inform participants as to the types of orders or other trading interest that they could enter into the system for execution. The Commission also believes that rules concerning prohibited trading practices would be important to every SB SEF, so that participants would be aware of the scope of allowable behavior on the SB SEF. Such rules would help to support the requirement in Core Principle 2 that every SB SEF would have to establish rules that would deter abuses and have the capacity to detect, investigate and enforce those rules.

The Commission believes that it is important to the efficient trading on a SB SEF that the SB SEF provide for the fair treatment of all trading interest on its market. In other words, a SB SEF should have rules designed to enhance liquidity, including rules that are not designed to disadvantage participants' orders, thereby causing them to miss out on trading opportunities. Such rules might include, for example, price/time priority or price/size priority rules.¹⁵¹ The SB SEF would need to apply these rules consistently and fairly with regard to all participants.

¹⁵¹ Generally, when orders are filled in price/time priority, if there are two orders at the same price, the order that arrived first would be given priority. Alternatively, size may be used to determine priority among trading interest at the same price. For example, orders may

In addition, as discussed in Section III above, the Commission believes that transparency of prices on a SB SEF is a critical element with respect to the operation of a SB SEF. Although the Commission is not proposing to dictate a certain type of trading system or trading rules for SB SEFs, it believes that a SB SEF would have to meet certain basic standards to comply with the requirements that its rules provide for the fair treatment of all trading interest and that these rules address the manner in which price transparency for participants entering trading interest into the system would be promoted. In this regard, under its proposed interpretation of the definition of SB SEF, if the SB SEF operates a RFQ or similar trading model, the rules of the SB SEF should include a functionality that allows the quote requesting participant to submit a RFQ to all participants that are willing to respond to requests, *i.e.*, those participants willing to provide liquidity. The SB SEF, however, could determine to provide the functionality for the requesting participant to choose to send the RFQ to less than all other participants at the request of its customer or when the participant is exercising investment discretion. In addition, the requestor would be able to determine to whom to send the RFQ.

Further, for example, if the SB SEF operates a RFQ mechanism, the rules of the SB SEF should specify that any response to an RFQ that is provided to the participant submitting the RFQ should be included in the composite indicative quote of the SB SEF.¹⁵² In addition, if a SB SEF displays firm, executable trading interest, it must display such interest to all participants.

be filled pro-rata, or in certain proportions based on other factors the SB SEF may determine are appropriate. See, e.g., International Securities Exchange Rule 713, Priority of Quotes and Orders.

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The composite indicative quote screen would be the quote screen available to all participants of the SB SEF. The composite quote shows an average quote for each SB swap available on the SB SEF. The composite indicative quote includes both composite indicative bids and composite indicative offers. As discussed below, proposed Rule 811(e) would require a SB SEF that operates a RFQ platform to create and disseminate

The Commission believes that it is important to foster pre-trade transparency to encourage greater price competition. However, the Commission is cognizant of comments received from market participants in the SB swap market, both from customers (“buy-side”) and liquidity providers (“sell-side”), who are concerned about the level of pre-trade price transparency that may be required. Some of these commenters have expressed the concern that pre-trade price transparency could potentially have an impact on dealers’ incentives or ability to provide competitive prices if others can use the information that would be made available through increased pre-trade price transparency to trade ahead of the order. The proposed rules relating to the dissemination of trading interest are designed to increase transparency from current levels, while at the same time recognizing the concerns that have been voiced about the potential effects of pre-trade transparency in certain circumstances. In this regard, proposed Rule 811(d)(5) has been drafted to allow maximum flexibility by a SB SEF to determine the best manner to disseminate trading interest by such SB SEF. The Commission believes that it is important for a SB SEF to make clear to its participants, in a rule, how trading interest would be disseminated. At the same time, the Commission recognizes that different platforms may require different means of disseminating trading interest, and that each SB SEF is in the best position to determine how such dissemination should occur on its own platform. In particular, the Commission believes that proposed Rule 811(d)(5) would require a SB SEF to develop rules that would incorporate responses received on an RFQ system into a composite indicative quote that is available to all participants, and that would not limit the number of dealers from whom a participant could request a quote.

through the SB SEF a composite indicative quote for SB swaps traded on or through the SB SEF and to make that screen available for viewing by all participants in the SB SEF.

The Commission also believes that SB SEFs should have rules that concern any prohibited trading practices. A SB SEF should determine those trading practices that it believes are inappropriate to the functioning of its market.

The Commission also believes that a SB SEF should have rules concerning the handling of clearly erroneous trades, and that those rules should provide for a fair and nondiscriminatory manner of handling such trades, as well as a procedure to resolve any resulting disputes.

Although under ordinary circumstances trades that are executed between parties should be honored, the Commission believes that clearly erroneous execution rules are necessary because, on rare occasions, the terms of the executed trade may indicate that an obvious error may exist. In such instances, it could be unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In such case, a clearly erroneous transaction may have taken place. The Commission believes that any clearly erroneous execution rule should provide for a clear and transparent process for resolving erroneous trades and for a fair process for hearing appeals of clearly erroneous decisions.

The Commission further believes that it is critical for a SB SEF to have rules concerning trading halts, so that trading on the SB SEF would not continue when trading has been halted or suspended in the underlying security or securities pursuant to the rules or an order of a regulatory authority with authority over the underlying security or securities.¹⁵³ The Commission believes that when trading has been halted on an underlying security, it is appropriate that derivative markets, such as the options markets and the SB swap market, also halt trading to avoid inefficient pricing and disruptions to the market.

¹⁵³ The Commission notes that the options and securities futures markets have rules providing for a trading halt in the event that the underlying security has been paused in the equity markets. See, e.g. Chicago Board Options Exchange Rule 43.4(b).

Core Principle 2 requires that SB SEFs establish (and have the capability to enforce) rules regarding trading procedures. The items enumerated in proposed Rule 811(d) are not meant to be an exhaustive list of rules relating to trading procedures and SB SEFs may put in place additional types of categories of rules that they deem to be necessary to govern the procedures for trading on the SB SEF. The Commission preliminarily believes that each SB SEF would be in the best position to determine precisely those rules that are necessary and appropriate to ensure that its market functions in a fair and orderly fashion. The rules of each SB SEF would be required to be filed as part of the initial Form SB SEF application, as well as in connection with the rule filing process in proposed Rules 805 and 806 of Regulation SB SEF.¹⁵⁴

The Commission requests comment on all aspects of proposed Rule 811(d). What are commenters' views on the proposed rules relating to trading procedures? Are the Commission's proposed rules concerning trading procedures, the need to promote pre-trade price transparency (proposed Rule 811(d)(4)) and the rule concerning dissemination of trading interest (proposed Rule 811(d)(5)) sufficiently clear? Would proposed Rule 811(d)(4) make a difference in price transparency in the SB swap market? How would it impact behavior? Are there any specific concerns with this proposed rule? If so, what are they? Should the proposed rule be refined? If so, how? Please provide specific suggestions.

What are commenters' views on the proposed requirement that responses to an RFQ must be included in the SB SEF's composite indicative quote? Would this requirement in fact promote pre-trade price transparency? What would be the benefits and drawbacks of the Commission's proposal to include RFQ responses in the composite indicative quote? Should the Commission instead require that only the response to an RFQ accepted by the party submitting

¹⁵⁴ See infra Section XXIII for a discussion of the proposed rule filing process for SB SEFs.

the RFQ be included in a composite indicative quote? Should the Commission require that any participant responding to an RFQ have the ability to see other participants' responses? Would such a requirement make a difference with respect to pre-trade price transparency? What would be the benefits and drawbacks of such a proposal? Should the Commission require that all requests for quote be shown to all participants? Would such a requirement make a difference with respect to pre-trade price transparency? What would be the benefits and drawbacks of such proposals?

Should the Commission require a SB SEF to have a rule prohibiting the SB SEF from disclosing to any liquidity provider that has received an RFQ information about how many participants were queried? What would be the impact of such a prohibition, taking into account such factors as the type of SB swap and the size of the transaction, on the liquidity provider's incentives in determining at what price to provide a response? Should the participant submitting the RFQ be able to waive any such prohibition in the exercise of its investment discretion?

For SB SEFs that choose to allow trading of uncleared SB swaps should the Commission require such SB SEFs to have additional trading rules related to uncleared SB swaps, such as rules for disclosing the counterparties to such transactions or other rules related to counterparty risks? Please provide specific suggestions.

Proposed Rule 811(e) would require a SB SEF that operates an RFQ platform to create and disseminate through the SB SEF a composite indicative quote for SB swaps traded on or through the SB SEF.¹⁵⁵ The composite indicative quote would need to be made available to all participants of the SB SEF. The composite indicative quote would include both composite indicative bids and composite indicative offers. The Commission preliminarily believes that a

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See supra note 152 for a description of a composite indicative quote.

composite indicative quote would provide valuable pricing information to the participants of a SB SEF, while at the same time not disclosing specific trading interest of individual participants when that interest is not firm. As discussed above, the Commission believes that including responses to an RFQ in the composite indicative quote also may be appropriate as a means to further increase pre-trade price transparency. A composite indicative quote would provide some information on pricing but would take into account concerns expressed by some market participants about information leakage that could occur, particularly with respect to larger sized orders.¹⁵⁶ In addition, the Commission understands that many platforms operating today in the SB swaps market create and disseminate a composite indicative quote.

The Commission requests comment on all aspects of proposed Rule 811(e). What are commenters' views on the proposed requirement that a SB SEF must disseminate a composite indicative quote? What would be the benefits or drawbacks of such a proposal? Would such a requirement provide an increased level of pre-trade price transparency compared to the level that is available today? Are there other measures the Commission should impose at this time to foster pre-trade price transparency? If so, what are they? For example, should the Commission require a SB SEF to provide functionality to enable market participants to post individual indicative quotes, in addition to a composite indicative quote? What would be the advantages and disadvantages of such a proposal?

Considering the early stage of development of the regulatory framework for the SB swap market and the existing structure of the SB swap market, the Commission is mindful that its interpretation of the definition of SB SEF, and the rules it is proposing herein to implement the Dodd-Frank Act, could have unforeseen consequences, either beneficial or undesirable, with

¹⁵⁶ See infra Section VIII.D for a discussion of block trades.

respect to the shape that this market will take. In the Commission's view, it is important that the regulatory structure will provide incentives for the trading of SB swaps on regulated markets that are designed to foster greater transparency and competition that are subject to Commission oversight, while at the same time allowing for the efficient operation and continued evolution of the SB swap market. With that in mind, should the Commission mandate greater pre-trade price transparency at the outset of trading of SB swaps on SB SEFs? What would be the benefits of mandating greater pre-trade price transparency at the start of trading of SB swaps on a SB SEF and what would be the drawbacks of such an approach? Would the benefits outweigh the drawbacks and vice versa? Commenters should explain their reasoning. Should the Commission propose additional trading rules to be required of SB SEFs? If so, what should those rules cover with regard to trading procedures?

D. Block Trades

Core Principle 2 requires a SB SEF to establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades.¹⁵⁷ The issue of block trades on a SB SEF has two components: (1) how should a "block trade" be defined, i.e., at what threshold would a trade be considered block size; and (2) how should block trades be handled on a SB SEF. Issues relating to the execution, as well as the reporting, of a block trade, have been a particular focus of market participants. Market participants that execute block trades in SB swaps, including dealers and buy-side customers, have raised concerns regarding pre-trade transparency of block trades. They believe that if other market participants know the terms of a block trade prior to the time it is executed, those other market participants could attempt to profit from the information

¹⁵⁷ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(2)(C) of the Exchange Act).

about the block to the detriment of the initiator of the block trade. If the information is disclosed before the block trader's liquidity provider is "on risk," other market participants could buy or sell ahead of the block trade initiator, moving the market against the block trade initiator (but not adversely affecting its counterparty). If the liquidity provider for the block trade initiator is "on risk" when the information is disclosed, other market participants could buy or sell ahead of the liquidity provider, making it more costly for the liquidity provider to hedge the transaction. If the liquidity provider anticipates such price movement, front-running by market participants could make the transaction more costly for the block trade initiator, as the liquidity provider may provide it with less favorable quotations in order to protect itself from the impact of such disclosure.¹⁵⁸ Some market participants also are concerned that if a block trade were required to interact with other trading interest on a SB SEF, there might not be enough liquidity on the SB SEF to execute the entire block trade, leaving a portion of the block trade unexecuted. These market participants are worried about the execution risk of doing block trades on a SB SEF. Not having a large trade filled, or having it filled at a disadvantageous price as a result of having to enter into more than one trade as part of the execution process, could hurt investment performance.¹⁵⁹

For these reasons, market participants have urged exceptions for the handling of block trades, including the ability to negotiate and execute block trades without having to interact with trading interest on the SB SEF. Market participants even have indicated a willingness to forego

¹⁵⁸ See Reporting and Dissemination Release, supra note 6, for a discussion of the concerns surrounding post-trade transparency.

¹⁵⁹ See, e.g., Hendrik Bessembinder & Kumar Venkataraman, Does an Electronic Stock Exchange Need an Upstairs Market? J. of Fin. Econ., Vol. 73 (2004) ("Bessembinder Paper"), finding that execution costs of a block trade in an "upstairs" market are much lower than would be if the block trade were executed in a "downstairs" market.

available pre-trade transparency in order to keep their proprietary block trading strategies private.

The Commission is sensitive to these concerns. However, the Commission also is concerned that allowing the execution of block trades on a SB SEF in a manner that is subject to less pre-trade transparency than the minimum level that would be required by Commission rules, for example, by allowing block trades to be executed off of the SB SEF and then reported to the SB SEF without interacting with trading interest on the SB SEF (i.e., using the SB SEF as a “print facility”), could circumvent the mandatory trade execution requirement and undermine the goals of providing for more transparent and competitive trading on a SB SEF. Therefore, although the Commission believes that it is permissible for a SB SEF to establish different trading rules for block trades generally, block trades would still be subject to the various minimum requirements that the Commission has established with respect to pre-trade transparency¹⁶⁰ and interaction with other trading interest on the SB SEF, as discussed above.¹⁶¹

SB SEFs would have flexibility, therefore, to establish different rules for the trading of block trades on their facilities, as long as those rules were clear as to how block trades would be handled and would comply with the rules being proposed today.¹⁶² A SB SEF could, for example, allow a limit order book platform to use a separate multi-dealer RFQ component to

¹⁶⁰ See, for example, supra Sections III.B and VIII.C, discussing the proposed requirement that SB SEFs that operate a RFQ mechanism disseminate a composite indicative quote and make it available to all participants, the aspects of the proposed interpretation that all responses to a request for quote be included within the composite indicative quote and that SB SEFs cannot limit the number of liquidity providers to whom a request for quote is sent.

¹⁶¹ See, for example, supra Section VIII.C.

¹⁶² Proposed Rule 811(d) would require that a SB SEF establish and enforce rules governing the procedures for trading on the SB SEF including the handling of block trades if different from other trades.

execute block trades, as long as the block trade interacts with existing interest on the SB SEF (i.e., the limit order book portion of the SB SEF that handles orders that are not blocks) and otherwise complies with the proposed requirements that are part of this rulemaking. Also, under the Commission's proposed interpretation of the definition of SB SEF, a SB SEF that operates a RFQ platform and that requires an RFQ to be disseminated to all participants, could, for example, permit participants to choose to send an RFQ to fewer than all participants, including just one. In a system that allows participants to display firm quotes, the system (and rules) would need to be designed to provide that a block trade, like any other trade, would interact with the displayed orders based on a fair method. Thus, to the extent that liquidity exists on a central limit order book trading platform of the SB SEF, a block trade would be required to interact with those pre-existing resting bids and offers.¹⁶³ The Commission also notes that, until a SB swap that is determined to be subject to the mandatory clearing requirement and is determined to have been made "available to trade" on a SB SEF or an exchange, the SB swap could be traded in block size off a SB SEF or exchange.

The Commission is proposing to require that a SB SEF define a "block trade" to have the same meaning as in Rule 900 of Regulation SBSR relating to trade reporting.¹⁶⁴ This would

¹⁶³ If a SB SEF operated a central limit order book and a separate RFQ mechanism, the SB SEF's systems would be required to ensure that any trade to be executed in the RFQ mechanism interacted with any existing firm interest on the central limit order book at the same or better price before interacting with interest on the RFQ platform. For example, assume that such a SB SEF had a 5,000 notional resting order on its limit order book in SB swap A and that a 100,000 notional RFQ in SB swap A was entered into and disseminated to liquidity providers in the RFQ mechanism. If the resting limit order has a price equal to or greater than the price at which a response(s) comes back in the RFQ mechanism to execute the RFQ order, the SB SEF system would be required to execute 5,000 of the RFQ order against the resting limit order and 95,000 against the response(s).

¹⁶⁴ See proposed Rule 800 (defining "block trade" as having the same meaning as in Rule 900 of Regulation SBSR under the Exchange Act) and Reporting and Dissemination Release, supra note 6. Rule 900 of Regulation SBSR would define a block trade to mean

mean that each SB SEF would use the same threshold for determining what constitutes a block trade for a particular “security-based swap instrument,” as calculated by a registered SDR.¹⁶⁵

The Commission believes that it is important for each SB SEF to use the same threshold for block trades to ensure consistency and uniformity across SB SEFs.¹⁶⁶ The Commission notes, however, that until it establishes the criteria and formula for determining a block trade pursuant to proposed Rule 907(b) of Regulation SBSR, proposed Rule 800 of Regulation SB SEF would permit a SB SEF to set its own criteria and formula for determining what constitutes a block trade as long as such criteria and formula are consistent with the Core Principles and the rules and regulations thereunder.

The Commission seeks comments on its proposed definition and treatment of block trades. Should the definition of block trade have the same meaning in the context of a SB SEF and in the context of trade dissemination and reporting? Is there anything about pre-trade versus post-trade transparency that warrants having different definitions of a block trade in the context of proposed Regulation SB SEF and proposed Regulation SBSR?¹⁶⁷ Are there other definitions

a large notional SB swap transaction that meets the criteria set forth in Rule 907(b) of Regulation SBSR, which states that a registered SDR shall establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all security-based swap instruments reported to the registered SDR in accordance with the criteria and formula for determining block size as specified by the Commission.

¹⁶⁵ See Reporting and Dissemination Release, *supra* note 6, and proposed Rule 900 for a definition of “security-based swap instrument.”

¹⁶⁶ The Commission notes that even if more than one registered SDR establishes the block trade threshold for a SB swap, the thresholds would be identical because each SDR in the same class of SB swap would use the same data to calculate the threshold. See Reporting and Dissemination Release, *supra* note 6, for a more detailed discussion.

¹⁶⁷ See, e.g., Memorandum by the Staff of the Division of Risk, Strategy and Financial Innovation of the U.S. Securities and Exchange Commission to File No. S7-34-10, Release No. 34-63346, dated January 13, 2011. The memorandum is submitted as a comment letter to the Reporting and Dissemination Release, *supra* note 6, and is available at: <http://www.sec.gov/comments/s7-34-10/s73410-12.pdf>.

of block trade that the Commission should consider? Do commenters agree with the proposed approach to block trades on SB SEFs? Is pre-trade transparency for block trades desirable? If so, why? If not, why not? Should SB SEFs be permitted to have discretion regarding implementation of rules governing the handling of block trades? For example, should block trades be permitted to be executed in “one participant to one participant” transactions and then “printed” on the SB SEF? If the Commission were to adopt its proposed interpretation of the definition of SB SEF, would such flexibility be necessary in light of the fact that, under the proposed interpretation, a requester can choose to submit an RFQ fewer than all participants, including to just one participant? Should there be other exceptions for block trades, such as an exception for a clean cross?¹⁶⁸ What would be the benefits and drawbacks of such proposals? Should any such proposals be subject to any conditions, such as allowing block trades an exemption from the minimum pre-trade transparency and order interaction requirements on a temporary basis or not permitting “one participant to one participant” transactions to be printed on a SB SEF after trading activity in the SB swap crosses a specified liquidity threshold?

What would be the effect of requiring block trades to interact with existing interest on the SB SEF, to the extent firm trading interest is available? What impact, if any, would that requirement have on price competition occurring on the SB SEF in that particular SB swap? If hidden trading interest were permitted on a SB SEF’s trading system, how should such interest be handled under the interaction requirement? If block trades were required to interact with hidden trading interest, would that encourage hidden interest and discourage displayed interest? What would be the impact of allowing block trades to be executed off of the SB SEF and then

¹⁶⁸ See, e.g., National Stock Exchange Rule 11.12 describing acceptable clean cross orders as a cross: (1) that is for at least 5,000 shares and has an aggregate value of at least \$100,000; (2) with a size greater than the size of the interest at each side of the top of book; and (3) with a price equal to or better than the Protected NBBO.

“printed” on a SB SEF, or to execute without interaction with existing interest? What impact, if any, would that have on price competition on the SB SEF in that particular SB swap? What impact would such a proposal have on the incentives of market participants to post firm interest in that SB swap? Would this proposal create a significant disincentive for market participants to enter any sizeable volume for execution on the SB SEF? What other requirements, if any, should the Commission impose to promote incentives to post firm quotes? Are there any alternative methods to provide for pre-trade transparency for block trades without requiring block trades to interact with other bids and offers on a SB SEF? If so, how would these alternative methods impact the requirements and goals of the Dodd-Frank Act? Are there alternative trading mechanisms, such as crossing systems, that could be used to trade blocks? How would these alternative trading mechanisms comply with the pre-trade transparency requirements? Are there other special provisions that should apply to block trades? If so, what are they, and why would they be appropriate?

The Commission recognizes that the SB swap market is different in certain respects than the market for cash equities and listed options. For example, many fewer market participants account for a significant amount of the trading in SB swaps. In addition, there is not at this time any direct retail participation in the SB swap market. Further, trading in SB swaps generally is much less liquid than for many NMS stocks and listed options. How, if at all, do these factors, or other factors regarding the structure of the SB swap market, impact the handling of block trades in the SB swap market, and how should they, if at all, impact the proposed treatment of block trades on SB SEFs?

E. Trade Processing Procedures

Proposed Rule 811(f) would require a SB SEF to establish and enforce rules concerning the reporting of trades executed on the SB SEF to a clearing agency and procedures for the processing of transactions in SB swaps that occur on or through the SB SEF, including, but not limited to, procedures to resolve any disputes concerning the execution of a trade.

The Commission believes that the types of rules contemplated by proposed Rule 811(f) are important to contributing to the fair and orderly functioning of any SB SEF, and to ensure that trades executed on a SB SEF are properly transmitted to the applicable registered clearing agency. In the Commission's view, these types of rules would aid a SB SEF in contributing to the operation of an orderly market. The Commission believes that the rules of the SROs could provide appropriate models to SB SEFs concerning the types of rules that would satisfy the requirements of this proposed rule. Alternatively, the Commission could find the rules of other regulated entities appropriate for use as models as well, upon review.

The Commission requests comment generally on all aspects of proposed Rule 811(f). Is the Commission's proposed rule sufficiently clear? Are there other aspects of trading procedures, aside from the reporting of trades to a clearing agency and procedures for the processing of transactions in SB swaps and for the handling of disputes that should be addressed? If so, what additional information should be included in such a rule? Should the Commission require SB SEFs to compare and report confirmed trades¹⁶⁹ to clearing agencies, or is it appropriate to leave the choice to SB SEFs? Please be specific.

F. Disciplinary Rules and Procedures

¹⁶⁹ This would parallel certain reporting requirements for locked-in trades in the equity and debt markets. A locked-in trade is one in which all of the terms and conditions of the trade are agreed to and accepted by the buyer and the seller. See, e.g., <http://www.amex.com/servlet/AmexFnDictionary?pageid=display&titleid=3784>.

Proposed Rule 811(g) would require a SB SEF to establish rules and procedures concerning the disciplining of its participants including, but not limited to: authorizing the SB SEF's staff to recommend and take disciplinary action for alleged violations of the SB SEF's rules; specifying the sanctions that may be imposed on participants for violations of the SB SEF's rules (provided that each sanction is commensurate with the corresponding violation); and establishing fair and non-arbitrary procedures for any disciplinary process, and appeals thereof.

SB SEFs are required by Section 3D(d)(2) of the Exchange Act to enforce compliance with their rules. Proposed Rule 811(g) is designed to require the SB SEF to have baseline rules relating to its disciplinary process to help it carry out its statutory responsibilities.¹⁷⁰

Proposed Rule 811(h) would require the SB SEF to make and keep specific records of all disciplinary proceedings and sanctions imposed, and all appeals, and to disclose disciplinary actions on an annual amendment to Form SB SEF and on the SB SEF's annual report of the CCO required by Section 3D(d)(14) of the Exchange Act and proposed Rule 823.¹⁷¹ While this proposed requirement also would be part of the recordkeeping requirement of the SB SEF under Core Principle 9, the Commission is restating it in connection with Core Principle 2, since these records would need to be maintained and information about disciplinary actions disclosed by the SB SEF. This information, which could be used by the Commission to review the disciplinary

¹⁷⁰ In fashioning their disciplinary rules, SB SEFs may be informed by the rules on disciplinary proceedings maintained by the national securities exchanges. See, e.g., Chicago Board Options Exchange, Chapter XVII (Disciplinary Rules) and New York Stock Exchange Rules 475-477 (Disciplinary Rules).

¹⁷¹ See infra Sections XXI (discussing Core Principle 14) and XXIII (discussing proposed Form SB SEF). The Commission notes that information provided on proposed Form SB SEF is public.

process at a SB SEF, would provide the Commission with an additional tool to carry out its oversight responsibilities with respect to SB SEFs.¹⁷²

The Commission requests comment generally on all aspects of proposed Rule 811(h). Is the Commission's rule concerning disciplinary rules and procedures sufficiently clear? Should the proposed rule include greater specificity regarding the disciplinary processes for SB SEFs, including the review of disciplinary actions? If so, what provisions should be included in any such rule? Should participants in the SB SEF, or customers of participants, be involved in the disciplinary process? If so, in what regard? Should the CCO be required to be involved in any disciplinary process?

G. Surveillance for Rule Violations

Proposed Rule 811(i) would require a SB SEF to establish rules and procedures to assure that the information to be used to determine whether rule violations have occurred is captured and retained in a timely manner. Proposed Rule 811(j) would require the SB SEF to have the capacity to capture information that may be used in establishing whether rule violations have occurred, including through the use of automated surveillance systems as set forth in proposed Rule 813(b),¹⁷³ maintain appropriate resources to fulfill these obligations, and investigate possible rule violations.

¹⁷² See Regulation MC Proposing Release, *supra* note 82, 75 FR at 65912, discussing the requirement in proposed Rule 702(g) under Regulation MC relating to compositionally balanced disciplinary panels for SB SEFs.

¹⁷³ See *infra* Section X (discussing Core Principle 4). Core Principle 4, which would be implemented in proposed Rule 813, requires a SB SEF, among other things, to monitor trading in SB swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

The Commission believes that, to be able to effectively carry out its obligations to enforce compliance with its rules, a SB SEF must have the capability to monitor trading activity to determine whether rule violations are occurring or have occurred.¹⁷⁴ The rules proposed in Rules 811(h) and (i) are designed to require a SB SEF to have baseline rules relating to surveillance of its market to help it carry out its statutory responsibilities.

The Commission requests comment generally on all aspects of proposed Rule 811(i). Are the Commission's proposed rules on surveillance of rule violations sufficiently clear? If not, what additional information is required? Please be specific. Should SB SEFs be required to exchange information with other SB SEFs that have listed the same SB swaps for trading to properly surveil trading in those SB swaps on its market? How would any exchange of information with other SB SEFs be accomplished? Should SB SEFs have access to trading information for similar SB swaps trading in the OTC derivatives market? If so, how would this be accomplished? What guidelines should the Commission use to determine what SB swaps are sufficiently similar to require such access? Should SB SEFs be required to share information with other regulatory authorities? For example, if a SB SEF detects unusually high activity in a particular SB swap, what guidelines would be appropriate for the sharing of this information with the Commission and other regulatory authorities that regulate the underlying asset?

IX. Core Principle 3 – Manipulation

Section 3D(d)(3) of the Exchange Act (Core Principle 3) provides that a SB SEF shall permit trading only in SB swaps that are not readily susceptible to manipulation.¹⁷⁵ To implement Core Principle 3, the Commission is proposing Rule 812.

¹⁷⁴ See infra Section X (discussing Core Principle 4).

¹⁷⁵ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(3) of the Exchange Act).

Proposed Rule 812(a) would implement the requirements of Core Principle 3. Proposed Rule 812(b) would provide that before a SB SEF may permit the trading of a SB swap on the SB SEF, the SB SEF's swap review committee must have determined, after taking into account all of the terms and conditions of the SB swap and the markets for the SB swap and any underlying security or securities, that such SB swap is not readily susceptible to manipulation. The proposed requirement that the swap review committee consider not only the market for the SB swap, but also the market for any underlying security or securities is intended to make clear that the swap review committee must consider whether an underlying or reference security could make a SB swap readily susceptible to manipulation.¹⁷⁶ Under proposed Rule 812(c), after a SB SEF commences trading of a SB swap, its swap review committee would be required to periodically review trading in the SB swap. If the swap review committee cannot determine, after taking into account all of the terms and conditions of the SB swap, the markets for the SB swap and any underlying security or securities, and trading in the SB swap, that such SB swap is not readily susceptible to manipulation, the SB SEF would be required to no longer permit the trading of the SB swap.

Because Core Principle 3 permits a SB SEF to trade only SB swaps that are not readily susceptible to manipulation, the Commission preliminarily believes that the proposal to require every SB SEF's swap review committee to consider the terms and conditions of the SB swap and the markets for the SB swap and any underlying security or securities, and make an affirmative

¹⁷⁶ The Commission notes that it is not unusual for national securities exchanges to include in their listing standards for derivatively-priced securities provisions concerning the market for the underlying components. *See, e.g.*, Chicago Board Option Exchange Rule 5.3 (listing standards for options contracts which include, among other things, requirements relating to the trading volume and number of holders of the underlying security); NYSE Arca Rule 5.2(j)(3) Commentary .01(a) (listing standards for index-based exchange-traded funds, which include, among other things, requirements relating to the trading volume and market value of underlying components).

determination that the SB swap is not readily susceptible to manipulation before a SB SEF trades a SB swap, and to periodically review that determination after trading commences, is a reasonable approach to implementing the statutory language of Core Principle 3. Further, as discussed above, proposed Rule 811(c)(1) would require a SB SEF's swap review committee to determine whether to trade a SB swap and whether a SB swap that has commenced trading should continue to trade on the SB SEF.¹⁷⁷ Under proposed Rule 812, the swap review committee would be required to also consider whether a SB swap raises manipulation concerns before trading such product.

The Commission generally requests comment on all aspects of proposed Rule 812. Additionally, the Commission requests comment as to whether there are any types of SB swaps trading today that a SB SEF's swap review committee should presume are not readily susceptible to manipulation. What factors would or should a SB SEF take into consideration when making a determination whether a SB swap would be readily susceptible to manipulation? Should the Commission provide more guidance regarding what being "readily susceptible to manipulation" means in the context of SB swaps? If so, what guidance should the Commission provide? Should the Commission require a SB SEF to consider objective criteria concerning the underlying security or securities? If so, what should these criteria be?¹⁷⁸

The Commission recognizes that it might be difficult to determine whether a particular SB swap is readily susceptible to manipulation. Further, individual SB SEFs – as well as

¹⁷⁷ Pursuant to proposed Rule 811(c)(3), a SB SEF would be required to establish criteria that its swap review committee should consider in determining which SB swaps should trade on the SB SEF. See *supra* Section VIII.B.

¹⁷⁸ See *supra* note 176, noting examples of national securities exchanges that have included in their listing standards for derivatively-priced securities required consideration of factors such as the trading volume, number of holders, and market value of the underlying security or securities.

various market participants and investors – may have differing views on whether a particular SB swap is readily susceptible to manipulation. In light of the potential need for further clarity on this question, the Commission therefore requests comment on whether it should consider adopting a safe harbor consisting of objective criteria for purposes of meeting the requirements of Section 3D(d)(1) of the Exchange Act with respect to Core Principle 3. If so, what would be appropriate objective criteria for such a safe harbor provision? Should the criteria relate to characteristics of the SB swap or the market for the underlying, or the procedures to be followed by the SB SEF in making a determination as to whether an SB swap is readily susceptible to manipulation, or a combination of both? For example, should the Commission consider adopting a safe harbor that includes thresholds relating to trading volume, number of holders, and/or market value of the underlying security or securities?¹⁷⁹ Should the criteria to be included in any safe harbor be the same as or different from any criteria that the Commission may adopt with respect to the mandatory clearing determination or the determination of when a SB swap is made available to trade? Commenters are requested to be as specific as possible as to what the appropriate criteria for a safe harbor would be.

Is the proposed periodic review requirement necessary or appropriate? Should the Commission define how frequently a SB SEF must review its determination that a SB swap is not readily susceptible to manipulation? If so, what would be an appropriate frequency for such a review?

X. Core Principle 4 – Monitoring of Trading and Trade Processing

Section 3D(d)(4) of the Exchange Act (Core Principle 4) requires a SB SEF to establish and enforce rules or terms and conditions defining or specifications detailing: (i) trading

¹⁷⁹ See supra note 176.

procedures to be used in entering and executing orders traded on or through the facilities of the SB SEF; and (ii) procedures for trade processing of SB swaps on or through the facilities of the SB SEF.¹⁸⁰ This Core Principle also requires SB SEFs to monitor trading in SB swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.¹⁸¹ The Commission is proposing Rule 813 of Regulation SB SEF to implement Core Principle 4. The Commission believes that the requirements of proposed Rule 813 would aid potential registrants in evaluating whether the rules they propose to implement and the mechanisms they would establish to monitor trading in SB swaps would comply with the Core Principle.

Proposed Rule 813(a) would implement the statutory language of the Core Principle. Proposed Rule 813(b) would require a SB SEF to have the capacity and appropriate resources to electronically monitor trading in SB swaps on its market by establishing an automated surveillance system, including real time monitoring of trading and the use of automated alerts, that is designed to detect and deter any fraudulent or manipulative acts or practices, including insider trading or other unlawful conduct or any violations of the rules of the SB SEF; to detect and deter market distortions or disruptions of trading that may impact the entry and execution of trading interest or the processing of trading interests; to conduct real-time monitoring of trading to provide for comprehensive and accurate trade reconstruction; and to collect and assess data to allow the SB SEF to respond promptly to market abuses or disruptions. The Commission preliminarily believes that requiring a SB SEF to establish such an automated surveillance

¹⁸⁰ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(4) of the Exchange Act).

¹⁸¹ Id.

system would enable the SB SEF to comply with the requirements of Core Principle 4 that SB SEFs monitor trading in SB swaps to prevent price manipulation, price distortion, and disruptions of the delivery or cash settlement process. In addition, Core Principle 4 specifically requires SB SEFs to have methods for conducting real-time monitoring of trading.¹⁸²

Proposed Rule 813(c) would require a SB SEF to establish and enforce rules that require any participant that enters an order, request for quote, or other trading interests, or executes any transaction on the SB SEF to maintain books and records of any such order, request for quote or other trading interests, or transaction, and any positions in any SB swap that is the result of any such order, request for quote, or other trading interest or transaction on the SB SEF, and to provide prompt access to such books and records to the SB SEF and the Commission. Finally, proposed Rule 813(d) would require a SB SEF to establish and maintain procedures to investigate possible rule violations, to prepare reports of the findings and recommendations of such investigations, and to take corrective actions, as necessary.

The proposed rule's requirement that participants maintain books and records of their activity on the SB SEF and make them available to the SB SEF and the Commission would aid the SB SEF in detecting and deterring fraudulent and manipulative acts with respect to trading on its market, as well as help it to fulfill the statutory requirement in Core Principle 4 that a SB SEF monitor trading in SB swaps, including through comprehensive and accurate trade reconstructions. The proposed rule also would aid the Commission in carrying out its responsibility to oversee the SB SEF. The proposed rule's requirement that the SB SEF establish and enforce procedures to investigate possible rule violations and prepare reports is designed to ensure that the SB SEF fulfills its statutory obligation under this Core Principle to prevent

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Id.

manipulation, price distortions, and disruptions in the market.

The Commission requests comment on all aspects of proposed Rule 813. Is the proposed rule sufficiently clear? Do commenters believe that SB SEFs would encounter issues in establishing an automated surveillance system for real-time monitoring of trading and in collecting or assessing data to allow the SB SEF to respond promptly to market abuses or disruptions? Would proposed Rule 813(c), which would require participants to provide access to their books and records to the SB SEF and the Commission, be difficult for any particular group of participants (e.g., non-registered ECPs or foreign participants) to comply with? If so, how should the Commission modify the rule to address any such issues?

Should SB SEFs be required to exchange information with each other regarding trading by their mutual participants to facilitate surveillance and investigation of potential manipulative or otherwise violative activity? If so, under what circumstances? Should SB SEFs be required to become members of the Intermarket Surveillance Group (“ISG”),¹⁸³ or to form a similar group among themselves? If so, should all SB SEFs be required to join? If not, what types of SB SEFs should be required to join? For example, should SB SEFs be required to join if they trade a certain volume threshold of SB swaps? If so, what should that volume threshold be? Should SB SEFs be required to share information with other regulatory authorities (including SROs)? For example, if a SB SEF detects an unusually high activity in a particular SB swap, what guidelines would be appropriate for the sharing of this information with the Commission and the other regulatory authorities that regulate the underlying asset?

¹⁸³ ISG was established in the early 1980s and is comprised of an international group of exchanges, market centers and market regulators. ISG states that its purpose is to effectively detect and prevent unfair transactions across markets through market information sharing among its members. See ISG’s website at www.isgportal.org for additional information on ISG.

XI. Core Principle 5 – Ability to Obtain Information

Section 3D(d)(5) of the Exchange Act (Core Principle 5) requires a SB SEF to establish and enforce rules that would allow the SB SEF to obtain any necessary information to perform any of the functions described in the Core Principles for SB SEFs, provide the information to the Commission on request, and have the capacity to carry out such international information-sharing agreements as the Commission may require.¹⁸⁴ To implement Core Principle 5, the Commission is proposing Rule 814 of Regulation SB SEF.

Proposed Rule 814(a) would require each SB SEF to establish and enforce rules requiring its participants to furnish to the SB SEF, upon request and in the form and manner prescribed by the SB SEF, any information that is necessary for the SB SEF to perform its responsibilities including, without limitation, surveillance, investigating, examinations and discipline of participants. Such information may include, without limitation, financial information, books, accounts, records, files, memoranda, correspondence, and any other information pertaining to orders, requests for quotes, responses, quotations, or other trading interest entered and transactions executed on or through the SB SEF.¹⁸⁵ Proposed Rule 814(a) further would require each SB SEF to establish and enforce rules requiring its participants to cooperate with the SB SEF and any representative of the Commission and allow access by the SB SEF and any

¹⁸⁴ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(5) of the Exchange Act).

¹⁸⁵ The requirement that SB SEF participants make, keep and preserve books and records is independent of proposed Rule 814. See 17 CFR 240.17a-3 and 240.17a-4, which are applicable to registered broker-dealers. See also Pub. L. No. 111-203, § 764(a) (adding Section 15F(f)(B) of the Exchange Act, requiring each registered SB swap dealer and major SB swap participant to keep books and records as may be prescribed by the Commission). See also proposed Rule 809(c)(2)(i), requiring registered SB swap dealers and registered major SB swap participants to meet the minimum recordkeeping and reporting requirements imposed by the Commission. With respect to eligible contract participants, proposed Rule 809(c)(2)(ii) would require eligible contract participants to meet the recordkeeping and reporting requirements established by the SB SEF pursuant to proposed Rule 813.

representative of the Commission at such reasonable times as the SB SEF or the Commission representative may request to examine the books and records of the SB SEF participant, or to obtain or verify other information related to orders, requests for a quote, responses, quotations, or other trading interest entered and transactions executed on or through, the SB SEF's facilities. These provisions would permit a SB SEF and any representative of the Commission to have access to any information that the SB SEF participants are required to make, keep, and preserve pursuant to any Commission or other rule, and should therefore assist the SB SEF to more effectively perform its obligations, as required by the Core Principles, and the Commission to perform its oversight responsibilities for SB SEFs.

Proposed Rule 814(b) would similarly require the SB SEF to cooperate with any representative of the Commission and allow access by any representative of the Commission to examine the books and records required to be kept by the SB SEF pursuant to proposed Rule 818, to obtain or verify other information related to orders, requests for quote, responses, quotations, or other trading interest entered and transactions executed on or through its facilities, and otherwise provide to any representative of the Commission, upon request, such information that the SB SEF may possess or obtain from its participants pursuant to proposed Rule 814(a). The Commission preliminarily believes that these provisions would be instrumental in enabling the Commission to carry out its oversight and regulation of SB SEFs and the SB swap market and would support the requirement in Core Principle 5 that the SB SEF establish and enforce rules that would allow the SB SEF to obtain any necessary information to perform any of the functions described in the Core Principles and provide the information to the Commission on request.

The Commission preliminarily believes that proposed Rule 814 would reasonably clarify the statutory language of Core Principle 5, which requires a SB SEF to have the ability to “obtain information” and “provide the information to the Commission on request.” Specifically, the Commission believes that it is important to its ability to regulate and oversee SB SEFs for the Commission to be able to obtain information by specifying that SB SEFs and SB SEF participants must cooperate, furnish information upon request, provide access to books and records, and be subject to examination.¹⁸⁶ These proposed requirements also would enable the SB SEF to monitor participants on its system and enforce compliance with its rules, as required by Section 3D(d) of the Exchange Act.

Further, proposed Rule 814(b)(3) would require a SB SEF to have the capacity to carry out such international information-sharing agreements as the Commission may require.¹⁸⁷ Proposed Rule 814(b)(4) would require every SF SEF to certify at the time of registration on Form SB SEF, and annually thereafter as part of the annual compliance report described in Rule 823, that the SB SEF has the capacity to fulfill its obligations under any international information-sharing agreements to which it is a party as of the date of such certification.

¹⁸⁶ The proposed requirements are analogous to the provisions of Section 17(b) of the Exchange Act, which provides that the records of a national securities exchange, among other things, shall be subject to reasonable periodic, special or other examinations by representatives of the Commission, and Rule 17a-4(j) under the Exchange Act, requiring exchange members, brokers and dealers to furnish promptly copies of records that are required to be preserved under the rule to representatives of the Commission. 15 U.S.C. 78q(b)(1) and 17 CFR 240.17a-4(j).

¹⁸⁷ The Commission notes that it is not unusual for a national securities exchange to enter into an information-sharing agreement with a foreign exchange for the purpose of securing information in connection with trading in securities on the foreign exchange that could impact the trading of securities on the U.S. exchange. *See, e.g.*, Securities Exchange Act Release No. 59835 (April 28, 2009), 74 FR 21041 (May 6, 2009) (noting, in connection with proposed listing standards, that NYSE Arca, Inc. had in place an information sharing agreement with the London Metal Exchange (“LME”) for the purpose of providing information in connection with trading in or related to futures contracts traded on LME.

These proposed regulations would implement the provision of Core Principle 5 requiring SB SEFs to have the capacity to carry out such international information-sharing agreements as the Commission may require. The Commission preliminarily believes that the proposed rule would help ensure that the SB SEF has the ability to fulfill its regulatory and reporting responsibilities with respect to its market place and its participants, and that the Commission has the information necessary to fulfill its oversight and regulatory responsibilities related to the SB swaps market. The proposed rule also would facilitate information-sharing in the global SB swaps market.

The Commission requests comment on all aspects of proposed Rule 814 relating to the ability to obtain information. Is the proposal that a SB SEF require its participants to furnish information upon request, cooperate with and provide access to the SB SEF too burdensome? Is the proposal that the SB SEF require its participants to furnish information upon request, cooperate with and provide access to any representative of the Commission appropriate?

Is the proposal to similarly require the SB SEF to furnish information upon request, cooperate with and provide access to any representative of the Commission at reasonable times as requested, appropriate? Are there other approaches that the Commission should take to implement the requirement that the SB SEF have the ability to obtain information and provide it to the Commission? Is there information that SB SEFs should be required to provide to the Commission on a regular, periodic basis? If so, what types of information should be provided in such a manner? How often should such information be provided?

Are there any other requirements with respect to international information-sharing agreements that a SB SEF should be required to comply with? Are the proposed requirements too burdensome? If so, why? What are the costs and benefits of the proposed requirements?

Should the Commission require a SB SEF to enter into information-sharing agreements with U.S. trading venues for SB swaps, as the Commission may require, or as necessary or appropriate to fulfill its regulatory and reporting responsibilities? Are there any other requirements with respect to domestic information-sharing agreements with which a SB SEF should be required to comply? If so, please explain.

XII. Core Principle 6 – Financial Integrity of Transactions

Section 3D(d)(6) of the Exchange Act (Core Principle 6) requires every SB SEF to establish and enforce rules and procedures for ensuring the financial integrity of SB swaps entered on or through the facilities of the SB SEF, including the clearance and settlement of SB swaps pursuant to Section 3C(a)(1) of the Exchange Act.¹⁸⁸ Pursuant to Section 3C(a)(1) of the Exchange Act, SB swap transactions must be cleared through a clearing agency registered with the Commission or a clearing agency exempt from registration, if the Commission has determined that the SB swap is required to be cleared.¹⁸⁹

The Commission believes that it is important that SB SEFs set specific standards designed to ensure the financial integrity of all their participants. Proposed Rule 815(a) would implement the requirements of Section 3D(d)(6) of the Exchange Act. Proposed Rule 815(b) would permit the rules of a SB SEF to allow a participant trading a SB swap that will not be cleared through a registered clearing agency to consider counterparty credit risk in selecting

¹⁸⁸ See Pub. L. No. 111-203, § 763(a) (adding Section 3C(a)(1) of the Exchange Act).

¹⁸⁹ The clearing requirement in Section 3C(a) of the Exchange Act contains certain exceptions. For example, Section 3C(g) of the Exchange Act states that a counterparty that is not a financial entity that is using a SB swap to hedge or mitigate commercial risk is not subject to the clearing requirement. Section 3C(g)(1)(C) requires each such counterparty to notify the Commission of how it generally meets its financial obligations associated with entering into non-cleared SB swaps. See Section 3C of the Exchange Act for all applicable exceptions and exemptions to the clearing requirements for SB swaps and the requirements relating to clearing agencies of SB swaps.

potential counterparties, notwithstanding the requirements of proposed Rule 810(b)(2).¹⁹⁰ The Commission believes that these requirements, taken together, should strengthen the financial integrity of SB swap transactions that occur on the SB SEFs by reducing the counterparty credit risks associated with uncleared SB swaps transactions.

As noted above,¹⁹¹ the Commission identified in the Regulation MC Proposing Release certain conflicts of interest that may provide incentives for certain dominant market participants to limit access by potential competing market participants to SB SEFs. A SB SEF could put in place participant standards, including capital requirements and other financial requirements, in a way that would unfairly restrict access to a SB SEF. For example, a SB SEF could have a very high capital requirement for participation that may exclude some smaller dealers from participation in the SB SEF. On the one hand, while appropriate participation standards, including financial requirements, would support this Core Principle that requires SB SEFs to have rules and procedures for ensuring the financial integrity of SB swaps entered on or through the facilities of the SB SEF, unduly high standards may without justification exclude persons who are otherwise qualified to trade on the SB SEF. On the other hand, the Commission is mindful that broadening access could come at the expense of sound risk management practices.

Thus, lessening capital or other financial requirements to increase participation beyond a certain level may increase the overall risk of the SB SEF's operations.

The Commission seeks comments on all aspects of this proposed Rule 815. The Commission seeks comments on whether an SB SEF should be prohibited from imposing higher

¹⁹⁰ Proposed Rule 810(b)(2) would prohibit a SB SEF's rules from unreasonably limiting any person in respect to access to the services offered by such SB SEF in an unfair or discriminatory manner. See supra Section VII for a discussion of proposed Rule 810(b)(2).

¹⁹¹ See supra Section VI, discussing access to SB SEFs.

capital requirements than the capital requirements imposed by any rules or regulations that the Commission may impose on participants of SB SEFs because such higher standards could be utilized as a means to deter access to a SB SEF. If such a prohibition were adopted, would it be appropriate for the SB SEF to tailor capital requirements to the status of the participant on an objective basis, e.g., having different capital requirements for a liquidity provider with market maker obligations than a participant without such obligations? If adopted, should such prohibition apply to trading in cleared and uncleared SB swaps? In addition, the Commission seeks comment on what additional safeguards, if any, would be necessary to ensure the financial integrity of SB swap transactions executed on a SB SEF. For swaps cleared by a registered clearing agency, should a SB SEF be required to ensure that it has the capacity to route transactions to the clearing agency? With respect to swaps that are not cleared, should a SB SEF be required to have rules requiring the transacting members to have entered into a credit arrangement for the transaction, demonstrate an ability to exchange collateral, and have appropriate credit filters in place?

XIII. Core Principle 7 – Emergency Authority

Section 3D(d)(7) of the Exchange Act (Core Principle 7) requires SB SEFs to adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any SB swap or to suspend or curtail trading in a SB swap.¹⁹² The Commission is proposing Rule 816 to implement Core Principle 7.

Proposed Rule 816(a) would require that every SB SEF establish rules and procedures to provide for the exercise of emergency authority, in consultation or cooperation with the

¹⁹² See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(7) of the Exchange Act).

Commission, as necessary or appropriate. "Emergency" would be defined in proposed Rule 800 to have the same meaning as set forth in Section 12(k)(7) of the Exchange Act.¹⁹³ The Commission believes that the definition of "emergency" in Section 12(k)(7) of the Exchange Act has the advantage of being broad enough to cover unusual or extreme circumstances without being unduly restrictive. The Commission also believes that the proposed use of the Exchange Act's definition of emergency would foster consistency among rules regarding the exercise of emergency authority and promote the use of a consistent definition across securities markets generally.

Proposed Rule 816(c) would require that every SB SEF have rules that permit the SB SEF to immediately take any or all of the following actions during an emergency: (1) impose or modify trading limits, price limits, position limits, or other market restrictions, including suspending or curtailing trading on its market in any SB swap or class of SB swaps; (2) extend or shorten trading hours; (3) coordinate trading halts with markets trading a security or securities underlying any SB swap; (4) coordinate with a registered clearing agency to liquidate or transfer positions in any open SB swap of one of its participants; and (5) any action directed by the Commission. The Commission preliminarily believes that the actions proposed in proposed Rule 816(c)(1) through (4) would be important powers for a SB SEF to have immediately without the need to seek additional authority from the Commission when an emergency has occurred. The

¹⁹³ See 15 U.S.C. 78l(k)(7) (defining the term emergency to mean "(A) a major market disturbance characterized by or constituting—(i) sudden and excessive fluctuations of securities prices generally, or a substantial threat thereof, that threaten fair and orderly markets; or (ii) a substantial disruption of the safe or efficient operation of the national system for clearance and settlement of transactions in securities, or a substantial threat thereof; or (B) a major disturbance that substantially disrupts, or threatens to substantially disrupt—(i) the functioning of securities markets, investment companies, or any other significant portion or segment of the securities markets; or (ii) the transmission or processing of securities transactions."

proposed rule would enable a SB SEF to respond promptly during an emergency to maintain fair and orderly markets and foster market integrity and efficiency when ordinary authority would be insufficient.

In light of the breadth of the proposed emergency authority for SB SEFs, proposed Rule 816 also would require that every SB SEF have rules governing the exercise of such emergency authority. Pursuant to proposed Rule 816(b), SB SEF rules and procedures would be required to specify: the person or persons authorized by the SB SEF to declare an emergency; how the SB SEF would notify the Commission and the public of its decision to exercise its emergency authority; the processes for decision making by facility personnel with respect to exercise of emergency authority, including alternate lines of communication and guidelines to avoid conflicts of interest in the exercise of such authority; and the processes for determining that an emergency no longer exists and notifying the Commission and the public of such decision. The Commission believes that it is important that SB SEFs put in place a process for exercising emergency authority in order to help ensure that a SB SEF is prepared prior to any emergency situation and to help ensure that a SB SEF exercises emergency authority appropriately and uniformly.

Proposed Rule 816(d) would require every SB SEF to promptly notify the Commission of the exercise of its emergency authority and, within two weeks following cessation of the emergency, submit written documentation explaining the basis for declaring an emergency, how conflicts of interest were minimized, and the extent to which the facility considered the effect of its emergency action on the markets for the SB swap and any security or securities underlying the SB swap. Proposed Rule 816(d) also would provide that, if a SB SEF implements any rule or rule amendment in the exercise of its emergency authority, it shall file such rule or rule

amendment with the Commission pursuant to Rule 806 prior to the implementation of such rule or rule amendment, or, if not practicable, within 24 hours after implementation of such rule or rule amendment. The Commission preliminarily believes that while it is important to provide SB SEFs with the tools necessary to react in emergency situations, requiring SB SEFs to submit a notice and, if applicable, file a certified emergency rule or rule amendment in accordance with proposed Rule 806, would help to deter SB SEFs from using such tools inappropriately. In addition, requiring a SB SEF to notify the Commission and, if applicable, file a certified emergency rule or rule amendment, would allow the Commission to determine whether a SB SEF acted in compliance with proposed Rule 816 and should provide the Commission timely information with respect to the actions taken in any emergency situation.

While some national securities exchanges have rules providing for the exercise of emergency authority by the exchange,¹⁹⁴ there is no specific Commission rule detailing how national securities exchanges should address the issue of emergency authority. In light of the mandate in Core Principle 7 that SB SEFs adopt rules governing the exercise of emergency authority, and in light of the fact that it is likely the same entities will be registered as SB SEFs and SEFs, the Commission's approach to implementing Core Principle 7 is guided by the approach the CFTC has taken with respect to the CEA's requirement that a designated contract market adopt rules to provide for the exercise of emergency authority.¹⁹⁵

¹⁹⁴ See, e.g., NYSE Rule 49 and Nasdaq Bylaws Article IX, Section 5.

¹⁹⁵ See Section 5(d) of the CEA, 7 U.S.C. 7(d) (requiring a board of trade to adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the CFTC, where necessary and appropriate). See also 17 CFR 38, Appendix B to Part 38 implementing Section 5(d) of the CEA. Appendix B to Part 38 provides, in part, that a designated contract market should have clear procedures for the exercise of emergency authority and should, among other things, be able to impose or modify price limits, order the liquidation or transfer of open positions, order the fixing of a settlement price, order a reduction in positions, extend or shorten the expiration date or the trading hours, suspend

The Commission generally requests comment on all aspects of the proposed rule regarding emergency authority. Additionally, the Commission requests comments as to whether the proposed list of emergency actions that a SB SEF may take is appropriate. Are there any additional actions that should be included? Are there any proposed actions that should not be included? Why or why not?

The Commission notes that it is common for a national securities exchange to consult and cooperate with the Commission prior to responding to highly unusual or emergency market conditions and expects that a SB SEF would likely do the same before exercising its emergency authority pursuant to proposed Rule 816. However, the Commission requests comment on whether it should require that a SB SEF consult and cooperate with the Commission before it takes any emergency action. Why or why not? Is the proposed definition of emergency appropriate? Is there another definition of emergency that would be more appropriate? Would it be preferable for the Commission not to define the term emergency? If not, why not? The Commission further requests comment on whether the proposed list of rules specifying processes for exercising emergency authority in proposed Rule 816(b) is appropriate. Are there any additional processes that should be included? Are there any proposed processes that should not be included? Why or why not?

XIV. Core Principle 8 – Timely Publication of Trading Information

Section 3D(d)(8) of the Exchange Act (Core Principle 8) requires SB SEFs to make public timely information on price, trading volume, and other trading data on SB swaps to the

or curtail trading on the market, order the transfer of customer contracts and the margin for such contracts from one member including non-intermediated market participants of the contract market to another, or alter the delivery terms or conditions, or, if applicable, should provide for such actions through its agreements with its third-party provider of clearing services.

extent prescribed by the Commission and to have the capacity to electronically capture and transmit and disseminate trade information with respect to transactions executed on or through the facility.¹⁹⁶ Section 13(m)(1) of the Exchange Act separately authorizes the Commission to make SB swap transaction, volume and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery.¹⁹⁷ The Commission has separately proposed rules relating to the reporting and public dissemination of SB swap transaction and pricing data.¹⁹⁸

To implement Core Principle 8, the Commission is proposing Rule 817. Proposed Rule 817(a) enumerates the requirements of Section 3D(d)(8) of the Exchange Act. Thus, every SB SEF would be required to: (1) have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF; and (2) make public timely information on price, trading volume, and other trading data on SB swaps, to the extent and in the manner prescribed by the Commission. As noted, the Commission has separately proposed rules relating to the public dissemination of SB swap transaction and pricing data.¹⁹⁹ The Commission is not at this time

¹⁹⁶ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(8) of the Exchange Act).

¹⁹⁷ See Pub. L. No. 111-203, § 763(i), (adding Section 13(m) of the Exchange Act).

¹⁹⁸ The Commission recently proposed Regulation SBSR that would require reporting and real-time public dissemination of certain information regarding SB swap transactions. Proposed Regulation SBSR identifies the SB swap information that would be required to be reported and disseminated, establishes reporting obligations, and specifies the time frames for reporting and disseminating. Proposed Regulation SBSR would require a registered SDR to publicly disseminate certain SB swap information that is reported to it in real time. See Reporting and Dissemination Release, supra note 6.

¹⁹⁹ Id.

proposing any additional requirements on SB SEFs relating to the public dissemination of such data.²⁰⁰

In addition, proposed Rule 817(b) would require that, if any SB SEF makes available information regarding a SB swap transaction to any person other than a counterparty to the transaction, then the SB SEF must make that information available to all participants on terms and conditions that are fair and reasonable and not unfairly discriminatory. This proposed requirement is designed to prevent a SB SEF from providing information on SB swap transactions to certain persons (other than counterparties) and not to others, or provide such information pursuant to different terms that are not justified. The Commission believes that fair, reasonable, non-discriminatory access to market information is essential to providing a level playing field for all market participants and that the proposed requirement in Rule 817(b) would prevent developments in the SB swap market that could undermine the goal of post-trade price transparency.

Proposed Rule 817(c) would also prohibit a SB SEF from making any information regarding a SB swap transaction publicly available prior to the time a SDR is permitted to do so under proposed Rule 902 of Regulation SBSR under the Act.²⁰¹

²⁰⁰ The rules proposed by the Commission pursuant to Section 13(m) of the Exchange Act would limit the public dissemination of SB swap transaction information by any person other than a registered SDR. Specifically, proposed Rule 242.902(d) of Regulation SBSR would prohibit any person other than a registered SDR from making available to one or more persons (other than a counterparty) information relating to a SB swap before the earlier of: (1) 15 minutes after the time of execution of the SB swap; or (2) the time that a registered SDR publicly disseminates a report of that SB swap. This prohibition on dissemination to one or more persons (other than a counterparty) during such time period would apply to SB SEFs and its participants, as it would to all other persons. See Reporting and Dissemination Release supra note 6.

²⁰¹ The Commission recently proposed Regulation SBSR, which would require reporting and real-time public dissemination of certain information regarding SB swap transactions. Proposed Regulation SBSR identifies the SB swap information that would be required to

The Commission understands, however, that for business reasons counterparties to a SB swap transaction may prefer to have a SB SEF act as its reporting agent for purposes of complying with the counterparty's responsibility under proposed Regulation SBSR to report required transaction information to a registered SDR. Proposed Rule 817(b) therefore would permit a SB SEF, acting as agent, to report transaction information on behalf of a counterparty responsible for submitting transaction information to a registered SDR. Under proposed Rule 817(c), SB SEFs would be permitted to publicly disseminate SB swap transaction information, but could not do so prior to the time SDRs would be permitted to do so under proposed Rule 902 of Regulation SBSR under the Act. Thus, a SB SEF could not publicly disseminate complete transaction reports for block trades (i.e., including the transaction ID and the full notional size) until the times specified in Rule 902(b)(1) through (3).²⁰²

The Commission believes that its proposed rules for implementation of Core Principle 8 would clarify the extent and manner in which SB SEFs could make information on transactions executed on the SB SEF available in a manner consistent with the requirements of proposed Regulation SBSR. The Commission requests comment on all aspects of proposed Rule 817 with respect to the timely publication of trading information. Additionally, the Commission requests comment on whether the proposed role of SB SEFs in the public dissemination of transaction

be reported and disseminated, establishes reporting obligations, and specifies the timeframes for reporting and disseminating. Proposed Regulation SBSR would require a registered SDR to publicly disseminate certain SB swap information that is reported to it in real time. See Reporting and Dissemination Release supra note 6.

²⁰² As proposed, subject to some exceptions, Rule 902(b) of Regulation SBSR would prohibit the public dissemination of the complete transaction report of a block trade (including the transaction ID and the full notional size): (1) executed on or after 5:00 UTC and before 23:00 UTC of the same day, until 7:00 UTC of the following; and (2) executed on or after 23:00 UTC and up to 5:00 UTC of the following day, until 13:00 UTC of that following day.

information is appropriate. Should SB SEF's be able to compete with SDRs for potential customers of transaction data? How, if at all, would the prohibition on dissemination of transaction information in proposed Rule 902 of Regulation SBSR impact the development of the market for SB swaps? Should the Commission prohibit a SB SEF from disseminating the full size of a block trade after the period specified in Rule 902(d), which could be after 15 minutes, but before a SDR has disseminated the full size of the block trade? Would such a prohibition be necessary? Or is it reasonable to expect that a SB SEF would not disseminate block trade information before a SDR if the SB SEF's market participants did not want dissemination of such information? With respect to data that a SDR is required to disseminate under proposed Rule 902 of Regulation SBSR, would proposed Rule 817(c) be effective in ensuring that SB SEF data feeds do not have any advantage over SDR data feeds? If not, should the proposed rule be revised, and if so, how so? Are SB SEFs likely to sell or otherwise disseminate market data following dissemination of data by a registered SDR? If not, why not?

XV. Core Principle 9 – Recordkeeping

Section 3D(d)(9) of the Exchange Act (Core Principle 9) requires SB SEFs 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. This Core Principle also requires SB SEFs to report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Exchange Act. In addition, this Core Principle requires the Commission to adopt data collection and reporting requirements for SB SEFs that are comparable to corresponding requirements for clearing agencies and SDRs.

The Commission is proposing Rule 818 setting forth the recordkeeping and reporting obligations of SB SEFs to implement this Core Principle. This proposed rule is comparable to the recordkeeping and reporting obligations of national securities exchanges and ATSS under the Exchange Act.²⁰³

Proposed Rule 818(a) would require every SB SEF to keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records, including the audit trail records, as shall be made and received in the conduct of its business. Proposed Rule 818(b) would require SB SEFs to keep and preserve such documents and other records for a period of not less than five years, the first two years in an easily accessible place. Proposed Rule 818(c) would require SB SEFs to establish and maintain the records necessary to create a meaningful audit trail. Specifically, the Commission proposes that SB SEFs establish and maintain accurate, time-sequenced records of all inquiries, responses, orders, quotations or other trading interest, and transactions that are received by, originated on, or executed on the SB SEF.²⁰⁴ These records must include the key terms of each inquiry, response, order, quotation or other trading interest or transaction and must document the complete life of each inquiry, response, order, quotation or other trading interest or transaction on the SB SEF, including any modification, cancellation, execution, or any other action taken with respect to such order, inquiry, response, quotation, or transaction.²⁰⁵ Further, proposed Rules 818(e) and (f) would require a SB SEF to report to the Commission such information as the Commission may, from time to time, determine to be necessary for the Commission to perform its duties under the Exchange Act, and upon request of any representative of the

²⁰³ See, e.g., 17 CFR 240.17a-1, 240-17a-3, and 17a-4, and 17 CFR 242.301-03.

²⁰⁴ Id.

²⁰⁵ See proposed Rule 818(c).

Commission, to promptly furnish to each representative copies of any documents, in such form and manner acceptable to such representative, required to be kept and preserved by the SB SEF pursuant to proposed Rules 818(a) and (b).

The Commission would use the information required under proposed Rules 818(a) through (c) to carry out its oversight responsibility over SB SEFs. The records required to be kept, maintained, and provided to the Commission under these provisions would provide an additional tool to help the Commission to determine whether a SB SEF is operating in compliance with the Exchange Act and the rules and regulations thereunder. The audit trail information required to be maintained under proposed Rule 818(c) would facilitate the ability of the SB SEF and the Commission to examine the complete history of all trading interest entered into and transactions executed on a SB SEF. This audit trail information would help the SB SEF and the Commission to detect and deter fraudulent and manipulative acts and prepare reconstructions of activity on a SB SEF or in the SB swaps market, and generally to understand the causes of unusual market activity.

Proposed Rule 818(d) would require a SB SEF to establish, maintain, and enforce written policies and procedures to verify the accuracy of the transaction data it collects and reports.²⁰⁶ This requirement is based on the premise that transaction data is only useful if it is accurate. If it is not accurate, then it will not enhance transparency. The SB swaps market participants must be able to trust that the information they receive is accurate in order to make appropriate investment decisions. Further, a SB SEF must have accurate information if it is to effectively carry out its

²⁰⁶ Nothing in proposed Regulation SBSR would prohibit a SB SEF from serving as the reporting agent on behalf of the counterparty with the obligation to report a trade to the SDR, if the counterparty effected the trade on the SB SEF. See Reporting and Dissemination Release, supra note 6.

obligations to surveil the market and enforce its rules. Similarly, the Commission must be able to trust that the information it receives is accurate so that it can oversee the market and properly determine whether the SB SEF is carrying out its statutory mandate.

The Commission requests comment on all aspects of proposed Rule 818. Are the documents required to be preserved pursuant to proposed Rule 818(a) appropriate? Are there additional documents that a SB SEF should be required to preserve? Is the proposed time period for record retention appropriate? Should SB SEF's be required to keep such records for a longer or shorter period of time? Are the records required to be preserved to maintain an audit trail pursuant to proposed Rule 818(c) appropriate? Are there additional records that a SB SEF should be required to keep? Should the Commission require SB SEFs to keep audit trail records in a particular format? What are the benefits and drawbacks of allowing each SB SEF to determine its own format to keep audit trail records? Would allowing each SB SEF to determine its own format for the maintenance of an audit trail hamper the Commission's ability to analyze trading activity across multiple SB SEFs? If yes, then how?

Is it appropriate to require SB SEFs to have policies and procedures to verify the accuracy of transaction data? If not, why not? In the absence of such requirements, how should the Commission ensure the integrity of transaction data that originates on or passes through a SB SEF? What are the specific benefits and drawbacks of any suggested approaches?

Proposed Rules 818(e) and (f) require a SB SEF to promptly furnish information and records required to be kept under the Rule to the Commission upon request. What, if any, additional reports or records should be furnished to the Commission upon request? What, if any, reports or records should the Commission require on a periodic basis? A SB SEF is required to promptly furnish information to the Commission in a manner that is acceptable to the

Commission. Are there particular time or format constraints or challenges that the Commission should be aware of with respect to such requests? Would the recordkeeping and reporting requirements be overly burdensome to SB SEFs? If so, why? Or, should the Commission require SB SEFs to provide the Commission direct electronic access to such information and records? Would such direct access be more or less burdensome to SB SEFs than the proposed requirements? If so, what requirements should the Commission consider limiting to reduce the burdens? What would be the basis, if any, to justify reducing the recordkeeping and reporting requirements for SB SEFs that are, as proposed, comparable to requirements for national securities exchanges that also trade SB swaps?

XVI. Core Principle 10 – Antitrust Concerns

Section 3D(d)(10) of the Exchange Act (Core Principle 10)²⁰⁷ provides that, unless necessary or appropriate to achieve the purposes of the Exchange Act, a SB SEF shall not: (1) adopt any rules or take any actions that result in any unreasonable restraint of trade, or (2) impose any material anticompetitive burden on trading or clearing. The Commission is proposing to implement this Core Principle in proposed Rule 819 by incorporating the statutory language.²⁰⁸ The Commission requests comment on all aspects of the proposed Rule 819. What

²⁰⁷ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(10) of the Exchange Act).

²⁰⁸ As discussed further in Section XVII below, the Commission proposed a number of requirements in Regulation MC designed to mitigate conflicts of interest relating to SB SEFs. The additional rules the Commission is proposing herein are designed to work together with proposed Regulation MC to help mitigate potential conflicts of interest, as identified in the Regulation MC Proposing Release. In addition, as discussed in Section XVII, the Commission is proposing governance rules that also are designed to help mitigate potential conflicts of interest relating to SB SEFs.

The Commission notes that the statutory language of Section 3D(d)(10)(B) of the Exchange Act differs somewhat from the requirements in the Exchange Act relating to national securities exchanges. Section 6(b)(8) of the Exchange Act, 15 U.S.C. 78f(b)(8), requires that the rules of a national securities exchange not impose any burden on

do commenters believe would be a “material anticompetitive burden” on trading and clearing? Should the Commission prescribe specific rules or offer guidance to address such situations?

XVII. Core Principle 11 – Conflicts of Interest

Section 3D(d)(11) of the Exchange Act (Core Principle 11) 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.²⁰⁹ Pursuant to this directive, the Commission is proposing Rule 820 to mitigate conflicts of interest through governance arrangements applicable to SB SEFs.

The Commission recently proposed new Regulation MC as part of its rulemaking²¹⁰ mandated by Section 765 of the Dodd-Frank Act.²¹¹ Section 765 of the Dodd-Frank Act requires the Commission to adopt rules to mitigate specified conflicts of interest relating to SB SEFs, security-based swap clearing agencies, and SBS exchanges.²¹² As the Commission explained in the Regulation MC Proposing Release, a conflict of interest could arise when a small number of market participants exercise control or influence over a SB SEF, either through ownership of voting interests or participation in the governance of the SB SEF. When a small group of market participants also dominate much of the trading in SB swaps, control of a SB SEF by these participants raises a heightened concern. Such market participants, through ownership interest in or influence over the governance of a SB SEF, potentially could exercise their influence to limit the number of direct participants in the SB SEF and restrict the scope of SB swaps that are listed

competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

²⁰⁹ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(11) of the Exchange Act).

²¹⁰ See Regulation MC Proposing Release, supra note 82.

²¹¹ See Pub. L. No. 111-203, § 765.

²¹² Id.

for trading on a SB SEF in an effort to limit competition and increase their ability to maintain higher profit margins.²¹³ The Commission also believes that a SB SEF's ownership and governance structure could create an incentive for behaviors that would promote its owners' commercial interests over its market oversight responsibilities.²¹⁴ Each of these potential conflicts of interest could limit the benefits of centralized trading in the SB swap market and potentially undermine the mandatory trading requirement in Section 3C(h) of the Exchange Act, thereby negatively affecting efficiency and competition in the SB swap markets.²¹⁵

Accordingly, the Commission proposed in Regulation MC to, among other things, impose a 20% limit on ownership (based on interests entitled to vote) and voting interest by any direct participants of SB SEFs; require the board of a SB SEF be composed of a majority of independent directors; require a fully independent nominating committee; require a fully independent ROC; and require the SB SEF to inform the Commission when a recommendation of the ROC is not implemented by the board.²¹⁶

As discussed above, in this proposal, the Commission is proposing rules relating to impartial access to SB SEFs and a review process for those SB swaps to be traded on a SB SEF, that are designed to work together with Regulation MC to help mitigate potential conflicts of

²¹³ See Regulation MC Proposing Release, 75 FR at 65890, supra note 82.

²¹⁴ The Commission notes that an entity that registers as a SB SEF would have oversight responsibility over its market pursuant to the Exchange Act (as amended by the Dodd-Frank Act), and rules adopted thereunder. See Pub. L. No. 111-203, § 763(c). Similarly, all national securities exchanges, including those that may post or make available for trading SB 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).

²¹⁵ See Pub. L. No. 111-203, § 763(a). Section 3C(h) of the Exchange Act imposes a mandatory trading requirement, which provides that counterparties shall execute a transaction in a SB 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).

²¹⁶ See Regulation MC Proposing Release, supra note 82.

interest.²¹⁷ As described in this section, the Commission also is proposing additional governance rules that are designed to mitigate potential conflicts of interest.²¹⁸ The proposed rules in this proposal – regarding both impartial access and governance – seek to address the same conflicts of interest issues as identified in proposed Regulation MC, but using different mechanisms. The Commission will consider both rulemaking proposals as a whole, including how they interact with each other, when considering how best to address these conflicts of interest issues. As requested in detail below, in reviewing the proposed rules, commenters are encouraged to do the same.

The Commission’s proposal for SB SEFs is informed by the Commission’s experience with national securities exchanges. Historically, national securities exchanges were owned by their members and were structured as not-for-profit or similar organizations.²¹⁹ With the advent of shareholder-owned exchanges, the Commission became concerned that the introduction of a class of owner that does not trade on the exchange could exacerbate the possibility that an exchange would put its commercial interests ahead of its responsibilities as a regulator.²²⁰ The Commission also recognizes the potential for any person that directly or indirectly controls an

²¹⁷ See supra Sections VI and VII.

²¹⁸ See proposed Rule 820.

²¹⁹ 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).

²²⁰ See, e.g., Securities Exchange Act Release No. 62158 (May 24, 2010), 75 FR 30082 (May 28, 2010) (order approving the demutualization of CBOE) (“Exchange Act Release No. 62158”).

exchange or facility thereof to direct its operation so as to cause the exchange to neglect its regulatory obligations under the Exchange Act or to improperly interfere with or restrict the ability of the Commission to effectively carry out its oversight responsibilities.²²¹

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.²²² To address these types of concerns, the Commission has approved proposed procedures, consistent with the requirements of Section 6 of the Exchange Act,²²³ for an approach to mitigate conflicts of interest for national securities exchanges through the Commission's review of proposals by exchanges with respect to their ownership²²⁴ and governance structures (generally from member-owned to shareholder-owned organizations) or of applications by entities to register as national securities exchanges.²²⁵ In its review, the

²²¹ Because ATSS do not have the regulatory obligations that are required of national securities exchanges under the Exchange Act, the Commission has not to date required ATSS to have governance structures that are similar to those of national securities exchanges.

²²² 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 as the trading of SB Swaps moves to regulated markets. However, the Commission recognizes that a SB SEF's regulatory obligations are not the same as a national securities exchange's regulatory obligations.

²²³ See Section 6(b) of the Exchange Act, 15 U.S.C. 78f(b).

²²⁴ The Commission is not proposing rules with respect to ownership and voting limitations for SB SEFs as part of this rulemaking. The Commission has proposed ownership and voting limitations for participants in a SB SEF, as well as for participants in a SBS exchange, as part of Regulation MC. See proposed Rule 702 of Regulation MC.

²²⁵ See, e.g., Exchange Act Release No. 62158, supra note 220; Securities Exchange Act Release No. 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"); Securities Exchange Act Release No. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (In the Matter of the Application of

Commission has examined the way in which an exchange addresses certain governance principles. Among other things, the Commission looks to assure that an exchange provides fair representation of members in the selection of directors and the administration of its affairs, and provide that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, broker or dealer, consistent with the requirement in Section 6(b)(3) of the Exchange Act.²²⁶

To complement the governance requirements proposed in Regulation MC, the Commission proposes additional substantive requirements with respect to the governance of SB SEFs that are designed to address the conflict of interest concerns identified above. The Commission proposes that SB SEF participants be provided “fair representation” in the selection of directors of the SB SEF and administration of its affairs. Thus, the proposed rule would require the rules of a SB SEF to assure a fair representation of its participants²²⁷ in the selection of its directors and administration of its affairs, but no less than 20% of the total number of

BATS Exchange, Inc. for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission) (“Exchange Act Release No. 58375”); and Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (order approving the merger of NYSE and Archipelago and NYSE’s demutualization).

²²⁶ 15 U.S.C. 78f(b)(3). Specifically, Section 6(b)(3) of the Exchange Act requires that the rules of an exchange assure a fair representation of its members in the selection of its directors and administration of its affairs, and must provide that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, broker or dealer. 15 U.S.C. 78f(b)(3). Pursuant to Section 6(b)(3), the Commission has approved SRO rules requiring that at least 20% of the directors on the board be selected by exchange members, as well as SRO rules requiring that exchange members be permitted to participate in the nomination process of such representative directors, with the right to petition for alternative candidates. See, e.g., Exchange Act Release No. 58375, 73 FR at 49500, id.

²²⁷ See proposed Rule 800 (defining the term “participant” as a person that is permitted to directly engage in or effect transactions on the SB SEF).

directors of the SB SEF must be selected by the SB SEF's participants.²²⁸ The Commission preliminarily believes that the proposed 20% requirement strikes a proper balance by giving SB SEF participants a practical voice in the governance of the SB SEF and the administration of its affairs, without undermining the overall independence of the Board.²²⁹

To ensure that SB SEF participants truly have a voice in the selection of directors, the Commission also proposes that SB SEF participants be permitted to participate in the nomination process of such representative directors, with the right to petition for alternative candidates. The proposed rule would require the rules of a SB SEF to establish a fair process for SB SEF participants to nominate an alternative candidate or candidates to the Board by petition and the percentage of SB SEF participants that is necessary to put forth such alternative candidate or candidates.²³⁰ A SB SEF would have some flexibility in implementing a fair process for members to select Board candidates.²³¹ In adopting such rules, a SB SEF should endeavor to

²²⁸ See proposed Rule 820(a). The Commission notes that national securities exchanges have established a 20% member director requirement for their boards of directors. See, e.g., EDGX Exchange, Inc. Amended and Restated Bylaws, Article III, Section 2(a)(iv) and BATS Y-Exchange Amended and Restated by-Laws Article III, Section 2(b)(ii).

The Commission proposes to define the term "Board" as the Board of Directors or Board of Governors of the SB SEF or any equivalent body. See proposed Rule 800 under Regulation SB SEF. The proposed definition is substantially identical to that proposed in the Regulation MC Proposing Release with respect to SB SEFs. See *supra* note 82.

²²⁹ Proposed Regulation MC would require that a Board of a SB SEF be composed of a majority of independent directors. See proposed Rule 702(c)(1) under proposed Regulation MC and the Regulation MC Proposing Release, *supra* note 82.

²³⁰ See proposed Rule 820(c).

²³¹ The Commission notes that national securities exchanges have implemented the 20% member director requirement by various means. For example, the BATS Y-Exchange, Inc. has a separate member nominating committee that will nominate candidates for each member representative director position on the exchange's board. BATS Global Markets, as the sole shareholder of BATS Y-Exchange, Inc., will elect those candidates nominated by the member nominating committee as member representative directors. See BATS Y-Exchange Amended and Restated by-Laws Article III, Section 4.

strike an appropriate balance that provides SB SEF participants a practical mechanism to put forth alternative candidates, without jeopardizing the overall integrity of the nominating process. The SB SEF participant candidates, of course, would be required to satisfy all relevant eligibility criteria for directors.

Further, the Commission proposes that SB SEF participant-owners be restricted in their ability to participate in the “fair representation” process. The rules of a SB SEF would therefore require the SB SEF to preclude any SB SEF participant, or any group or class of participants, either alone or together with its related persons, that beneficially owns, directly or indirectly, an interest in the SB SEF from dominating or exercising disproportionate influence in the selection of the fair representation directors if the participant or participants may thereby dominate or exercise disproportionate influence in the selection or appointment of the entire Board.²³² For example, if a group of five participants together owned the SB SEF and, as a result of such ownership, were effectively able to select the directors on the Board of the SB SEF, those owners would be precluded from also being the fair representation directors on the Board. The Commission believes that such a requirement should help mitigate any conflicts of interest that may arise between SB SEF participants who are also owners of the SB SEF. Given the nature of the conflict concerns for the trading of SB swaps and the structure of the SB swaps market—namely, the dominance by a small group of dealers and the concerns with respect to undue influence in the operation of the SB SEF²³³—the Commission believes that it is necessary and appropriate for the Commission to require that a SB SEF take means to prevent a SB SEF

²³² See proposed Rule 820(a).

²³³ For further discussion of the current structure of the SB swaps market, see the Regulation MC Proposing Release, supra note 82, at Section III.B.

participant or group of participants from exerting undue influence in the nomination and selection of the entire Board.

Finally, the Commission proposes that at least one director on the Board of a SB SEF shall be representative of investors who are not SB swap dealers or major SB swap participants and such director must not be a person associated with a SB SEF participant.²³⁴ The Commission believes that requiring representation by investors who are not SB swap dealers or major SB swap participants, or associated with SB SEF participants, would provide an important perspective to the governance and administration of a SB SEF. Investor directors could provide unique and different perspectives from dealers and other participants of the SB SEF, which should enhance the ability of the Board to address issues in an impartial fashion and consequently support the integrity of a SB SEF's governance.

The Commission believes that the proposed governance requirements, described above, are important to help ensure that all SB SEF participants and investors have a voice in the administration and governance of the SB SEF. The proposed requirements should reduce the possibility that a single group of market participants has the ability to unfairly disadvantage other market participants through the SB SEF governance process. Moreover, the proposed requirements for SB SEFs would be consistent with Exchange Act requirements for national

²³⁴ See proposed Rule 820(b). The term "person associated with a participant" is proposed to mean any partner, officer, director, or branch manager of such 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 participant, or any employee of such participant. See proposed Rule 800. The proposed definition is substantially identical to the definition of "person associated with a security-based swap execution facility participant" that has been proposed under Regulation MC. See proposed Rule 700(t) under Regulation MC and Regulation MC Proposing Release, *supra* note 82.

securities exchanges.²³⁵ The Commission believes that similar requirements for SB SEFs would help to minimize conflicts of interest in the SB SEF decision-making process.

The Commission requests comments on all aspects of the proposed rules related to governance of the SB SEF. Are there provisions of the proposed rules that are unnecessary or are there other provisions that should be added? If so, why? Are there aspects of the proposed rules that would be difficult for SB SEFs to implement and, if so, why would that be the case?

Should the Commission adopt compositional requirements to provide certain constituencies a guaranteed voice in the selection of the SB SEF's directors and the administration of its affairs, in addition to those proposed? For example, the proposed "fair representation" requirement relates to the fair representation of a SB SEF's participants. Should the requirement instead specifically require fair representation of specific categories of participants, such as SB swap dealers and major SB swap participants? Are there constituencies that commenters believe should be entitled to representation in the election of the Board of a SB SEF that are not addressed in this proposal?

Should the "fair representation" proposal be broadened to include non-participant dealers? Would representation by non-participant dealers be useful to help assure that SB SEFs implement rules and procedures that are designed to provide impartial access? If commenters believe that such representation should be required, should non-participant dealers be provided representation in addition to any required independent directors,²³⁶ or should they be a subset of independent directors?

Are the provisions relating to the "fair representation" requirements appropriate? Should the proposed 20% minimum threshold for "fair representation" be higher or lower? Do

²³⁵ See Section 6(b)(3) of the Exchange Act, 15 U.S.C. 78f(b)(3).

²³⁶ See Regulation MC Proposing Release, *supra* note 82.

commenters agree that it is appropriate for a SB SEF to restrict the ability of a SB SEF participant that is also an owner to dominate or exercise influence in the selection of "fair representation" directors, particularly if the SB SEF would thereby dominate the selection or appointment of the entire Board? If not, why not? If so, why? Is the proposed rule's requirement that the Board include at least one investor representative appropriate? Should SB SEFs be required to have more than one investor representative on its Board? If so, how many, and why?

Should the Commission require a specific percentage of the total number of SB SEF participants to put forth alternative member candidate or candidates by petition that would be required to be set forth in the SB SEF's rules? If so, what percentage would be appropriate? In the SRO Governance Proposing Release, the Commission proposed a threshold of 10% as the percentage of members necessary to put forth an alternative member candidate or candidates for the exchange board of directors.²³⁷ Would a 10% threshold be appropriate for SB SEFs as well? Should investors who are not SB SEF participants be provided with further representation in the governance and administration of a SB SEF beyond representation on the SB SEF Board?²³⁸ Should the Commission require SB SEFs to have a participation committee that would, for example, determine the standards and requirements for participant eligibility and review denials

²³⁷ See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) at 71137-71138. See also, e.g., NASDAQ Stock Market LLC, Bylaws, Article II, Section 1(b)(ii) stating that Nasdaq members may submit a petition in support of an alternate candidate (i.e., candidate not selected by the nominating committee) provided that the petition is executed by "10% or more of all Nasdaq Members."

²³⁸ See discussion *supra* at Section VIII.B discussing proposed Rule 811(c)(2), which would provide that the SB SEF must establish a swap review committee that would provide for the fair representation of participants of the SB SEF and other market participants, such that each class of participant and other market participants would be given the right to participate in such committee and no single class of participant or category of market participant would predominate.

of participation applications? If so, should there be any requirements as to the composition of such a committee? For example, should any such committee be required to have a majority of independent directors? Would some other percentage of independence be appropriate for a participation committee? Should the Commission require investor representation on a participation committee? If so, should the Commission require a minimum percentage of investor representation and if so what percentage and why?

As noted above, various provisions of proposed Regulation SB SEF, such as the impartial access requirements of proposed Rule 811(b) and the governance requirements of proposed Rule 820 are intended to be complementary measures, along with proposed Regulation MC, designed to mitigate conflicts of interest for SB SEFs. The Commission seeks commenters' views regarding the interaction of proposed Regulation SB SEF with proposed Regulation MC. Taking into account both proposals, commenters should address whether the proposals contained in Regulation SB SEF would appropriately address conflicts of interest concerns or whether they should be revised either as unnecessary or insufficient to address conflicts of interest. Are there any redundancies or gaps for mitigating conflicts of interest that should be addressed?

In reviewing proposed Rule 820 specifically, commenters are asked to consider how this proposed rule would work together with Regulation MC. Are the requirements of proposed Rule 820 and the requirements of Regulation MC mutually supportive? Are any of the requirements of proposed Rule 820 redundant with, or otherwise unnecessary in light of, the proposed requirements of Regulation MC? Are there additional or different measures that the Commission should take to mitigate conflicts of interest? For example, should the Commission require SB SEFs to make publicly available, or available to the Commission but not to the public, Board and committee decisions with respect to the listing of SB swaps? Should the Commission require

that the independent directors of the Board conduct and submit to the Commission, or make publicly available, an annual governance self-assessment, which would include ways in which the SB SEF addressed conflicts of interest? If so, are there particular areas that should be the focus of any such annual governance self-assessment? What would be the benefits and drawbacks of any such annual governance self-assessment? Should proposed Form SB SEF require SB SEFs to provide details about the background of each independent director and why it believes that each independent director qualifies as independent?²³⁹

A number of commenters on Regulation MC raised concerns about the overall approach of, and the proposed requirements in, Regulation MC and expressed a range of views.²⁴⁰ Several other commenters on Regulation MC, however, generally supported the overall approach to mitigate conflicts of interest and expressed a range of views on the proposed requirements.²⁴¹ In

²³⁹ See Section XXII for a description of proposed Form SB SEF, which would require the disclosure of certain information relating to directors of an SB SEF. Proposed Exhibit C to Form SB SEF would require that an applicant provide a list of the officers and directors of the SB SEF, or persons performing similar functions, who presently hold or have held their offices or positions during the previous year, and a list of all standing committees and their members, indicating the following for each: their name and title; date of commencement and termination of term of office or position; the type of business in which each is primarily engaged (e.g., SB swap dealer, major SB swap participant, inter-dealer broker, end-user etc.); and, if such person is a director, whether such director qualifies as an “independent director” pursuant to proposed Rule 800 under Regulation SB SEF and whether such director is a member of any standing committees or committees that have the authority to act on behalf of the Board or the nominating committee.

²⁴⁰ See, e.g., Letter from Nancy C. Gardner, Executive Vice President & General Counsel, Thomson Reuters Markets, to Elizabeth M. Murphy, Secretary, Commission, dated November 24, 2010, Letter from Lee H. Olesky, Chief Executive Officer, and Douglas L. Friedman, General Counsel, Tradeweb Markets LLC, to David A. Stawick, Secretary, CFTC, dated November 17, 2010, and Letter from Ernest C. Goodrich, Jr., Managing Director, Deutsche Bank AG, and Marcelo Riffaud, Managing Director, Deutsche Bank AG, to Elizabeth M. Murphy, Secretary, Commission, and David A. Stawick, Secretary, CFTC, dated November 8, 2010.

²⁴¹ See, e.g., Letter from U.S. Department of Justice, Antitrust Division, In the Matter of: RIN 3235-AK47, File No. S7-27-10, dated December 28, 2010, Letter from Mark

particular, the Commission notes that some commenters who have submitted comment letters on proposed Regulation MC raised additional sources of conflicts to consider.²⁴² These commenters suggested that the Commission should focus on conflicts arising from dealers directing volume to SBS exchanges and SB SEFs, dealer concentration of market activity, and close association of the dealers with decision-making in SBS exchanges and SB SEFs. Namely, the commenters believed that the Commission should address the incentives SB SEFs and SBS exchanges may use to attract business, such as volumetric or profit-based incentives. The commenters argued that if arrangements to attract large liquidity providers' business are overly generous, such arrangements may undermine any improvements made by the proposed voting and ownership limitations and governance requirements in Regulation MC. Do commenters agree with these concerns? If not, why not? If so, do commenters believe that the Commission should take any measures to mitigate these concerns? For example, should the Commission prohibit, or take other measures with respect to, revenue sharing, volume discounts, rebates, and other similar arrangements by a SB SEF to attract order flow? Should SB SEFs be required to file with the Commission any arrangements with participants, potential participants, or other market

Scanlan, Vice President, Agriculture and Rural Policy, Independent Community Bankers of America, to Elizabeth M. Murphy, Secretary, Commission, dated November 26, 2010, and Letter from Laurel Leitner, Senior Analyst, Council of Institutional Investors, to Elizabeth M. Murphy, Secretary, Commission, dated November 19, 2010.

²⁴² Letter from U.S. Senator Carl Levin, Michigan, to Elizabeth M. Murphy, Secretary, Commission, dated December 20, 2010; Letter from Dennis M. Kelleher, President & CEO, and Wallace C. Turbeville, Derivatives Specialist, Better Markets, Inc. to Elizabeth M. Murphy, Secretary, Commission, dated November 26, 2010; Letter from U.S. Senator Sherrod Brown, Ohio, to Elizabeth M. Murphy, Secretary, Commission, and David A. Stawick, Secretary, CFTC, dated November 17, 2010; Letter from U.S. Senator Tom Harkin, Iowa, to Elizabeth M. Murphy, Secretary, Commission, and David A. Stawick, Secretary, CFTC, dated November 17, 2010; and Letter from Americans for Financial Reform, to Elizabeth M. Murphy, Secretary, Commission, dated November 16, 2010.

participants that would promote the sending of order flow to the SB SEF, such as equity incentive plans? Would such requirements help to mitigate conflicts of interest?

XVIII. Core Principle 12 – Financial Resources

Section 3D(d)(12)(A) of the Exchange Act (Core Principle 12) requires SB SEFs to have adequate financial, operational, and managerial resources to discharge each responsibility of the SB SEF, as determined by the Commission. In addition, Section 3D(d)(12)(B) of the Exchange Act states that the financial resources of a SB SEF shall be considered to be adequate if the value of the financial resources (i) enables the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions; and (ii) exceeds the total amount that would enable the SB SEF to cover the operating costs of the SB SEF for a one year period, as calculated on a rolling basis. The Commission believes that the financial strength of a SB SEF is vital to ensure that a SB SEF can discharge its regulatory responsibilities in accordance with the Exchange Act. Strong, viable SB SEFs will be a key to market continuity and efficiency. Therefore, the Commission believes that it is important to install safeguards to ensure that a SB SEF's resources are adequate.

The Commission proposes to implement in proposed Rule 821 the requirements of Section 3D(d)(12) of the Exchange Act. Specifically, proposed Rule 821(a) would require every SB SEF to have adequate financial, operational, and managerial resources to discharge each responsibility of the SB SEF, as determined by the Commission. Proposed Rule 821(b) would state in part that the financial resources of a SB SEF shall be considered to be adequate if the value of the financial resources enables the SB SEF to meet its financial obligations to participants notwithstanding a default by the participant creating the largest financial exposure

for the SB SEF in extreme but plausible market conditions. This requirement would help ensure that the financial failure of one participant would not be able to destroy the financial viability of the entire SB SEF. Proposed Rule 821(b) would require that in making this calculation (which is required by Section 3D(d)(12)(B) of the Exchange Act), a SB SEF shall use reasonable estimates and assumptions and not overestimate resources or underestimate expenses, liabilities, and financial exposure. This requirement should provide guidance to SB SEFs on the estimates they should use to comply with the requirements of Core Principle 12.

Proposed Rule 821(b) also would state in part that the financial resources of a SB SEF shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the SB SEF to cover its operating costs for a one year period, as calculated on a rolling basis. This test would help to ensure that a SB SEF is in a sufficiently strong financial position to sustain operations through unpredictable business cycles. As with the first requirement, in making this calculation (which is required by Section 3D(d)(12)(B) of the Exchange Act), a SB SEF must use reasonable assumptions and estimates and not overestimate resources or underestimate expenses, liabilities, and financial exposure. Each of these requirements would be an ongoing requirement and a SB SEF must always be in compliance.²⁴³ The Commission seeks comments in general regarding all aspects of these financial requirements.

XIX. Core Principle 13 – Systems Safeguards

Section 3D(d)(13)(A) of the Exchange Act (Core Principle 13) requires that a SB SEF shall establish and maintain a program of risk analysis and oversight to identify and minimize

²⁴³ In addition to the requirements of proposed Rule 821, a SB SEF would be required to submit annual financial reports in accordance with the requirements discussed in Section XXII of this release.

sources of operations risk, through the development of appropriate controls and procedures, and automated systems, that: (1) are reliable and secure and (2) have adequate scalable capacity. Additionally, Section 3D(d)(13)(B) of this Core Principle requires that a SB SEF establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for: (1) timely recovery and resumption of operations and (2) the fulfillment of the responsibilities and obligations of the SB SEF. Further, Section 3D(d)(13)(C) of this Core Principle requires that a SB SEF shall periodically conduct tests to verify that the backup resources of the SB SEF are sufficient to ensure continued: (1) order processing and trade matching, (2) price reporting, (3) market surveillance, and (4) maintenance of a comprehensive and accurate audit trail. The Commission is proposing Rule 822 to implement this Core Principle.

The Commission is proposing Rule 822 to provide standards for SB SEFs with regard to their automated systems' capacity, resiliency, and security.²⁴⁴ These standards are comparable to the standards applicable to SROs, including national securities exchanges and clearing agencies, pursuant to the Commission's Automation Review Policy ("ARP") standards.²⁴⁵ Systems failures can limit access to quotes or other trading interest, call into question the integrity of quotes or other trading interest, and prevent market participants from being able to post quotes or other trading interest, and thereby have a large impact on market confidence, risk exposure, and market efficiency. To promote the maintenance of stable and orderly SB swap markets, the

²⁴⁴ Proposed Rule 822 is being promulgated under Section 3D(d)(13) of the Exchange Act.

²⁴⁵ See Securities Exchange Act Release Nos. 27445 (Nov. 16, 1989), 54 FR 48703, 48706 – 48707 (November 24, 1989) ("ARP I Release") and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991) ("ARP II Release"). See also Rule 301(b)(6) of Regulation ATS, 17 CFR 242.301(b)(6) and Securities Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 (December 22, 1998).

Commission believes that SB SEFs should be required to meet the ARP capacity, resiliency and security standards.²⁴⁶

Proposed Rule 822 would require a SB SEF to establish, maintain, and enforce written policies and procedures designed to ensure that its systems provide adequate levels of capacity, resiliency, and security; and submit to the Commission annual reviews of its automated systems, systems outage notices, and prior notices of planned system changes. These proposed requirements essentially codify and parallel the ARP requirements that have been in place for almost twenty years. Commission staff has found these standards to be effective in overseeing the capacity, resiliency, and security of major automated systems in use in the securities markets. These proposed requirements, as applied to the market for SB swaps, are designed to prevent and minimize the impact of systems failures that might negatively impact the stability of this market.

A. Requirements for SB SEFs' Automated Systems

1. Policies and Procedures

Proposed Rule 822(a)(1) would require a SB SEF to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security. Such policies and procedures would require a SB SEF to, at a minimum: (1) establish reasonable current and future capacity estimates; (2) conduct periodic capacity stress tests of critical systems to determine such systems' ability to process transactions in an accurate, timely, and efficient manner; (3) develop and implement

²⁴⁶ Because SB SEFs would be an integral part of the market for SB swaps, and therefore an integral part of the national market system, the Commission believes that it is appropriate to model a SB SEF's rules on system safeguards on ARP. Proposed Rule 822 will impose data maintenance standards on SB SEFs that are comparable to those imposed by the Commission on national securities exchanges by applying the ARP standards to them. In addition, nearly identical rules have been proposed by the Commission for SDRs, also applying the ARP standards to those entities. See SDR Release, supra note 6.

reasonable procedures to review and keep current its system development and testing methodology; (4) review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters; and (5) establish adequate contingency and disaster recovery plans which shall include plans to resume trading of SB swaps by the SB SEF no later than the next business day following a wide-scale disruption. In developing such contingency and disaster recovery plans, the SB SEF would be required to take into account: (1) the extent of alternative trading venues for the SB swaps traded by the SB SEF, including the number of SB swaps traded on the SB SEF, the market share of the SB SEF, and the number of participants in its SB SEF; and (2) the necessity of geographic diversity and diversity of infrastructure between the SB SEF's primary site and any back-up sites.

This list of proposed requirements is based on existing ARP requirements applied to significant-volume ATSS under Rule 301(b)(6) of Regulation ATS.²⁴⁷ In addition, Commission staff has applied these requirements to SROs and other entities in the securities markets for a number of years in the context of its ARP inspection program.

As a general matter, the Commission preliminarily believes that, if a SB SEF's policies and procedures satisfy industry best practices standards, then these policies and procedures would be adequate for purposes of proposed Rule 822(a)(1).²⁴⁸ However, in the event that industry best practices standards of widely recognized professional organizations are not consistent with the public interest, protection of investors, or the maintenance of fair and orderly

²⁴⁷ See 17 CFR 242.301(b)(6)(D)(ii).

²⁴⁸ Proposed Rule 822(a)(1) would require a SB SEF to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security. A SB SEF's policies and procedures may still meet the requirement to be reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security without necessarily being identical to industry best practices standards. However, generally speaking, industry best practices standards would provide an objective, easily identifiable standard.

markets, the Commission would have flexibility to establish such standards that a SB SEF would be required to meet to comply with proposed Rule 822(a)(1).²⁴⁹

The proposed rule would require a SB SEF to quantify, in appropriate units of measure, the limits of the SB SEF's capacity to receive (or collect), process, store, or display the data elements included within each function, and identify the factors (mechanical, electronic, or other) that account for the current limitations.²⁵⁰ This would make it easier for the Commission to detect any potential capacity constraints of a SB SEF, which, if left unaddressed, could compromise the ability of a SB SEF to collect and maintain SB swap data. A SB SEF's failure to clearly understand and have procedures to address its capacity limits would increase the likelihood that it would experience a loss or disruption of system operations.

2. Objective Review

Proposed Rule 822(a)(2) would require a SB SEF to submit an objective review of its systems that support or are integrally related to the performance of its activities to the Commission, on an annual basis, within thirty calendar days of completion. This proposed requirement is critical to help ensure that SB SEFs have adequate capacity, resiliency, and security and that their automated systems are not subject to critical vulnerabilities. Proposed Rule 800 would define "objective review" as "an internal or external review, performed by competent, objective personnel following established procedures and standards, and containing a risk assessment conducted pursuant to a review schedule."²⁵¹ The proposed definition of

²⁴⁹ Industry best practices standards currently are established by organizations such as: the Information Systems Audit and Control Foundation ("ISACF"); the Federal Financial Institutions Examination Council's ("FFIEC"); the Institute of Internal Auditors ("IIA"); and the SANS Institute.

²⁵⁰ See proposed Rule 822(a)(1)(i).

²⁵¹ Proposed Rule 800 would define "competent, objective personnel" as "a recognized information technology firm or a qualified internal department knowledgeable of

“objective review” is based on the standard for the review of automated systems set forth in the ARP II Release.²⁵²

As in the current ARP program, the Commission preliminarily believes that a reasonable basis for determining that a review is objective for purposes of proposed Rule 822(a)(2) is if the level of objectivity of a SB SEF’s reviewers complied with standards set by widely recognized professional organizations.²⁵³ However, in the event that industry best practices standards of widely recognized professional organizations are not consistent with the public interest, protection of investors, or the maintenance of fair and orderly markets, the Commission would have flexibility to establish standards that a SB SEF would be required to meet to comply with proposed Rule 822(a)(2).

The decision on which type of reviewer, an internal department or an external firm, should perform the review is a decision for each SB SEF to make. The Commission preliminarily believes that, as long as the reviewer has the competence, knowledge, consistency,

information technology systems.” This proposed definition is based on the standard for reviewers of automated systems set forth in the ARP II Release. See ARP II Release, 56 FR 22490, supra note 245. Proposed Rule 800 would define “review schedule” as “a schedule in which each element contained in paragraph (a)(1) of Rule 822 would be assessed at specific, regular intervals.” This proposed definition codifies the Commission’s policy set forth in the ARP II Release. See ARP II Release, 56 FR 22490, supra note 245.

²⁵² See ARP II Release, 56 FR 22490, supra note 245.

²⁵³ Such standards are currently established by organizations such as the IIA, the Information Systems Audit and Control Association (“ISACA”) (formerly the Electronic Data Processing Auditors Association (“EDPAA”)), and the American Institute of Certified Public Accountants (“AICPA”).

Proposed Rule 822(a)(2) would require a SB SEF to submit an objective review of its systems that support or are integrally related to the performance of its activities to the Commission, on an annual basis, within thirty calendar days of completion. A SB SEF’s policies and procedures may still meet this requirement without necessarily being identical to industry best practices standards. However, generally speaking, industry best practices standards would provide an objective, easily identifiable standard.

and objectivity sufficient to perform the role, the review can be performed by either recognized information technology firms or by a qualified internal department knowledgeable of information technology systems.

Proposed Rule 822(a)(2) would further require that, where the objective review is performed by an internal department, an objective, external firm must assess the internal department's objectivity, competency, and work performance with respect to the review performed by the internal department. Proposed Rule 822(a)(2) would require that the external firm issue a report of that review, which the SB SEF must submit to the Commission on an annual basis, within thirty calendar days of completion of the review.

The proposed requirement in proposed Rule 822(a)(2) that a SB SEF submit an annual objective review to the Commission is drawn from the ARP II Release.²⁵⁴ In addition, the proposed requirement in proposed Rule 822(a)(2) that, where the objective review is performed by an internal department, an objective, external firm must assess the internal department's objectivity, competency, and work performance, is similarly drawn from the ARP II Release.²⁵⁵

The proposed annual review would not be required to address each element contained in proposed paragraphs (i) through (v) of Rule 822(a)(1) every year. Rather, using its own risk assessment, a SB SEF's reviewer would review each element on a "review schedule," as defined in proposed Rule 800, in which each element would be assessed at specific, regular intervals, thus facilitating systematic and timely review of each element. This should provide a reasonable and cost-effective level of assurance that automated systems of SB SEFs are being adequately developed and managed with respect to capacity, security, development, and contingency planning concerns.

²⁵⁴ See ARP II Release, 56 FR 22490, *supra* note 245.

²⁵⁵ See *id.*

The proposed requirement to submit an objective review within thirty days of completion assures the Commission will have timely notice of the information required. The Commission has found through its experience with the current ARP program for SROs and other entities in the securities market that an entity generally requires approximately thirty calendar days after completion of the review to complete the internal review process necessary to submit an annual review to the Commission. A shorter timeframe might not provide a SB SEF with sufficient time to complete its internal review of the document; a longer timeframe might serve to encourage unnecessary delays.

3. Material Systems Outages

Under proposed paragraph (3) of Rule 822(a), a SB SEF would be required to promptly notify the Commission in writing of material system outages and any remedial measures that have been implemented or are contemplated, including: (1) immediately notifying the Commission when a material systems outage is detected; (2) immediately notifying the Commission when remedial measures are selected to address the material systems outage; (3) immediately notifying the Commission when the material systems outage is addressed; and (4) submitting to the Commission within five business days of when the material systems outage occurred a detailed written description and analysis of the outage and any remedial measures that have been implemented or are contemplated.

This paragraph would codify the procedures followed by SROs and certain other entities under the Commission's current ARP program with respect to providing the staff with notification of material system outages. In particular, proposed paragraph (3) would clarify that the Commission expects to receive immediate notification that an outage has been detected, that remedial measures have been selected to address the outage, and that the outage has been

addressed. Proposed paragraph (3) also would clarify that a SB SEF should submit a detailed written description and analysis of the outage within five business days of the occurrence of the outage.

The Commission preliminarily believes that the proposed rule would assist the Commission in assuring that a SB SEF has diagnosed and is taking steps to correct system disruptions, so that systems of the SB SEF are reasonably equipped to accept and securely maintain transaction data. The Commission preliminarily believes that requiring a SB SEF to submit notifications of material system outages to the Commission is essential to help ensure that the Commission can continue to effectively oversee the SB SEF.

Proposed Rule 800 would define "material systems outage" as an unauthorized intrusion into any system, or an event at a SB SEF involving systems or procedures that results in: (1) a failure to maintain accurate, time-sequenced records of all orders, quotations, and transactions that are received by, or originated on, the SB SEF; (2) a disruption of normal operations, including switchover to back-up equipment with no possibility of near-term recovery of primary hardware; (3) a loss of use of any system; (4) a loss of transactions; (5) excessive back-ups or delays in processing; (6) a loss of ability to disseminate vital information; (7) a communication of an outage situation to other external entities; (8) a report or referral of an event to the SB SEF's Board or senior management; (9) a serious threat to systems operations even though systems operations were not disrupted; (10) a queuing of data between system components or queuing of messages to or from participants of such duration that a participant's normal service delivery is affected; or (11) a failure to maintain the integrity of systems that results in the entry of erroneous or inaccurate inquiries, responses, orders, quotations, other trading interest, transactions, or other information in the SB SEF or the securities markets.

Based on its experience in requiring SROs and other entities to report material systems outages in the context of the current ARP program, the Commission preliminarily believes that this proposed definition is appropriate for SB SEFs. The Commission preliminarily believes that each of the events listed in paragraphs (1) through (11) of proposed Rule 800 are significant events that warrant reporting to the Commission because such material systems outages could negatively impact the stability of the SB swap market. The application of the proposed definition is relatively straightforward, and it focuses on the types of events that the Commission preliminarily believes should require notification to the Commission under proposed Rule 822(a)(3), so that the Commission can respond appropriately to the event that caused the loss or disruption.

Specifically, the Commission preliminarily believes that proposed paragraphs (1), (2), (3), (4), and (5) of proposed Rule 800 address events that cause a significant loss or disruption of normal system operations sufficient to warrant notification to the Commission. In addition, the Commission preliminarily believes that proposed paragraph (6) of proposed Rule 800 addresses a type of event that impairs transparency or accurate and timely regulatory reporting.

The Commission also preliminarily believes that proposed paragraphs (7) and (8) of proposed Rule 800 are appropriate because communications of an outage to entities outside of the SB SEF or to the SB SEF's Board or senior management are indicia of a significant system outage sufficient to warrant notification to the Commission. Specifically, proposed paragraph (8)'s reference to "a report or referral of an event . . ." seeks to address situations in which a SB SEF might seek to apply an overly narrow definition of an "outage situation" in proposed paragraph (7), in order to avoid reporting a problem that nevertheless has a significant impact on the performance of the SB SEF's systems and therefore warrants reporting to the Commission.

For example, where a SB SEF experiences a slowing, but not a stoppage, of its ability to accept orders or quotes, and that slowing is sufficiently significant to have been reported or referred to the SB SEF's Board or senior management, the Commission preliminarily believes that this situation would constitute a material system outage under proposed paragraph (8) that must be reported to the Commission. By including proposed paragraph (8) in the definition of "material systems outage," the Commission seeks to ensure that it is informed of events that most entities subject to current ARP standards would already understand should be covered under the current program. This should permit the Commission to effectively monitor the operation of SB SEF's automated systems. The Commission preliminarily believes that proposed paragraphs (9) and (10) are appropriate because threats to system operations and queuing of data are events that may result in a significant disruption of normal system operations warranting notification to the Commission.

Proposed paragraph (11) of proposed Rule 800 covers a failure to maintain the integrity of systems that results in the entry of erroneous or inaccurate inquiries, responses, orders, quotations, other trading interests, transactions, or other information in a SB SEF or to market participants. This paragraph is designed to address the unique role of SB SEFs in the SB swaps market. In particular, it is intended to cover such events as breakdowns in a SB SEF's internal controls that result in the entry of erroneous orders into the market. For example, it is possible that a SB SEF could, while in the process of testing its systems, inadvertently retain "test" data in its database. This, in turn, could result in erroneous reporting of SB swaps to the SB SEF's participants, registered SDRs, the Commission, other regulators, and counterparties. Counterparties may become uncertain of their positions, leading to market disruptions. This, in turn, could erode investor confidence in the integrity of the SB swaps market, damaging liquidity

and impeding the capital formation process. Accordingly, the Commission preliminarily believes that this type of breakdown in a SB SEF's systems controls should be reported to the Commission.

By including proposed paragraph (11) of proposed Rule 800 in the definition of "material systems outage," the Commission is seeking to ensure that it is informed of events that could negatively impact the integrity of systems that result in the entry of erroneous or inaccurate transaction data or other information in a SB SEF or the securities markets. This should permit the Commission to monitor effectively the operation of each SB SEF's automated systems.

The definition of material systems outage also includes an unauthorized intrusion into any system. This includes unauthorized intrusions by outside parties, insiders, or parties unknown. The Commission preliminarily believes that including this in the definition would assist the Commission's review by requiring SB SEFs to notify the Commission of unauthorized intrusions into systems or networks, and should permit the Commission to continue to effectively monitor the operation of SB SEF's automated systems. SB SEFs would need to immediately report unauthorized intrusions regardless of whether the intrusions were part of a cyber attack, potential criminal activity, other unauthorized attempts to retrieve, manipulate or destroy data or to disrupt or destroy systems or networks, or any other malicious activity affecting data, systems, or networks. If unauthorized intrusions were successful in breaching systems or networks, SB SEFs would need to report these intrusions even if the parties conducting the unauthorized intrusion were unsuccessful in achieving their apparent goals (such as the introduction of malware or other means of disrupting or manipulating data, systems, or networks). SB SEFs would need to follow up on their initial reports by sending the Commission updates on any harm to data, systems, or networks as well as any remedial measures that the SB SEFs are

contemplating or undertaking to address the unauthorized intrusions. SB SEFs, however, would not need to report unsuccessful attempts at unauthorized intrusions that did not breach systems or networks.

The Commission preliminarily believes that the proposed five business day requirement regarding submission of a written description of material systems outages is an appropriate time period. In the Commission's experience with the current ARP program for SROs and other entities in the securities market, an entity generally requires approximately five business days after the occurrence of a material systems outage to gather all the relevant details regarding the scope and cause of the outage. A shorter timeframe might not provide sufficient time for the SB SEF to gather all relevant details surrounding the outage and describe them in a written submission; a longer timeframe might encourage unnecessary delays.

4. Material Systems Changes

Under proposed paragraph (4) of Rule 822(a), a SB SEF would be required to notify the Commission in writing at least thirty calendar days before implementation of any planned material systems changes. Proposed Rule 800 would define "material systems change" as "a change to automated systems that: (1) significantly affects existing capacity or security; (2) in itself, raises significant capacity or security issues, even if it does not affect other existing systems; (3) relies upon substantially new or different technology; (4) is designed to provide a new service or function; or (5) otherwise significantly affects the operations of the security-based swap execution facility."

Based on its experience in requiring SROs and other entities to report material systems changes in the context of the current ARP program, the Commission preliminarily believes that this proposed definition is appropriate for SB SEFs. Each of the events listed in paragraphs (1)

through (5) are significant events that warrant reporting to the Commission because any of those events can lead to a material systems outage that could negatively affect the stability of the SB swap market. The application of the proposed definition is relatively straightforward, and it focuses on the types of events that should require notification to the Commission under proposed Rule 822(a)(4). Specifically, the proposed paragraphs (1) through (4) are events that concern the adequacy of capacity estimates, testing, and security measures taken by a SB SEF, and thus are sufficiently significant to warrant notification to the Commission. Proposed paragraph (5) covering a change that “otherwise significantly affects the operations of the security-based swap execution facility” is more open-ended in order to require notification of other major systems changes. Examples of changes that fall within proposed paragraph (5) include, but are not limited to: major systems architectural changes; reconfigurations of systems that cause a variance greater than five percent in throughput or storage;²⁵⁶ introduction of new business functions or services; material changes in systems; changes to external interfaces; changes that could increase susceptibility to major outages; changes that could increase risks to data security; changes that were, or will be, reported to or referred to a SB SEF’s Board or senior management; and changes that may require allocation or use of significant resources.

The Commission preliminarily believes that the proposed thirty calendar day requirement regarding pre-implementation written notification to the Commission of planned material systems changes is an appropriate time period. The Commission has found through its experience with the current ARP program that this amount of time is necessary for the

²⁵⁶ The Commission has identified the five percent threshold as triggering the definition of “material systems change” in proposed Rule 800 because, based on experience in administrating the ARP program in the equities markets for almost twenty years, it believes that reconfigurations that exceed five percent in throughput or storage typically have the greatest potential to cause significant disruptions to automated systems.

Commission staff to evaluate the issues raised by a planned material systems change. A shorter timeframe might not provide sufficient time for the Commission staff to analyze the issues raised by the systems change; a longer timeframe might unnecessarily delay the covered entity in implementing the change.

The Commission requests comment on all aspects of proposed Rule 822(a). Should the Commission consider imposing other requirements or standards? Should any of the proposed requirements be eliminated or refined? If so, please explain your reasoning. Would it be appropriate to impose the proposed systems safeguards requirements on SB SEFs only after they account for a certain percentage of the total volume of transactions, as measured by the aggregate total volume received by all SB SEFs? If so, what is the appropriate volume level? Five percent? Ten percent? Please be specific. In addition, the Commission is mindful of the potential costs of a SB SEF's compliance with the proposed systems safeguards and seeks commenters' views on whether there are ways to minimize those costs while assuring adequate systems safeguards.

Would it be appropriate to delay implementing the proposed systems safeguards requirements on SB SEFs until after a specified period of time, such as one year after Commission approval of the SB SEF's registration? If so, is one year an appropriate time period? If not, what would be an appropriate time period for any delay and why? Would it be appropriate to delay implementation of systems safeguard requirements until either a specified time period after the Commission's approval of the SB SEF's registration and/or a particular volume threshold such as those discussed above is reached? If so, why? If not, why not? Are there other circumstances in which a SB SEF should be excepted from systems safeguards requirements? If so, commenters should provide a rationale.

Are there factors specific to SB swap transactions that would make applying a system that is traditionally used in the equity markets inappropriate? What is the likely impact of these requirements on the SB swaps market, including the impact on the incentives and behaviors of SB SEFs, the willingness of persons to register as SB SEFs, and the technologies used for maintaining SB swap data at the SB SEF?

Should the Commission require a SB SEF's contingency and disaster recovery plans (required in proposed paragraph (a)(1)(v) of proposed Rule 822) to be tested periodically to assure their effectiveness and adequacy?²⁵⁷ Should the Commission require such contingency and disaster recovery plans to cover at a minimum: preparation for contingencies through such devices as appropriate remote and on-site hardware back-up and periodic duplication and off-site storage of data files? Off-site storage of up-to-date, duplicative software, files and critical forms and supplies need for processing operations, including a geographically diverse back-up site that does not rely on same infrastructure components (e.g., transportation, telecommunications, water supply, and electric power) as the SB SEF primary operations center? Immediate availability of software modifications, detailed procedures, organizational charts, job descriptions, and personnel for the conduct of operations under a variety of possible contingencies? Emergency mechanisms for establishing and maintaining communications with participants, regulators and other entities involved?²⁵⁸

²⁵⁷ This requirement would be similar to what is required of clearing agencies and proposed to be required of SDRs. See Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (June 20, 1980) and SDR Release, supra note 6.

²⁵⁸ These requirements are similar to requirements related to disaster recovery plans of clearing agencies and proposed to be required of SDRs. See id. and SDR release, supra note 6. The requirement for geographical diversity is currently applicable to securities firms. See Exchange Act Release No. 47638 (April 7, 2003), 68 FR 17809 (April 11, 2003) (the "BCP Whitepaper").

Should the Commission require a SB SEF's contingency and disaster recovery plans (required in proposed paragraph (a)(1)(v) of proposed Rule 822) to include resources, emergency procedures, and backup facilities sufficient to enable timely recovery and resumption of its operations following any disruption of its operations? If so, what should the recovery time objective be? Should the SB SEFs contingency and disaster plans and resources generally enable resumption of the SB SEF's operations during the next business day following the disruption?

Should the Commission require a SB SEF, to the extent practicable, coordinate its contingency and disaster recovery plans (required in proposed paragraph (a)(1)(v) of proposed Rule 822) with those of the SDRs, clearing agencies, SB swap dealers, and major SB swap participants, and with those of regulators in a manner adequate to enable effective resumption of the SB SEF's operations following a disruption causing activation of the SB SEF's contingency and disaster recovery plans, including participating in periodic, synchronized testing of its contingency and disaster recovery plans?

Should the Commission require a SB SEF ensure that its contingency and disaster recovery plans (required in proposed paragraph (a)(1)(v) of proposed Rule 822) take into account the business continuity-disaster recovery plans of its telecommunications, power, water, and other essential service providers?

Should the Commission require a SB SEF to identify the potential risks that can arise as a result of interoperability and/or interconnectivity with other market infrastructures and venues from which data can be submitted to the SB SEF (such as exchanges, SDRs, clearing agencies, SB swap dealers, and major SB swap participants) and service providers and how the SB SEF mitigates such risks?

Should the Commission require a SB SEF to abide by substantive requirements (in addition to, or in place of, the policies and procedures approach of proposed Rule 822(a)(1)), such as (i) having robust system controls and safeguards to protect the data from loss and information leakage, (ii) having high-quality safeguards and controls regarding the transmission, handling, and protection of data to ensure the accuracy, integrity, and confidentiality of the trade information recorded in the SB SEF, or (iii) having reliable and secure systems and having adequate, scalable capacity?

Should the Commission require a SB SEF to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the transaction data that it accepts is from the entity it purports to be from, such as requiring robust passwords?

Are the time periods specified in proposed Rule 822(a)(2) through (4) with respect to submission of annual reviews and written notices of material system outages and material systems changes the correct time periods to use? Should any of the proposed time periods be shortened or lengthened? Should the time periods be replaced with less specific requirements, such as "promptly" or "timely"? If so, please explain your reasoning.

Should the Commission require the notification required by proposed Rule 822(a)(4) to be sufficiently detailed to explain the new system development process, the new configuration of the system, its relationship to other systems, the timeframes or schedule for installation, any testing performed or planned, and an explanation on the impact of the change on the SB SEF's capacity estimates, contingency protocols and vulnerability estimates?²⁵⁹

Are there specific provisions in the proposed definitions that should be eliminated or refined? Are there some events which should be included in the definitions of "material systems

²⁵⁹ See ARP II Release, 56 FR 22490, supra note 245.

outage” and “material systems change” that are not, or events that should not be included in these definitions but are? If so, please explain your reasoning.

Are the definitions “objective review” and “competent, objective personnel” parallel to the requirements for SROs and other entities in the securities markets in the context of the current ARP program? Should the objective review required in proposed Rule 822(a)(2) be done on a regular, periodic basis, rather than on an annual basis?

The proposed requirement for an objective review focuses on a review of the SB SEF’s automated systems that support or are integrally related to the performance of its activities. Is this an appropriate scope, or should other aspects of the SB SEF’s operations be included? If so, which? In addition is this scope sufficiently understandable or should it be further defined?

Is the requirement in proposed Rule 822(a)(2) for an objective, external firm to assess the objectivity, competency, and work performance of an internal department that performed an objective review necessary or appropriate? If the objective review is done by an internal department, should the Commission require that the objective review be done by a department or persons other than those responsible for the development or operation of the systems being tested?

Do the proposed requirements for SB SEFs establish sufficient criteria against which an evaluation can be performed by a third party? If not, should the Commission impose a specific framework for the SB SEFs to use in establishing automated systems and related controls? If so, what would the critical components of the framework include? Are existing frameworks available that are suitable for this purpose and, if so, which ones would be considered appropriate?

Should the Commission require the use of a specific framework by outside or inside parties for evaluating whether SB SEFs have adequate capacity, resiliency, and security and that their automated systems are not subject to critical vulnerabilities? If so, what would the critical components of the framework include? Are existing frameworks available that are suitable for this purpose and, if so, which ones would be considered appropriate?

For reviews performed by internal audit departments, are the requirements for an external firm involvement appropriate? If not, what improvements could be made to promote appropriate reviews by external firms in these circumstances?

B. Electronic Filing

Proposed Rule 822(b) would require that every notification, review, or description and analysis required to be submitted to the Commission under proposed Rule 822 be submitted in an appropriate electronic format to the Office of Market Operations at the Division of Trading and Markets at the Commission's principal office in Washington, DC. This proposed requirement is intended to make proposed Rule 822 consistent with electronic-reporting standards set forth in other Commission rules under the Exchange Act, such as Rule 17a-25 (Electronic Submission of Securities Transaction Information by Exchange Members, Brokers, and Dealers)²⁶⁰ and Rule 19b-4 (Filings with respect to Proposed Rule Changes by Self-regulatory Organizations).²⁶¹

The Commission preliminarily believes that the proposed provision would benefit SB SEFs by automating the process by which they submit notifications, reviews, and descriptions and analyses under proposed Rule 822 to the Commission. The Commission currently receives this type of information from SROs and other entities in the securities market in electronic

²⁶⁰ 17 CFR 240.17a-25.

²⁶¹ 17 CFR 240.19b-4.

format. Moreover, as noted above, this provision is intended to be consistent with other Commission rules.

Proposed Rule 822(b) would require submission of notifications, reviews, and descriptions and analyses in an “appropriate electronic format.” The Commission anticipates that, if the provision is adopted, the staff would work with SB SEFs to determine appropriate electronic formats that could be used.

The Commission requests comment on all aspects of proposed Rule 822(b) as well as on the following specific issues. Are there specific provisions in proposed Rule 822(b) that should be eliminated or refined? If so, please explain your reasoning.

What is the likely impact of this requirement on the SB swap market, including the impact on the incentives and behaviors of SB SEFs, the willingness of persons to register as SB SEFs, and the technologies used for reporting information to the Commission?

C. Confidential Treatment

Proposed Rule 822(c) would provide that a person who submits a notification, review, or description and analysis pursuant to this Rule for which he or she seeks confidential treatment should clearly mark each page or segregable portion of each page with the words “Confidential Treatment Requested.” Proposed Rule 822(c) would state that “[a] notification, review, or description and analysis submitted pursuant to this [Rule] will be accorded confidential treatment to the extent permitted by law.”

The Commission would use the information collected under proposed Rule 822 to evaluate whether SB SEFs are reasonably equipped to handle market demand. For this reason, requiring SB SEFs to submit this information would be critical to the Commission’s ability to effectively oversee SB SEFs.

Much of the information that the Commission expects to receive from SB SEFs under proposed Rule 822 is, by its nature, competitively sensitive. If the Commission were unable to afford confidential protection to the information that it expects to receive, then the SB SEFs may hesitate to submit the required information to the Commission. This result could potentially undermine the Commission's ability effectively to oversee SB SEFs, which, in turn, could undermine investor confidence in the SB swap market.

The Freedom of Information Act ("FOIA") provides at least two exemptions under which the Commission has authority to grant confidential treatment for the information submitted under proposed Rule 822. First, FOIA Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential."²⁶² As specified in proposed Rule 822(c), "a notification, review, or description and analysis submitted pursuant to this [Rule] will be accorded confidential treatment to the extent permitted by law." The information required to be submitted to the Commission under proposed Rule 822 may contain proprietary information regarding automated systems that is privileged or confidential and thus subject to protection from disclosure under Exemption 4 of the FOIA.

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."²⁶³ Similarly, Commission Rule 80(b)(8), Commission Records and Information, implementing Exemption 8, states that the Commission generally will not publish or make available to any person matters that are "[c]ontained in, or related to, any examination, operating, or condition report prepared by, on behalf of, or for the use of, the Commission, any other Federal, state, local, or foreign

²⁶² 5 U.S.C. 552(b)(4).

²⁶³ 5 U.S.C. 552(b)(8).

governmental authority or foreign securities authority, or any securities industry self-regulatory organization, responsible for the regulation or supervision of financial institutions.”²⁶⁴

The Commission requests comment on the following specific issues. Are there specific provisions in proposed Rule 822(c) that should be eliminated or refined? If so, please explain your reasoning. What is the likely impact of this requirement on the SB swaps market, including the impact on the incentives and behaviors of SB SEFs and the willingness of persons to register as SB SEFs?

XX. Core Principle 14 – Chief Compliance Officer

Section 3D(d)(14) of the Exchange Act (Core Principle 14), requires registered SB SEFs to designate a CCO and requires the CCO to perform certain duties and to file compliance reports and financial reports annually.²⁶⁵ Proposed Rule 823 would incorporate the requirements of Core Principle 14 and provide certain additional requirements for its implementation.

A. Appointment and Duties of CCO

Proposed Rule 823(a) would require a registered SB SEF to identify on its Form SB SEF a person who has been designated by the Board to serve as the CCO. The compensation and removal of the CCO would require the approval of a majority of the Board.²⁶⁶ Proposed Rule 823(b) would incorporate the duties of the CCO contained in Core Principle 14.²⁶⁷ Specifically, proposed Rule 823(b) would provide that each CCO shall: (1) report directly to the Board or the senior officer of the SB SEF; (2) review the compliance of the SB SEF with respect to the Core Principles in Section 3D of the Exchange Act and the rules and regulations thereunder; (3) in

²⁶⁴ 17 CFR 200.80(b)(8).

²⁶⁵ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14) of the Exchange Act).

²⁶⁶ See proposed Rule 823(a).

²⁶⁷ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14)(B) of the Exchange Act).

consultation with the Board or the senior officer, resolve any conflicts of interest that may arise; (4) be responsible for establishing each policy and procedure that is required to be established under Section 3D of the Exchange Act and the rules and regulations thereunder; (5) monitor compliance with the Exchange Act and the rules and regulations thereunder relating to its business as a SB SEF, including each rule prescribed by the Commission under Section 3D of the Exchange Act; (6) establish procedures for the remediation of noncompliance issues identified by the CCO through any (i) compliance office review, (ii) look-back, (iii) internal or external audit finding, (iv) self-reported error, or (v) validated complaint; and (7) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

The CCO would be responsible for, among other things, keeping the SB SEF's Board or senior officer apprised of significant compliance issues and advising of needed changes in the SB SEF's policies and procedures. Given the critical role that a CCO is intended to play in ensuring a SB SEF's compliance with the Exchange Act and the rules and regulations thereunder, the Commission believes that a SB SEF's CCO should be competent and knowledgeable regarding the federal securities laws and should be empowered with full responsibility and authority to develop and enforce appropriate policies and procedures for the SB SEF.²⁶⁸ To meet the statutory obligations, a CCO also should have a position of sufficient seniority and authority within the SB SEF to compel others to adhere to the SB SEF's policies and procedures. The Commission notes, however, that the SB SEF would not be required to hire an additional person

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The Commission believes that the person that is designated by the Board to serve as the CCO should have the background and qualifications necessary to fulfill the responsibilities of the position.

to serve as its CCO. Instead, the SB SEF could designate an individual already employed by the SB SEF to serve as its CCO.

The Commission is concerned that a SB SEF's commercial interests might discourage its CCO from making forthright disclosure to the Board or the senior officer about any compliance failures. To mitigate this potential conflict of interest, the Commission believes that the CCO should be independent from the SB SEF's management so as not to be conflicted in reporting or addressing any compliance failures. To support this independence, the proposed rule would allow only a majority of the Board to approve the CCO's compensation and to remove the CCO from his or her responsibilities.

The Commission notes that proposed Regulation MC would require a SB SEF to establish a fully independent ROC, which would be the Board committee that would be responsible for monitoring a SB SEF's regulatory program for sufficiency, effectiveness, and independence.²⁶⁹ The Board of a SB SEF should consider the appropriate reporting structure for the CCO, taking into account the potential conflicts of interest between the CCO and other senior officers of the SB SEF. Because the SB SEF would be required to have a ROC, the Board could elect to delegate to the ROC the duty of overseeing the CCO.

The Commission generally requests comments on all aspects of the proposed rules relating to the appointment and duties of the CCO. Should the Commission require a CCO to meet minimum competency standards? If so, what background, skills and other qualifications should a CCO be required to have? Does the proposed requirement that the CCO report directly to the Board or the senior officer balance the CCO's needs to work effectively with management and to have an adequate separation of business and regulatory influence? Are there situations

²⁶⁹ See Regulation MC Proposing Release, *supra* note 82, (proposing that the SB SEF establish a ROC composed solely of independent directors).

when the CCO's ability to conduct his or her duties under the Exchange Act could be compromised if he or she were required to report to the senior officer? If so, are there steps that the SB SEF could take to resolve differences between the CCO and the senior officer? Should the Commission require a CCO to report to a specific senior officer? If so, to whom and why? Would it be preferable for the CCO to report to the Board? If so, would it be preferable for the Board to delegate the responsibility for oversight of the CCO to its ROC?

Is the Commission's proposed requirement regarding the Board's approval of a CCO's compensation and removal necessary or appropriate? Absent specific requirements imposed by federal statute or rules, in general, the entity has the discretion to create the governance structure that it believes best promotes compliance with applicable laws and regulations, in accordance with the relevant laws of the entity's jurisdiction of incorporation or formation. As noted above, the Commission has identified potential conflict concerns between a SB SEF's commercial interests and its regulatory obligations. To mitigate such concerns and support the independence of the CCO from management of the SB SEF, the Commission is proposing the requirement described above.²⁷⁰ Do commenters believe that it would be appropriate to impose this requirement, or do commenters believe that SB SEFs would be able to comply with their regulatory obligations without this requirement? Would the removal of this requirement affect the ability of a CCO to comply with the extensive duties required of the CCO under the Dodd-Frank Act? If commenters do not agree that the proposed requirements are necessary or appropriate, why and what would be a better alternative, if any, to promote the independence and effectiveness of the CCO? For example, should the required percentage of Board approval be

²⁷⁰ The Commission proposed this same requirement in its proposal relating to the registration and regulation of security-based swap data repositories. See SDR Release, supra note 6.

lower or higher? Or, should the Commission require that the CCO meet separately with the independent directors of the SB SEF, without anyone else present?²⁷¹ Would such a requirement promote the independence and effectiveness of the CCO by supporting his or her ability to speak freely with the independent directors about any sensitive compliance issues of concern to any of them? Do commenters believe that it would be appropriate to impose this type of requirement, or do commenters believe that SB SEFs would be able to comply with their regulatory obligations without a requirement such as this?

Should the Commission add a rule explicitly prohibiting any officers, directors, or employees of a SB SEF from, directly or indirectly, taking any action to coerce, manipulate, mislead, or fraudulently influence the CCO in the performance of his other responsibilities?

Are there any terms in proposed Rule 823(b) regarding the duties of the CCO that should be clarified or modified (e.g., “look-back,” “self-reported error,” or “validated complaint”)? If so, which terms and how should they be defined?

Are the duties of the CCO in proposed Rule 823(b) sufficiently clear? Should the Commission provide further guidance or rules on how the CCO should comply with these duties? If so, what kinds of guidance or rules would be appropriate to adopt in this context?

Should the Commission provide guidance in its proposed rules about the CCO’s procedures for the remediation of noncompliance issues? Should the Commission provide guidance in its proposed rules on what would be considered “appropriate procedures” for the

²⁷¹ The concept of an individual with regulatory oversight responsibilities having mandated access to the independent directors without the presence of non-independent directors on the entity’s board is not novel, although it has not to date been specifically mandated by the Exchange Act or rules thereunder. See, e.g., Article IV, Sec. 7 of the Nasdaq Bylaws (requiring the Chief Regulatory Officer of Nasdaq to meet in executive session with the Regulatory Oversight Committee of Nasdaq, which is a fully independent committee of the Nasdaq board).

handling, management response, remediation, retesting, and closing of noncompliance issues? If so, what factors should the Commission take into consideration?

Would the CCO have difficulty discharging any of the obligations under proposed Rule 823? Would any of the CCO's obligations under proposed Rule 823 conflict with current obligations imposed on a CCO? If so, which ones and why? Should the Commission impose any additional duties on the CCO that are not already enumerated in Section 3D(d)(14) of the Exchange Act and incorporated in the proposed rule?

What is the likely impact of the Commission's proposed rule on the SB swap market? Would the proposed rule potentially promote or impede the establishment of SB SEFs? With respect to entities that currently provide a marketplace for trading SB swaps and that may be required to register under the Dodd-Frank Act, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SB SEFs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

How might the evolution of the SB swaps market over time affect SB SEFs and impact the Commission's proposed rule?

B. Annual Reports

Section 3D(d)(14)(C) of the Exchange Act requires the CCO to prepare and sign a annual report, in accordance with rules prescribed by the Commission.²⁷² Proposed Rule 823(c) would prescribe the rules to implement this statutory provision.²⁷³ Proposed Rule 823(c)(1) would implement the requirements in Section 3D(d)(14)(C)(i) under Exchange Act for the CCO to annually prepare and sign a report that contains a description of: (i) the compliance of the SB

²⁷² See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14)(C) of the Exchange Act).

²⁷³ See proposed Rule 823(c).

SEF with respect to the Exchange Act and the rules and regulations thereunder; and (ii) the policies and procedures of the SB SEF (including the code of ethics and conflicts of interest policies of the SB SEF).²⁷⁴

The Commission also is proposing certain minimum requirements in proposed Rule 823(c)(1) for the information that should be provided in the CCO's annual report.²⁷⁵ The proposed minimum requirements would provide guidance for including in the report certain key disclosures about the SB SEF's compliance with the Core Principles. However, this proposed provision is not intended to be an exhaustive list; any other relevant descriptions of the SB SEF's compliance with the Exchange Act and the policies and procedures of the SB SEF related thereto, consistent with the broader statutory requirement in Section 3D(d)(14)(C) of the Exchange Act, also should be included in the CCO's annual report.²⁷⁶

Proposed Rule 823(c)(1)(i) through (ii) would require the annual report to include a description of the SB SEF's enforcement of its policies and procedures and information on all investigations, inspections, examinations, and disciplinary cases opened, closed, and pending during the reporting period. Proposed Rule 823(c)(1)(iii) would require the annual report to include a description of all grants of access (including, for all participants, the reasons for granting such access) and all denials or limitations of access (including, for each applicant, the reasons for denying or limiting access), consistent with Rule 811(b)(3). The disclosures in proposed Rule 823(c)(i) through (iii) would provide a basis for evaluating the effectiveness of

²⁷⁴ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14)(C)(i) of the Exchange Act) and proposed Rule 823(c)(1).

²⁷⁵ See proposed Rule 823(c)(1).

²⁷⁶ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14)(C) of the Exchange Act).

the SB SEF's compliance program under the standards in Core Principle 2, which generally requires the SB SEF to establish and enforce compliance with its rules.

Proposed Rule 823(c)(1)(iv) through (v) would require the annual report to include any material changes to the SB SEF's policies and procedures since the date of the preceding compliance report and any recommendation for material changes to the policies and procedures as a result of the annual review (including the rationale for such recommendation, and whether such policies and procedures were or will be modified by the SB SEF to incorporate such recommendation).²⁷⁷ The proposed requirements should demonstrate the kinds of compliance issues the SB SEF is facing and how the CCO is addressing those issues.

Proposed Rule 823(c)(1)(vi) through (vii) would require the annual report to include the results of the SB SEF's surveillance program (including information on the number of reports and alerts generated, and the reports and alerts that were referred for further investigation or for an enforcement proceeding) and any complaints received on the SB SEF's surveillance program. The proposed requirements should provide a demonstration of the effectiveness of the SB SEF's compliance program in detecting violations and the appropriateness of the SB SEF's response in addressing such detected violations.

Finally, proposed Rule 823(c)(1)(viii) would require the CCO's annual report to include any material compliance matters identified since the date of the preceding compliance report.²⁷⁸

²⁷⁷ The term "material change" would be defined as a change that a CCO would reasonably need to know in order to oversee compliance of the SB SEF. See proposed Rule 800.

²⁷⁸ The term "material compliance matter" would be defined as any compliance matter that the Board would reasonably need to know to oversee the compliance of the SB SEF and includes, without limitation: (1) a violation of the federal securities laws by the SB SEF, its officers, directors, employees, or agents; (2) a violation of the policies and procedures of the SB SEF, by the SB SEF, its officers, directors, employees, or agents; or (3) a weakness in the design or implementation of the SB SEF's policies and procedures. See proposed Rule 800.

This proposed requirement would indicate the most significant compliance matters that the SB SEF is dealing with on its market. The Commission notes that individual compliance matters may not be material when viewed in isolation, but may collectively suggest a material compliance matter.

Although the proposed rule would require only annual reviews, the CCO should consider the need for interim reviews in response to significant compliance events, changes in business arrangements, and regulatory developments. For example, if there is an organizational restructuring of a SB SEF, its CCO should evaluate whether the SB SEF's policies and procedures are adequate to guard against potential conflicts of interest. Additionally, if a new rule regarding SB SEFs is adopted by the Commission, then the CCO should review its policies and procedures to ensure compliance with the rule.

Proposed Rule 823(c)(2) would implement the requirement in Section 3D(d)(14)(C)(ii)(I) of the Exchange Act for the CCO to submit the annual report with the appropriate financial reports of the SB SEF at the time of filing.²⁷⁹ The proposed rule also would implement the requirement in Section 3D(d)(14)(C)(ii)(II) of the Exchange Act that the CCO include a certification in its report, under penalty of law, that the report is accurate and complete.²⁸⁰

Under proposed Rule 823(d), the CCO would be required to submit the annual compliance report to the Board for its review prior to the submission of the report to the Commission.²⁸¹ The Commission notes, however, that the CCO should promptly bring serious

²⁷⁹ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14)(C)(ii)(I) of the Exchange Act) and proposed Rule 823(c)(2).

²⁸⁰ See Pub. L. No. 111-203, § 763(c) (adding Section 3D(d)(14)(C)(ii)(II) of the Exchange Act) and proposed Rule 823(c)(2).

²⁸¹ See proposed Rule 823(d).

compliance issues to the attention of the full Board or the Board's independent directors rather than wait until an annual report is prepared.

The Commission generally requests comments on all aspects of the proposed rules regarding annual compliance reports. Are the Commission's proposed rules regarding annual compliance reports appropriate and sufficiently clear? If not, why not and what would be a better approach?

Are the proposed definitions of "material change" and "material compliance matter" appropriate? If not, are they over-inclusive or under-inclusive, and how else should these terms be defined?

Proposed Rule 823(c)(1) lists specific disclosures that would need to be included in each annual compliance report. Are there other specific items that should be required? For example, should disclosures about instances when the SB SEF or the Board has not accepted the recommendations of the swap review committee be required to be included in the annual compliance report? Would such information be helpful to the Commission in evaluating whether conflicts of interest are impacting decisions about whether to trade, or how to trade, a particular SB swap?

Should the Commission propose a timeframe for the CCO to submit his or her annual compliance report for the review by the Board? If so, what would be an appropriate timeframe? Should the Commission permit the SB SEF to request an extension to file an annual compliance report (e.g., due to substantial, undue hardship)?

If a CCO reports to the senior officer of the SB SEF rather than to the Board, should the Commission permit the CCO to submit his or her annual compliance report for prior review to the senior officer rather than to the Board, in addition to the Board, or only when the SB SEF

does not have a Board? Would any of these alternatives lessen the independence of the CCO in any way?

Should the Commission prohibit a SB SEF's Board from requiring its CCO to make any changes to the annual compliance report? If the Commission permits the CCO to submit his or her annual compliance report to the senior officer for prior review, instead of to the Board or in addition to the Board, should a similar prohibition be applied to the senior officer? Would such a prohibition be necessary, in either case, in light of the CCO's statutory requirement to certify that the compliance report is accurate and complete?

Is the Commission's proposed requirement that the CCO meet separately with the independent directors of a SB SEF appropriate? If not, why not and what would be a better alternative?

Are the Commission's proposed minimum disclosure requirements in the CCO's annual compliance report appropriate? If not, why not and what would be a better alternative? Should the Commission require any other disclosures in the CCO's annual compliance report?

Would keeping the compliance reports confidential encourage the CCO to be more forthcoming about sensitive compliance issues or would it likely not have any impact on the disclosure of such issues? Are there any disadvantages to keeping the CCO's compliance report confidential? How could the Commission address any such disadvantage? Would making the CCO's compliance report public be useful to the public or other regulators?

What is the likely impact of the Commission's proposed rule on the SB swap market? Would the proposed rule potentially promote or impede the establishment of SB SEFs? With respect to entities that currently provide a marketplace for trading SB swaps and that may be required to register under the Exchange Act, as amended by the Dodd-Frank Act, how do current

practices compare to the practices that the Commission proposes to require in this rule? What would be the incremental costs to potential SB SEFs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

How might the evolution of the SB swaps market over time affect SB SEFs and impact the Commission's proposed rule?

C. Financial Reports

Section 3D(d)(14)(C)(ii)(I) of the Exchange Act requires a compliance report filed by the CCO to be accompanied by each appropriate financial report of the SB SEF that is required to be furnished to the Commission pursuant to Section 3D of the Exchange Act. The Commission is proposing Rule 823(e), which would set forth the appropriate financial reports that a SB SEF would be required to include with its annual compliance reports.²⁸² Proposed Rule 823(e)(1) would require the financial reports of the SB SEF to: (1) be a complete set of financial statements of the SB SEF that are prepared in accordance with U.S. generally accepted accounting principles for the most recent two fiscal years of the SB SEF; (2) be audited in accordance with standards of the Public Company Accounting Oversight Board ("PCAOB") by a public accounting firm that is registered with the PCAOB and is qualified and independent in accordance with Rule 2-01 of Regulation S-X (17 CFR 210.2-01); (3) include a report of the registered public accounting firm that complies with paragraphs (a) through (d) of Rule 2-02 of

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The financial statements required by these proposed rules are the same as the requirements for the annual financial statements that would be required to be submitted pursuant to Exhibits F and H of proposed Form SB SEF. See infra Section XXII. To avoid submitting duplicative financial statements, the CCO may represent in the annual compliance report that the financial statements required by proposed Rule 823(e) have been submitted to the Commission as part of the annual update of Form SB SEF required by proposed Rule 802(f).

Regulation S-X (17 CFR 210.2-02); and (iv) include the SB SEF's accounting policies and practices.²⁸³

Under Proposed Rule 823(e)(1)(v), if the SB SEF's financial statements contain consolidated information of the SB SEF's subsidiaries, then the SB SEF's financial statements also would need to provide condensed financial information, in a financial statement footnote, as to the financial position, changes in financial position and results of operations of the SB SEF, as of the same dates and for the same periods for which audited consolidated financial statements are required.²⁸⁴ Such financial information would need not be presented in greater detail than is required for condensed statements by Rules 10-01(a)(2), (3), and (4) of Regulation S-X. Detailed footnote disclosure that would normally be included with complete financial statements may be omitted with the exception of disclosures regarding material contingencies, long-term obligations, and guarantees. Descriptions of significant provisions of the SB SEF's long-term obligations, mandatory dividend or redemption requirements of redeemable stocks, and guarantees of the SB SEF would also be required to be provided along with a five-year schedule of maturities of debt. If the material contingencies, long-term obligations, redeemable stock requirements and guarantees of the SB SEF have been separately disclosed in the consolidated statements, then they would not need to be repeated in this schedule.²⁸⁵ This proposed requirement is substantially similar to Rule 12-04 of Regulation S-X, which pertains to condensed financial information of registrants.²⁸⁶

²⁸³ See proposed Rule 823(e)(1).

²⁸⁴ See proposed Rule 823(e)(1)(v).

²⁸⁵ Id.

²⁸⁶ See 17 CFR 210.9-06.

Under proposed Rule 823(e)(2), for SB SEFs with affiliated entities (any subsidiary in which the applicant has, directly or indirectly, a 25% interest and for every entity that has, directly or indirectly, a 25% interest in the applicant), for each affiliated entity, the financial report would also be required to include a complete set of unconsolidated financial statements (in English) for the latest two fiscal years and such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading.²⁸⁷ The Commission notes that information on affiliated entities is currently requested for national securities exchanges²⁸⁸ and is important information for the Commission to obtain because the financial health of affiliated entities could potentially have an impact on the financial condition of the SB SEF.

Proposed Rule 823(e)(4) also would require the financial statements to be provided in XBRL, consistent with Rules 405(a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T.²⁸⁹ Specifically, information in the financial statements would be required to be tagged²⁹⁰ using XBRL to allow the Commission to assess and analyze effectively the SB SEF's financial and operational condition.

Finally, annual compliance reports and financial reports filed pursuant to proposed Rule 823 would be required to be filed within 60 days after the end of the fiscal year covered by such reports.²⁹¹

²⁸⁷ See proposed Rule 823(e)(2).

²⁸⁸ See Form 1 and instructions thereunder.

²⁸⁹ See 17 CFR 232.405 (imposing content, format, submission and website posting requirements for an interactive data file, as defined in Rule 11 of Regulation S-T).

²⁹⁰ Tagging refers to labeling fields of data electronically so that it can be searched electronically by categories. See proposed Rule 800.

²⁹¹ See proposed Rule 823(f).

The Commission notes that with respect to its other registrants, the Commission has required, at a minimum, the proposed financial information and in some instances, significantly more information.²⁹² The Commission believes that it would be important to obtain an audited annual financial report covering two years from each registered SB SEF to understand the SB SEF's financial and operational condition, particularly because SB SEFs are intended to play a pivotal role in improving the transparency of the OTC derivatives markets.²⁹³ Among other things, the financial statements could help the Commission evaluate whether a SB SEF has adequate financial resources to comply with its statutory obligations or is having financial difficulties. If a SB SEF ultimately ceases doing business, it could create a significant disruption in the OTC derivatives market. The Commission believes that the financial information that it is seeking pertaining to the affiliates of the SB SEF is relevant and necessary as the financial condition of the affiliates could have an immediate or future impact on the condition of the SB SEF.

The Commission requests comments on all aspects of the proposed rules relating to financial statements. Is the Commission's proposed rule regarding a SB SEF's financial report appropriate and sufficiently clear? If not, why not and what would be a better alternative? Should the Commission permit a financial report by a SB SEF that is a foreign private issuer to be in compliance with International Financial Reporting Standards as an alternative to GAAP? If so, why and what are the costs and benefits to permitting this?

Is the Commission's proposed rule requiring financial reports to cover the most recent two fiscal years of a SB SEF appropriate? If not, should the lookback timeframe be greater (e.g., the most recent three fiscal years) or shorter (e.g., the most recent fiscal year)?

²⁹² See, e.g., Rule 17a-5(d) under the Exchange Act, 17 CFR 240.17a-5(d).

²⁹³ See Pub. L. No. 111-203, §763(c) (adding Section 3D of the Exchange Act).

Is the Commission's proposed requirement regarding a SB SEF's condensed financial information appropriate and sufficiently clear? If not, why not and what would be a better alternative?

Is the Commission's proposed 60-day timeframe for a SB SEF to file the annual and financial report appropriate? If not, should the timeframe be shorter or longer (e.g., 30 days or 90 days)? Would a SB SEF's financial report be useful to the public or other regulators? If so, explain.

Are the financial report requirements relating to certain affiliates of SB SEFs too broad or overly burdensome? Are there any terms in the Commission's proposed rule regarding a SB SEF's financial report that need to be defined or clarified? If so, which terms?

What is the likely impact of the Commission's proposed rule on the SB swap market? Would the proposed rule potentially promote or impede the establishment of SB SEFs? With respect to entities that currently provide a marketplace for trading SB swaps and that may be required to register under the Dodd-Frank Act, how do current practices compare to the practices that the Commission proposes to require in this rule? What would be the incremental costs to potential SB SEFs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

How might the evolution of the SB swaps market over time affect SB SEFs and impact the Commission's proposed rule relating to the CCO?

XXI. Registration of Security-Based Swap Execution Facilities

As stated above, a primary goal of the Dodd-Frank Act is to improve the transparency and oversight of the OTC derivatives market and to guard against systemic risk in the trading of these instruments. A key aim of the legislation is to bring the trading of mandatorily cleared

OTC derivatives onto regulated markets. In this regard, the Dodd-Frank Act amends the Exchange Act to add new Section 3D of the Exchange Act.²⁹⁴ Section 3D(a)(1) of the Exchange Act provides that no person may operate a facility for the trading or processing of SB swaps, unless the facility is registered as a SB SEF or as a national securities exchange.²⁹⁵ Core Principle 1 for SB SEFs, as set forth in Section 3D(d)(1)(A) of the Exchange Act,²⁹⁶ provides that, to be registered and maintain its registration as a SB SEF, a SB SEF must comply with the 14 Core Principles governing SB SEFs and any requirement that the Commission may impose by rule or regulation.²⁹⁷

The Commission's rules currently provide for registration frameworks for two types of trading venues for securities, namely national securities exchange registration and broker-dealer registration for ATSS. SB SEFs represent an additional category of registered entities under the Exchange Act and the Commission preliminarily believes that it would be appropriate to adopt a registration process for SB SEFs that is similar to the Commission's existing registration framework for national securities exchanges. SB SEFs, like national securities exchanges, have regulatory obligations pursuant to the Exchange Act.²⁹⁸ Also, pursuant to the Dodd-Frank Act,

²⁹⁴ See Pub. L. No. 111-203, § 763(c) (adding Section 3D of the Exchange Act).

²⁹⁵ Id.

²⁹⁶ Id.

²⁹⁷ Id.

²⁹⁸ For example, pursuant to Section 3D(d)(2) of the Exchange Act, Pub. L. No. 111-203, § 763(c), a SB SEF is required to: (1) establish and enforce compliance with any rule established by it, including (i) the terms and conditions of the SB swaps traded or processed on or through the facility and (ii) any limitation on access to the facility; (2) establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means (i) to provide market participants with impartial access to the market; and (ii) to capture information that may be used in establishing whether rule violations have occurred; and (3) establish rules governing the operation of the facility, including rules

both national securities exchanges and SB SEFs would be permitted to trade SB swaps, although exchange trading of SB swaps is governed by Section 6 of the Exchange Act²⁹⁹ and other provisions of the Exchange Act relevant to SROs.³⁰⁰ The registration process for national securities exchanges is already established, but no process exists for SB SEFs. Thus, the Commission is proposing rules that would require an application registration process for SB SEFs and a form for such application, which would be subject to approval by the Commission.

A. Initial SB SEF Registration

1. Procedures for Registration

Proposed Rule 801(a) provides that an application for the registration of a SB SEF would need to be filed electronically in a tagged data format³⁰¹ with the Commission on the new proposed Form SB SEF, in accordance with the instructions contained in the Form SB SEF.³⁰² Proposed Form SB SEF also would be used by a SB SEF for submitting all amendments to the Form SB SEF.³⁰³ The Commission's proposal contemplates the use of an online filing system

specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades.

²⁹⁹ 15 U.S.C. 78f.

³⁰⁰ See, e.g., Section 19 of the Exchange Act, 15 U.S.C. 78s.

³⁰¹ Proposed Rule 800 would define the term "tag" or "tagged" to mean an identifier that highlights specific information submitted to the Commission and that is in the format required by the EDGAR Filer Manual, as described in Rule 301 of Regulation S-T, 17 CFR 232.301.

³⁰² See proposed Rule 801(a).

³⁰³ See Section XXI.B *infra* for a discussion of the amendments to Form SB SEF required in proposed Rule 802. An application for registration or any amendment thereto filed pursuant to Regulation SB SEF would be considered a "report" filed with the Commission for purposes of Sections 18(a) and 32(a) of the Exchange Act and the rules and regulations thereunder. See proposed Rule 801(f). Exchange Act Sections 18(a) and 32(a) set forth the potential liability for a person who makes, or causes to be made, any false or misleading statement in any "report" filed with the Commission (e.g., Form SDR). Specifically, Exchange Act Section 18(a) provides, in part, that "[a]ny person

through which a SB SEF would be able to file a completed Form SB SEF, which would be available on the Commission's website and accessible from any computer with Internet access.³⁰⁴ Based on the widespread use and availability of the Internet, the Commission believes that filing Form SB SEF in an electronic format would be less burdensome and a more efficient filing process for SB SEFs, the Commission, and the public.

The Commission's proposal requires a Form SB SEF to be filed with the Commission in a tagged data format. As part of the Commission's longstanding efforts to increase transparency and the usefulness of information, the Commission has been implementing data-tagging of information contained in electronic filings to improve the accuracy of financial information and facilitate its analysis.³⁰⁵ Data becomes machine-readable when it is labeled, or tagged, using a computer markup language that can be processed by software programs for analysis. Such

who shall make or cause to be made any statement in any . . . report . . . which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading." 15 U.S.C. 78r(a). Exchange Act Section 32(a) provides, in part, that "[a]ny person who willfully and knowingly makes, or causes to be made, any statement in any . . . report . . . which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding \$25,000,000 may be imposed." 15 U.S.C. 78ff(a).

³⁰⁴ If the Commission adopts the rule as proposed, it is possible that SB SEFs may be required to file Form SB SEF in paper until such time as an electronic filing system is operational and capable of receiving the form. In such a case, SB SEFs would be notified as soon as the electronic system is operational to accept filings on Form SB SEF.

³⁰⁵ See Regulation S-T, 17 CFR 232. See also Securities Act Release No. 8891 (Feb. 6, 2008), 73 FR 10592 (Feb. 27, 2008); Securities Act Release No. 9002 (Jan. 30, 2009), 74 FR 6776 (Feb. 10, 2009); Securities Act Release No. 9006 (Feb. 11, 2009), 74 FR 7748 (Feb. 19, 2009); Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009); Investment Company Release No. 29132 (Feb. 23, 2010), 75 FR 10060 (Mar. 4, 2010).

computer markup languages use standard sets of definitions, or “taxonomies,” that translate text-based information in Commission filings into structured data that can be retrieved, searched, and analyzed through automated means. Requiring the information to be tagged in a machine-readable format using a data standard that is freely available, consistent, and compatible with the tagged data formats already in use for Commission filings would enable the Commission to review and analyze effectively Form SB SEF submissions.

Proposed Rule 801(a) provides that a registration application on Form SB SEF must include information sufficient to demonstrate compliance with the Exchange Act and rules and regulations thereunder. The proposed rule provides that if a registration application is not complete, the Commission will notify the applicant that the application will not be deemed to have been submitted for purposes of the Commission's review.³⁰⁶ Pursuant to the proposed rule, an application on Form SB SEF would not be considered to be complete unless an applicant has submitted, at a minimum, the Execution Page and Exhibits as required in proposed Form SB SEF, and any other material that the Commission may require, upon request, in order to be able to determine whether the applicant is able to comply with the Exchange Act and rules and regulations thereunder. Such other material may include, but is not limited to, information regarding the applicant's system test procedures, contingency or disaster recovery plans, and the manner in which the applicant would conduct market and financial surveillance.

Proposed Rule 801(b) sets forth the SB SEF registration application processes for (i) applications received during the initial implementation phase of Regulation SB SEF, from the date of Regulation SB SEF's effectiveness up to and including July 31, 2014 (“initial implementation period”), and (ii) applications received after the initial implementation period

³⁰⁶ See Proposed Rule 801(a).

(i.e., after July 31, 2014).

Proposed Rule 801(b)(1) would provide that for applications for registration as a SB SEF filed on Form SB SEF with the Commission on or before July 31, 2014, within 360 days of the date of the filing of such application (or within such longer period as to which the applicant consents), the Commission would be required to either grant the registration or institute proceedings to determine whether registration should be denied. Such proceedings would include notice of the grounds for denial under consideration and opportunity for hearing and would be required to be concluded within 450 days after the date on which the application for registration is furnished to the Commission. At the conclusion of such proceedings, the Commission, by order, would be required to grant or deny such registration. The Commission would be able to extend the time for conclusion of such proceedings for up to 90 days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the applicant consents.

Proposed Rule 801(b)(2) would provide that for applications for registration as a SB SEF filed on Form SB SEF with the Commission after July 31, 2014, within 180 days of the date of filing of such application (or within such longer period as to which the applicant consents), the Commission would be required to either grant the registration or institute proceedings to determine whether registration should be denied. Such proceedings would include notice of the grounds for denial under consideration and opportunity for hearing and would be required to be concluded within 270 days after the date on which the application for registration is furnished to the Commission. At the conclusion of such proceedings, the Commission, by order, would be required to grant or deny such registration. The Commission would be able to extend the time for conclusion of such proceedings for up to 90 days if it finds good cause for such extension and

publishes its reasons for so finding or for such longer period as to which the applicant consents.

The proposed rule further provides that the Commission would grant the registration of an applicant if it finds that the requirements of the Exchange Act and the rules and regulations thereunder with respect to the applicant are satisfied, and would deny such registration if it does not make such finding.³⁰⁷

The proposed process for SB SEF's to apply for initial registration would provide a mechanism for an applicant to demonstrate that it has the operational and financial capability to operate as a SB SEF and can comply with the federal securities laws and the rules and regulations thereunder, including the Core Principles, and would allow the Commission to consider the materials provided by the SB SEF and to make an informed determination as to whether the SB SEF complies with the Exchange Act and the rules and regulations thereunder. In addition, the application process would allow the Commission staff to ask questions and, as needed, to require amendments or changes to the application or additional information to address legal and regulatory concerns before approving an application for registration. Further, providing a process and timeframes for the application process would provide certainty to applicants as to the procedural aspects of registering as a SB SEF.

As no SB SEF is currently registered with the Commission and a number of entities have informed the Commission that they may seek to register as a SB SEF, the Commission contemplates receiving a large volume of applications for registration as a SB SEF within the first 3 years following any adoption of rules applicable to SB SEFs. The proposed timeframes for the Commission to review applications for registration as a SB SEF set forth in proposed Rule 801(b) recognize that, as the Commission has limited resources, the Commission may

³⁰⁷ See proposed Rule 801(b)(3).

require an extended period of time to review these applications. For applications filed after the initial implementation period, the proposed timeframes for the Commission to review applications for registration as a SB SEF would be decreased to mirror those set forth in Section 19(a)(1) of the Exchange Act applicable to the review of SRO registration applications. The Commission believes that the timeframes for Commission review during and after the initial implementation period are appropriate in light of the anticipated volume of registration applications during the initial implementation period. The Commission also believes that the temporary registration provisions of proposed Rule 801(c), discussed below, should work in combination with the proposed review and approval process to allow both the Commission and entities seeking to register as SB SEFs to comply with the provisions of the Exchange Act, as amended by the Dodd-Frank Act, in a timely manner. In addition, the Commission notes that the process for the Commission to review registration applications for SB SEFs would be similar to the process for reviewing applications of other registrants by the Commission (e.g., national securities exchanges, national securities associations, and clearing agencies).³⁰⁸

The Commission requests comments on all aspects of the proposed rules relating to the registration process for SB SEFs. Is the Commission's proposed registration process appropriate and sufficiently clear? If not, why not and what would be a better alternative? Are the timeframes in the proposed registration process appropriate? If not, why not and what would be more appropriate timeframes? Should timeframes be omitted from the process? Should different time periods apply to the Commission's review of applications during the initial implementation period? If not, why not? Should the Commission have greater flexibility to

³⁰⁸ See Section 19(a)(1) of the Exchange Act, 15 U.S.C. 78s(a)(1). In addition, the Commission notes that the SEC Rules of Practice would be applicable to the Commission's review of registration applications for SB SEFs. See 17 CFR 201.100, *et seq.*

extend the timeframes?

Are the proposed factors in determining whether the Commission should grant or deny an application for registration appropriate and sufficiently clear? If not, why not? Should the Commission take into consideration any other factors in determining whether to grant or deny an application for registration?

In order to form a more complete and informed basis on which to determine whether to grant, deny, or revoke a SB SEF's registration, the Commission is considering whether to adopt a requirement that a SB SEF file with the Commission, as a condition of registration or continued registration, a review relating to the SB SEF's operational capacity and ability to meet its regulatory obligations. The Commission could require such a review to be in the form of a report conducted by the SB SEF, an independent third party, or both. This review could be required as an exhibit to Form SB SEF at the time of registration or as an amendment to Form SB SEF at a later date (e.g., one year after the registration becomes effective) to allow the review to evaluate the SB SEF's capabilities after some operational experience following registration.

Should the Commission require a SB SEF to conduct or obtain a review relating to the SB SEF's operational capacity and ability to meet its regulatory obligations? If not, why not? If so, how should the Commission define the nature and scope of this review? Should the Commission identify a specific framework for SB SEFs or independent third parties to follow when conducting a review? If so, what would the critical components of the framework include? Are existing frameworks available that are suitable for this purpose and, if so, which ones would be considered appropriate? Should the review resemble a report, audit, or something else?

Should the Commission require the SB SEF, an independent third party, or some other entity to conduct the review? What are examples of such a review? Should the Commission

require a review on a case-by-case basis or for all SB SEFs? Should the Commission require that the review be filed with the Commission? If not, why not? If so, should it be required to be filed with the Commission as a condition of registration pursuant to proposed Rule 801? If not, why not? When should the Commission require the filing of any review? Would conducting or obtaining a review, or filing such review with the Commission, impose impracticable burdens and costs on SB SEFs? Please explain the burdens and quantify the costs of such a review.

If the Commission were to adopt a rule requiring a review by an independent third party, should the rule specify some minimum standard of review or the types of review that should be performed? If so, what should the standards be? Should there be minimum qualification standards for the independent third party? Are there any particular types of third party service providers that should not be permitted to conduct a review of a SB SEF? Should the Commission also require that a SB SEF certify the accuracy of the review and provide disclosure regarding the nature of the review, findings, and conclusions? To what extent should a SB SEF be permitted to rely on a third party that it hired to perform the review? Should the Commission condition the ability of a SB SEF to rely on a third party's review? Would a review by an independent third party be necessary in light of the CCO's annual compliance report or proposed Rule 822?

2. Temporary Registration

Proposed Rule 801(c) under Regulation SB SEF would provide a method for the Commission to grant temporary registration to SB SEFs.³⁰⁹ Specifically, for any application for registration as a SB SEF filed with the Commission in accordance with the provisions of proposed Rule 801(a) on or before July 31, 2014 for which the SB SEF indicates on the

³⁰⁹ See proposed Rule 801(c).

Execution Page that it would like to be considered for temporary registration, the Commission could grant such temporary registration to the SB SEF, which temporary registration would expire on the earlier of: (1) the date that the Commission grants or denies registration of the SB SEF; or (2) the date that the Commission rescinds the temporary registration of the SB SEF. In considering whether to grant a request for temporary registration, the Commission would review and consider the information and materials provided by the SB SEF in its registration application on Form SB SEF that the Commission believes to be relevant, including, but not limited to: whether the applicant's trading system satisfies the definition of a "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act and any Commission rules, interpretations or guidelines regarding such definition;³¹⁰ any access requirements or limitations imposed by the SB SEF;³¹¹ the ownership and voting structure of the SB SEF;³¹² and any certifications made by the SB SEF, including with respect to its capacity to function as a SB SEF and its compliance with the Exchange Act and the rules and regulations thereunder.³¹³ In addition, the Commission would expect that SB SEFs registered on a temporary registration basis demonstrate that they have the capacity and resources to comply with their regulatory obligations on an ongoing basis as their business evolves. After granting a temporary registration to a SB SEF, the Commission could rescind such temporary registration if, upon further review, the Commission found that the applicant did not meet the requirements for granting the registration of a SB SEF set forth in proposed Rule 801(b)(3),³¹⁴ or if the conditions for revoking or canceling the registration of a SB SEF in proposed Rules 804(d) and (e) under

³¹⁰ See Exhibit I, Item 1 of proposed Form SB SEF.

³¹¹ See Exhibit I, Item 2 and Exhibit L of proposed Form SB SEF.

³¹² See Exhibit E of proposed Form SB SEF.

³¹³ See Execution Page of proposed Form SB SEF.

³¹⁴ See proposed Rule 801(b)(3).

Regulation SB SEF were met.³¹⁵

The Dodd-Frank Act provides that, unless otherwise provided, the provisions of Title VII shall be effective on the later of 360 days after the date of the enactment of Title VII or not less than 60 days after the publication of final rules or regulations implementing such provisions.³¹⁶

The Commission preliminarily believes that the proposed temporary registration process for SB SEFs could serve as a useful tool during the initial implementation period to allow the

Commission to temporarily register an applicant as a SB SEF following an initial review of a SB SEF's application for registration where it believes such temporary registration is appropriate.

The Commission preliminarily believes that this would be beneficial in order to allow SB SEFs to comply with the timeframe set forth in the Dodd-Frank Act while still giving the Commission sufficient time to review an application more thoroughly before granting a registration that is not

limited in duration. A SB SEF that is temporarily registered with the Commission would still need to comply with all provisions of the Exchange Act and the rules and regulations thereunder, including Section 3D of the Exchange Act and proposed Regulation SB SEF.

The Commission requests comments on all aspects of the proposed rules with respect to temporary registration. Is the Commission's proposed rule regarding temporary registration appropriate? If not, why not? Is the Commission's proposed rule for temporary registration sufficiently clear? If not, how can it be clarified? What is the best method for a SB SEF to request temporary registration from the Commission? Is it appropriate to include a check box on

³¹⁵ See proposed Rule 804(c) and discussion infra Section XXI.C. Proposed Rule 804(c) provides that the Commission may, by order, cancel or revoke a SB SEF's registration if the Commission finds that the SB SEF obtained its registration by making a false or misleading statements with respect to any material fact, is no longer in existence, has ceased to do business in the capacity specified in its application for registration, or has violated or failed to comply with any provision of the federal securities laws and the rules and regulations thereunder.

³¹⁶ See Pub. L. No. 111-203, § 774.

Form SB SEF as proposed? Would a different method be more appropriate? Are there more appropriate methods other than temporary registration that would allow SB SEFs to meet the timelines for compliance set forth in the Dodd-Frank Act? If so, what are those methods?

As discussed above, the Commission anticipates receiving a large volume of applications for registration as a SB SEF within the first 3 years following the adoption of the proposed rules, and the ability to grant temporary registration during such initial implementation period could be an important tool for the Commission to allow SB SEFs to comply with the provisions of the Exchange Act, as amended by the Dodd-Frank Act, while providing the Commission with additional time to conduct a thorough review of the SB SEF prior to granting permanent registration. Should temporary registration be limited to those registration applications filed during the initial implementation period as proposed? If not, why not? Should the Commission be able to grant temporary registration to any registration application, regardless of when filed? If temporary registration should be limited to a specific time period, would a time period other than the initial implementation period be appropriate? If so, what time period would be appropriate?

Should temporary registration be granted only after the filing of a completed registration application? Should there be a separate application for temporary registration other than proposed Form SB SEF? Should the proposed rule specify the items the Commission must review prior to granting temporary registration? Should temporary registration be granted by the Commission only when certain conditions are met? If so, what should those conditions be? Should the proposed rule specify the findings the Commission must make in order to grant a temporary registration? In what instances should a temporary registration be denied? For example, should a temporary registration be denied if a Form SB SEF is not sufficiently

complete? Are there any reasons not specified in this release upon which a temporary registration should be rescinded?

Should the Commission be required to grant temporary registration within a specified time frame? If so, what time period would be appropriate? Is it appropriate to stay the time period for Commission action on a registration application if the Commission grants a SB SEF temporary registration? If so, should such stay be limited in duration? What would be the appropriate time period for such stay?

Would it be feasible for a SB SEF to comply with Section 3D of the Exchange Act and the rules and regulations thereunder within 60 days after publication of the final rules applicable to SB SEFs? If not, which requirement(s) would be difficult for a SB SEF to comply with upon the effective date? Should any requirement(s) be imposed on an incremental basis or with a phased-in approach? If so, what would be an appropriate timeframe for such requirement(s) to be met?³¹⁷

Is it essential that a SB SEF that is temporarily registered be required to comply with all provisions of the Exchange Act and the rules and regulations thereunder? If not, are there specific requirements that the Commission should consider not requiring a SB SEF to comply with during a temporary registration period? If so, what are such requirements and for what reasons should the Commission consider not requiring them?

3. Non-Resident Persons and Control Persons

Proposed Rule 801(d) would require each SB SEF applying for registration with the Commission to designate and authorize on Form SB SEF an agent in the United States, other than a Commission member, official, or employee, to accept notice or service of process,

³¹⁷ See infra Section XXV for a discussion regarding a potential phased-in approach.

pleadings, or other documents in any action or proceedings brought against the SB SEF to enforce the federal securities laws and the rules and regulations thereunder.³¹⁸

The Commission preliminarily believes that before granting registration to a SB SEF, it is appropriate to obtain assurance that such person has an agent for service of process in the United States in order to facilitate proper notification to the SB SEF of any actions or proceedings the Commission may wish to bring against such SB SEF.

Proposed Rule 801(e) would require any person applying for registration on Form SB SEF that is controlled by another person³¹⁹ to certify on Form SB SEF and provide an opinion of counsel that any person that controls such applicant will consent to and can, as a matter of law, (1) provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF; and (2) submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF.³²⁰ In addition, proposed Rule 802(c) would require any SB SEF controlled by any other person to file an amendment to Exhibit P on Form SB SEF within 5 business days after any changes in the legal or regulatory framework of any person that controls the SB SEF that would impact the ability of or the manner in which any such person consents to or provides the

³¹⁸ See proposed Rule 801(d).

³¹⁹ For purposes of Regulation SB SEF, proposed Rule 800 would define the term "control" or any derivatives thereof as the direct or indirect possession 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. Proposed Rule 800 would provide that a person would be 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% 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 (3) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital. See Instructions to Form 1.

³²⁰ See proposed Rule 801(e).

Commission prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, or impacts the Commission's ability to inspect and examine any such person with respect to the activities of the SB SEF.³²¹ Such amendment would be required to include a revised opinion of counsel pursuant to Exhibit P describing how, as a matter of law, any person that controls the SB SEF would continue to meet its obligations to consent to and provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, and to consent to and be subject to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF under such new legal or regulatory framework.³²² The Commission emphasizes that the proposed provisions would be applicable only to those books and records or activities that are related to the activities of the SB SEF. The Commission believes that it is important for the SB SEF to have access to books and records that are related to the activities of a SB SEF and to have examination and inspection authority with respect to activities of a SB SEF, in order for a SB SEF to be able to effectively carry out its regulatory responsibilities. Similarly, the Commission believes that it is important for the Commission to have access to those books and records and such examination and inspection authority so that it may effectively conduct its oversight and regulatory responsibilities under the Exchange Act.

Proposed Rule 801(f) would require that any non-resident person³²³ seeking to register as a SB SEF certify on Form SB SEF and provide an opinion of counsel that the SB SEF can, as a

³²¹ See proposed Rule 802(c).

³²² Id.

³²³ The term "non-resident person" would be defined to mean: (1) in the case of an individual, one who resides in or has his principal place of business in any place not in the United States; (2) in the case of a corporation, one incorporated in or having its principal place of business in any place not in the United States; and (3) in the case of a

matter of law, (1) provide the Commission with prompt access to the books and records of such SB SEF and (2) submit to onsite inspection and examination by representatives of the Commission.³²⁴

The Commission preliminarily believes that before granting registration to a non-resident SB SEF, it is appropriate to obtain assurance that such person is legally permitted to provide the Commission with prompt access to its books and records and to be subject to inspection and examination by the Commission. Similarly, the Commission preliminarily believes that before granting registration to a SB SEF controlled by another person, it is appropriate to obtain assurance that the person controlling such SB SEF is legally permitted to provide the Commission with prompt access to its books and records related to the SB SEF and to be subject to inspection and examination by the Commission with respect to activities of the SB SEF. The Commission preliminarily believes that the certifications and opinions of counsel required by proposed Rules 801(e) and (f) would be important to confirm that each non-resident SB SEF or control person of a SB SEF has taken the necessary steps to be in the position to provide the Commission with prompt access to its books and records and to be subject to inspection and examination by the Commission. Certain foreign jurisdictions may have laws that complicate the ability of financial institutions, such as SB SEFs located in their jurisdictions, from sharing or transferring certain information, including personal financial data of individuals that financial institutions come to possess from third parties (*i.e.*, personal data relating to the identity of market participants or their customers). Providing an opinion of counsel that the SB SEF can provide prompt access to books and records and can be subject to inspection and examination

partnership or other unincorporated organization or association, one having its principal place of business in any place not in the United States. See proposed Rule 800.

³²⁴

See proposed Rule 801(f).

would allow the Commission to better evaluate a SB SEF's ability to meet the requirements of registration and ongoing supervision. In addition, certain persons controlling a SB SEF may not be under the jurisdiction of the Commission or may be non-resident persons. Providing an opinion of counsel that such control persons have consented to and can provide prompt access to books and records and be subject to inspection and examination would help the Commission to monitor and oversee individuals that control SB SEFs in cases where such individuals may not otherwise be subject to the jurisdiction of the Commission or may be subject to foreign jurisdictions. Failure to make these certifications or provide an opinion of counsel may be a basis for the Commission to deny an application for registration. Similarly, if a registered non-resident SB SEF or a registered SB SEF that is controlled by another person becomes unable to comply with these certifications or provide such opinions of counsel, then this may be a basis for the Commission to revoke the SB SEF's registration.³²⁵

The Commission requests comments on all aspects of the proposed rules relating to non-resident persons and applicants controlled by other persons seeking to register as SB SEFs. Is the Commission's proposed rule regarding service of process appropriate and sufficiently clear? If not, why not and what would be a better alternative? Should the Commission impose any minimum requirements on the agent whom a person designates to accept any notice or request for service of process? Are there any factors that the Commission should take into consideration to help provide effective service of process on a non-resident person or a person controlled by another person applying for registration as a SB SEF?

If a non-resident SB SEF that is registered in a similar capacity in a foreign jurisdiction seeks to apply for registration as a SB SEF with the Commission, should the registration process

³²⁵ See proposed Rule 804(d) and discussion infra Section XXI.C.

for the non-resident SB SEF be any different than the Commission's proposed registration process? For example, should the registration process incorporate additional registration requirements for such non-resident SB SEF? Should the Commission consider any other factors relating to a non-resident SB SEF with respect to the Commission's registration rules or in general?

Are there any factors that the Commission should take into consideration to ensure that a non-resident person seeking to register as a SB SEF can, in compliance with applicable foreign laws, provide the Commission with access to its books and records and can submit to inspection and examination by the Commission? Should such a non-resident person be required to provide any additional information or documents on proposed Form SB SEF to establish its ability to comply with the federal securities laws and the rules and regulations thereunder?

Are there any factors that the Commission should take into consideration to ensure that a person controlling a person seeking to register as a SB SEF can provide the Commission with access to its books and records and can submit to inspection and examination by the Commission? Should such control persons or the SB SEFs which they control be required to provide any additional information or documents on proposed Form SB SEF to establish the ability of the SB SEF to comply with the federal securities laws and the rules and regulations thereunder? For example, should a SB SEF controlled by another person be required to provide on proposed Form SB SEF a copy of the document evidencing the consent by the controlling person to the books and records and examination and inspections requirements contained in proposed Rule 801(e)?

B. Proposed Filing Requirements for Maintaining SB SEF Registration

Proposed Rule 802 under Regulation SB SEF would require SB SEFs registered with the

Commission to submit certain amendments and updates to Form SB SEF. Proposed Rule 803 under Regulation SB SEF would require SB SEFs registered with the Commission to file certain supplemental information with respect to the trading of SB swaps.

Proposed Rule 802(a) would require a SB SEF to file an amendment to its Form SB SEF promptly, but in no event later than five business days, after discovering that any information filed on Form SB SEF, any statement therein, or any exhibit or amendment thereto, was inaccurate when filed in order to correct such inaccuracies.

Proposed Rule 802(b) would require a registered SB SEF to file an amendment on Form SB SEF with the Commission within five business days after any action is taken that renders inaccurate, or that causes to be incomplete, any information filed on the Execution Page of the SB SEF's Form SB SEF, or any amendment thereto, or any information filed as part of Exhibits C, E, G, or N,³²⁶ or any amendments thereto.³²⁷ Any such amendments must set forth the nature and effective date of the action taken, provide any new information, and correct any information rendered inaccurate. Proposed Rule 802(c) would require a SB SEF that is under the control of any other person to file an amendment to Exhibit P to its Form SB SEF within 5 business days after any changes in the legal or regulatory framework of any person that controls the SB SEF that would impact the ability of or the manner in which any such person consents to or provides the Commission prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, or impacts the Commission's ability to inspect and examine any such person with respect to the activities of the SB SEF.³²⁸ Such amendment would

³²⁶ These exhibits pertain to the list of officers, governors and committees of the SB SEF (Exhibit C), ownership of the SB SEF (Exhibit E), certain material operating agreements (Exhibit G), and criteria for determining what securities may be traded (Exhibit N).

³²⁷ See proposed Rule 802(b).

³²⁸ See proposed Rule 802(c).

be required to include a revised opinion of counsel pursuant to Exhibit P describing how, as a matter of law, any person that controls the SB SEF will continue to meet its obligations to consent to and provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, and to consent to and be subject to onsite inspection and examination by representatives of the Commission under such new legal or regulatory framework.³²⁹ Proposed Rule 802(d) would require non-resident SB SEFs to file an amendment to Exhibit P to their Form SB SEF within five business days after any changes in legal or regulatory framework that would impact the SB SEF's ability to or the manner in which it provides the Commission prompt access to its books and records or impacts the Commission's ability to inspect and examine the SB SEF.³³⁰ Such amendment would be required to include a revised opinion of counsel describing how, as a matter of law, the entity will continue to: (1) meet its obligations to provide the Commission with prompt access to its books and records and (2) be subject to onsite inspection and examination by representatives of the Commission under such new legal or regulatory framework.³³¹

The Commission preliminarily believes that it is appropriate to require the updating of only the Execution Page and Exhibits C, E, G, and N to proposed Form SB SEF on a continuous basis. The exhibits required to be updated pursuant to proposed Rule 802(b) are substantially similar to the exhibits to Form 1 required to be updated on a continuous basis by national securities exchanges pursuant to Rule 6a-2 under the Exchange Act.³³² The Commission believes that it is important for the Commission to receive updates to the information included in

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Id.

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See proposed Rule 802(d).

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Id.

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17 CFR 240.6a-2.

the enumerated exhibits, namely information regarding a SB SEF's governance, ownership, operations, and criteria used to determine the SB swaps that may be traded on the SB SEF, on a real-time basis to allow the Commission to effectively oversee SB SEFs to ensure compliance with the Exchange Act. The Commission also believes that it is important for the Commission to receive updated opinions of counsel under Exhibit P pursuant to proposed Rules 802(c) and (d) to ensure that the Commission can oversee and ensure compliance with the Exchange Act of non-resident SB SEFs and control persons of SB SEFs. Although the comparable amendments to the Form 1 for national securities exchanges are required to be filed within 10 days pursuant to Rule 6a-2, given the improvements in technology since the adoption of Rule 6a-2, the Commission preliminarily believes that five business days should provide SB SEFs sufficient time to prepare and file a Form SB SEF amendment. In addition, the proposed time frame would ensure that the relevant exhibits remain timely and that the Commission has up-to-date information in a timely manner.

Proposed Rule 802(e) also would provide that if the number of changes to be reported in an amendment, or the number of amendments filed, are so great that the purpose of clarity will be promoted by the filing of a new complete Form SB SEF and exhibits, a SB SEF may elect to, or upon request of any representative of the Commission shall, file as an amendment a complete new Form SB SEF together with all exhibits thereto.

Under proposed Rule 802(f), a registered SB SEF would be required to update its Form SB SEF on an annual basis. Specifically, within 60 days of the end of its fiscal year, a registered SB SEF would be required to file an amendment to its Form SB SEF to update the Form SB SEF in its entirety.³³³ Each exhibit to the amended Form SB SEF would be required to be up-to-date

³³³ See proposed Rule 802(f).

as of the end of the latest fiscal year of the SB SEF.³³⁴ The purpose of this requirement is to provide the Commission and the public with updated information on all the exhibits required in the Form SB SEF, particularly those exhibits that are not otherwise required to be updated under proposed Rules 802(b), (c) and (d), on an annual basis. The Commission preliminarily believes that a 60-day filing deadline would give SB SEFs sufficient time in which to file an annual amendment to Form SB SEF.

Proposed Rule 803 would require a registered SB SEF to file with the Commission any material relating to the trading of SB swaps (including notices, circulars, bulletins, lists, and periodicals) issued or made generally available to SB SEF participants. A SB SEF would be required to file such supplementary material with the Commission upon issuing or making the material available to SB SEF participants.³³⁵ However, if such information is available continuously on an Internet website controlled by the SB SEF, the SB SEF may indicate to the Commission the location of the website and certify that such information is accurate instead of filing with the Commission.³³⁶

The Commission preliminarily believes that the amendments required by proposed Rule 802 and the supplemental material required by proposed Rule 803 would provide a useful tool for the Commission to carry out its oversight of SB SEFs and their compliance with the Exchange Act and the rules and regulations thereunder. Requiring SB SEFs to provide consistent and up-to-date disclosures about significant changes in their governance, ownership, operations and criteria used to determine the SB swaps that may be traded on the SB SEF, and requiring non-resident SB SEFs and SB SEFs controlled by another person to update the opinion

³³⁴ See *id.*

³³⁵ See proposed Rule 803(a).

³³⁶ See proposed Rule 803(b).

of counsel whenever changes in legal or regulatory framework would impact their ability to comply with proposed Rules 801(e) and (f), respectively, pursuant to proposed Rules 802(b), (c) and (d) would provide the Commission with important information in monitoring whether a SB SEF is in compliance with the Core Principles throughout its fiscal year. Requiring a SB SEF to update its Form SB SEF and the exhibits thereto on an annual basis pursuant to proposed Rule 802(f) would provide updated information on the parts of the Form SB SEF that are not required to be updated within five business days and thus enable the Commission to have a full picture of the changes at a SB SEF on a year-to-year basis. Requiring SB SEFs to provide to the Commission material made available to SB SEF participants regarding the trading of SB swaps pursuant to proposed Rule 803 would provide the Commission with important information to monitor the trading of SB swaps on the SB SEF and whether such trading is being conducted in compliance with the federal securities laws and the rules and regulations thereunder.

Providing the Commission with the necessary information it needs to effectively regulate SB SEFs and the trading of SB swaps on SB SEFs is especially important because SB SEFs would be new entities and SB SEFs, and the trading of SB swaps on SB SEFs, would be newly regulated by the Commission. The operation of SB SEFs and trading of SB swaps on SB SEFs is likely to change as the regulated market for SB swaps and the trading of SB swaps on trading venues regulated by the Commission continue to develop. The proposed amendments to Form SB SEF, including the proposed annual update, and the proposed supplemental information filing, would help the Commission keep abreast of the changes that may occur with respect to the trading of SB swaps on SB SEFs, and the operation and ownership of SB SEFs, and thus should enable the Commission to more effectively regulate the trading of SB swaps and SB SEFs.

The Commission requests comments on all aspects of the proposed rules relating to required amendments and updates to proposed Form SB SEF and the required filing of supplemental information. Are the Commission's proposed rules appropriate and sufficiently clear? If not, why not and what would be a better alternative? Are the exhibits to proposed Form SB SEF that would require prompt updating pursuant to proposed Rule 802(b) appropriate? Are there other exhibits to Form SB SEF that should be updated on a continuous basis? Are there exhibits that should not be updated on a continuous basis? Is it appropriate to require SB SEF's to update their registration statement annually? Would a different time period be more appropriate? What would be the cost to SB SEFs of the proposed rules requiring amendments?

Is the material required to be filed pursuant to proposed Rule 803 appropriate? Is there other information that the Commission should require to be filed with respect to the trading of SB swaps? Is there information that the Commission should not request? Should the Commission request any information at all? Is it appropriate, in lieu of requiring a SB SEF to file supplemental material with the Commission pursuant to proposed Rule 803(a), to allow the SB SEF to direct the Commission to a website where such information is located and certify that the information is accurate pursuant to proposed Rule 803(b)? Should the Commission make such an allowance for SB SEFs with respect to required amendments pursuant to proposed Rule 802?

C. Withdrawal or Revocation of Registration of SB SEF

Proposed Rule 804 under Regulation SB SEF would permit a registered SB SEF to withdraw from registration by filing a written notice of withdrawal with the Commission, which notice must designate a person associated with the SB SEF to serve as the custodian of the SB

SEF's books and records.³³⁷ Prior to filing a notice of withdrawal, a SB SEF would be required to file an amended Form SB SEF to update any inaccurate information.³³⁸ A notice of withdrawal from registration filed by a SB SEF would become effective on the 60th day after the filing thereof with the Commission, or within such longer period of time as to which such SB SEF consents or which the Commission, by order, may determine as necessary or appropriate in the public interest or for the protection of investors, or within such shorter period of time as the Commission may determine.³³⁹

The Commission preliminarily believes that is appropriate to provide for a mechanism for SB SEFs to withdraw from registration. In addition, the Commission preliminarily believes that 60 days following notice of withdrawal is an appropriate effective date for any SB SEF registration withdrawal. Providing a period between filing of notice of withdrawal and the effective date of any withdrawal should enable the Commission to allow a SB SEF to withdraw its registration with the Commission and cease operating as a SB SEF and market participants to react to any such withdrawal without dislocating the SB swap market or causing any other unintended consequences with respect to the trading of SB swaps.

Proposed Rule 804(d) would provide that the Commission may, by order, revoke the registration of a registered SB SEF if the Commission finds, on the record after notice and opportunity for hearing, that the SB SEF obtained its registration by making false or misleading statements with respect to any material fact or has violated or failed to comply with any

³³⁷ See proposed Rule 804(a). A notice of withdrawal filed pursuant to proposed Rule 804 would be considered a "report" filed with the Commission for purposes of Sections 18(a) and 32(a) of the Exchange Act and the rules and regulations thereunder. See proposed Rule 804(c). See also *supra* note 303.

³³⁸ See proposed Rule 804(a).

³³⁹ See proposed Rule 804(b).

provision of the federal securities laws or the rules and regulations thereunder.³⁴⁰ Pending a final determination as to whether the registration of a SB SEF shall be revoked, the Commission may, by order, suspend the registration of the SB SEF if such suspension appears to the Commission, after notice and opportunity for hearing, to be necessary or appropriate in the public interest or for the protection of investors.³⁴¹ The Commission believes that it is appropriate to provide a mechanism for the Commission to revoke a SB SEF's registration if a SB SEF obtained its registration unlawfully or has violated the federal securities laws or rules or regulations thereunder.

Proposed Rule 804(e) would provide that the Commission may, by order, cancel the registration of a SB SEF if the Commission finds that the SB SEF is no longer in existence or has ceased to do business in the capacity specified in its application for registration.³⁴² The Commission believes that it is appropriate to provide a mechanism for the Commission to cancel a SB SEF's registration if a SB SEF is no longer in existence or has ceased to do business in the manner set forth in the registration application.

The Commission requests comments on all aspects of the proposed rule relating to withdrawal or revocation of registration. Is the Commission's proposed rule regarding the withdrawal, revocation and cancellation of a SB SEF's registration appropriate and sufficiently clear? If not, why not and what would be a better alternative? Should a SB SEF be required to file an amendment on Form SB SEF before withdrawing its registration? If not, why not and what would be a better alternative? Should the Commission require a SB SEF to file a form to request withdrawal of registration? If so, why and what should the SB SEF be required to

³⁴⁰ See proposed Rule 804(d).

³⁴¹ Id.

³⁴² See proposed Rule 804(e).

disclose in the form? Should this form be required in lieu of or in addition to an amendment on Form SB SEF? Is the proposed effective date of 60 days from the filing of the notice of withdrawal with the Commission appropriate? If not, would an earlier or later date be more appropriate? Are the findings required by the Commission to revoke, suspend or cancel a SB SEF's registration appropriate? Are any other instances not specified in this proposed rule in which the Commission should revoke, suspend or cancel a SB SEF's registration?

XXII. New Proposed Form SB SEF for the Registration of Security-Based Swap Execution Facilities

The Commission is proposing that applications for registration as a SB SEF, and amendments to such registration, be submitted on new proposed Form SB SEF. Proposed Form SB SEF is similar in style and format to the existing Form 1 for registration as a national securities exchange. Proposed Form SB SEF, however, is tailored to solicit information that the Commission believes would be useful for considering whether a SB SEF meets the requirements for registration in Section 3D of the Exchange Act, including whether the SB SEF can comply with the Core Principles contained in Section 3D(d) of the Exchange Act, and the rules thereunder, including proposed Regulation SB SEF.

The Execution Page to proposed Form SB SEF would require an applicant to provide certain identifying information. The Execution Page would include a box for the applicant to indicate whether the applicant was seeking consideration for temporary registration pursuant to proposed Rule 801(c). In addition, the Execution Page would require the applicant to designate and authorize an individual, other than a Commission official, for service of process, pleadings, or other documents in connection with any action or proceeding against the applicant, as required by proposed Rule 801(d).

The Execution Page to proposed Form SB SEF further would require the applicant to certify that the statements contained therein are current, true and complete, and that the applicant is currently in compliance with, and is currently operating its business in a manner consistent with, the Exchange Act and all rules and regulations thereunder. The applicant also would be required to certify that it is so organized, and has the capacity, to assure the prompt, accurate, and reliable performance of its functions as a SB SEF, and that it has the capacity to fulfill its obligations under all international information-sharing agreements to which it is a party. In addition, the applicant would be required to certify that any person that controls the applicant has consented to and can, as a matter of law, (1) provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the security-based swap execution facility; and (2) submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF, as required by proposed Rule 801(e). Finally, the applicant would be required to certify that, if it is a non-resident person, it can, as a matter of law, (1) provide the Commission with prompt access to its books and records and (2) submit to an onsite inspection and examination by representatives of the Commission, as required by proposed Rule 801(f).

Proposed Exhibit A to Form SB SEF would require the applicant to provide a copy of the governing documents of the applicant, including but not limited to a corporate charter, articles of incorporation or association, limited liability company agreement, or partnership agreement, with all subsequent amendments, and by-laws or corresponding rules or instruments, whatever the name, of the applicant. This information is intended to be used to assess the applicant's compliance with Core Principle 1 (Compliance with Core Principles), Core Principle 2 (Compliance with Rules), and Core Principle 11 (Conflicts of Interest). The information

provided in this proposed exhibit is designed to allow the Commission to confirm that the applicant has the appropriate authority to operate the trading system and to regulate its participants, and that the ownership structure is consistent with the Exchange Act and the rules and regulations thereunder relating to the governance of SB SEFs.

Proposed Exhibit B to Form SB SEF would require the applicant to provide a copy of all written rulings, settled practices having the effect of rules, stated policies and interpretations of the Board or other committee of the applicant in respect of any provisions of the governing documents, rules or trading practices of the applicant which are not included in Exhibit A. This information required in proposed Exhibit B would be critical to the Commission's ability to assess the applicant's compliance with all of the Core Principles that require SB SEFs to establish and enforce rules relating to a variety of matters (e.g., Core Principle 2 (Compliance with Rules); Core Principle 4 (Monitoring of Trade and Trade Processing); Core Principle 5 (Ability to Obtain Information); Core Principle 6 (Financial Integrity of Transactions); Core Principle 7 (Emergency Authority); Core Principle 10 (Antitrust Considerations); and Core Principle 11 (Conflicts of Interest)). Consequently, the Commission believes that such information is necessary for the Commission to confirm that the applicant's rules meet the requirements of those Core Principles and of the Exchange Act and the rules and regulations thereunder, including proposed Regulation SB SEF.

Proposed Exhibit C to Form SB SEF would require the applicant to provide a list of the officers and directors of the SB SEF, or persons performing similar functions, who presently hold or have held their offices or positions during the previous year, and a list of all standing committees and their members, indicating the following for each: their name and title; date of commencement and termination of term of office or position; the type of business in which each

is primarily engaged (e.g., SB swap dealer, major SB swap participant, inter-dealer broker, end-user etc.); and, if such person is a director, whether such director qualifies as an "independent director" pursuant to proposed Rule 800 under Regulation SB SEF and whether such director is a member of any standing committees or committees that have the authority to act on behalf of the Board or the nominating committee. The Commission believes that mandating SB SEFs to disclose this information should better inform the Commission about SB SEF officers, the persons responsible for the day-to-day operation of the SB SEF, and SB SEF directors, the persons that comprise the Board. In addition, the Commission believes that the information required in Exhibit C is necessary for the Commission to determine the applicant's compliance with the governance requirements of Core Principle 11 (Conflicts of Interest) and the proposed rules under Regulation SB SEF relating thereto, and would aid the Commission in ascertaining any affiliations and relationships that would preclude directors from being considered independent.

Proposed Exhibit D to Form SB SEF would require an applicant to provide a chart or charts illustrating fully the internal organizational structure of the SB SEF. The charts would need to indicate the internal divisions or departments, the responsibilities of each such division or department, and the reporting structure of each division or department, including its oversight by committees or their equivalent. The charts should be sufficiently detailed to permit the Commission and the public to gain a complete understanding of the manner in which the SB SEF is structured and should be able to provide the Commission with an overview of the entity's organizational structure. The Commission preliminarily believes that disclosure of these organizational charts would be an important means by which to provide the Commission with a better understanding of the governance structure of the SB SEF and would enable the

Commission to determine the applicant's compliance with Core Principle 11 (Conflicts of Interest) and the proposed rules under Regulation SB SEF relating thereto. In addition, the Commission preliminary believes that these organizational charts would inform the Commission's view on the ability of the SB SEF to carry out its regulatory and oversight responsibilities with respect to its markets.

Proposed Exhibit E to Form SB SEF would require an applicant to provide certain ownership information. Specifically, Exhibit E would require a list of each person that has a direct or indirect ownership or voting interest in the SB SEF that equals or exceeds 5%, and a list of all related persons of such persons that have an ownership or voting interest in the SB SEF or that are SB SEF participants. For each of the persons and related persons listed in the Exhibit E, an applicant would also need to provide such person's name, title or legal status and whether such person is a SB SEF participant; the date such title, status or participation in a SB SEF was acquired or commenced; the percentage ownership interest held; the type of ownership held, including whether such ownership interest qualifies as "beneficial ownership" under proposed Rule 800 or is entitled to vote; the percentage of voting interest held; and the type of voting interest held. The purpose of this information is to provide the Commission, participants of the SB SEF, and investors with detailed information about which persons or groups of persons potentially could control or influence the SB SEF. In addition, the information proposed to be required by Exhibit E relating to ownership of a SB SEF would provide the Commission, as well as participants in the SB SEF, with up-to-date information regarding a change or potential change in control of a SB SEF. The Commission expects that the disclosure of information concerning persons that hold ownership or voting interests of more than 5% of a SB SEF should

help the Commission more effectively oversee and regulate SB SEFs, especially if the SB SEF is owned or controlled by persons who are not regulated by the Commission.

Proposed Exhibit F to Form SB SEF would require an applicant to provide, for the latest two fiscal years of the applicant, audited financial statements, which would be prepared in accordance with the same requirements for the preparation of financial statements submitted pursuant to the proposed rules under Regulation SB SEF relating to Core Principle 14.³⁴³ The Commission preliminarily believes that this information would enable the Commission to assess the applicant's compliance with Core Principle 12 (Financial Resources) and the proposed rules under Regulation SB SEF relating thereto. In addition, the Commission believes that disclosure of audited financial statements would permit the Commission to better understand the financial resources and decisions of SB SEFs. The Commission preliminarily believes that these statements should be submitted by SB SEFs pursuant to Form SB SEF in addition to the rules relating to Core Principle 14, because documents submitted pursuant to Form SB SEF will be disclosed to the public. This would allow the public to be informed about the financial position of these SB SEFs and should facilitate investor confidence in the markets. In addition, because Exhibit F and the rules relating to Core Principle 14 have the same requirements with respect to the preparation and presentation of such financial statements, this should not create an additional burden on SB SEFs.

Proposed Exhibit G to Form SB SEF would require an applicant to provide an executed or executable copy of any agreements or contracts entered into or to be entered into by the applicant, or a subsidiary or an affiliate of the applicant, including partnership or limited liability company, third-party regulatory service, or other agreements relating to the operation of an

³⁴³ See supra Section XX.C for a discussion of the financial statement requirements pursuant to Core Principle 14. See also proposed Rule 823.

electronic trading system to be used to effect transactions on the SB SEF ("System") that enable or empower the applicant to comply with Section 3D of the Exchange Act. The Commission believes that the provision of these material agreements would be useful for the Commission and the public. They would enable the Commission to understand how and through what parties the System is being operated and to have a better understanding of the arrangements that the SB SEF has entered into to meet its obligations under the Exchange Act. The information required in this exhibit would allow the Commission generally to ascertain the applicant's compliance with all Core Principles.

Proposed Exhibit H to Form SB SEF would require an applicant to provide unconsolidated financial statements (in English) for the latest two fiscal years for every subsidiary in which the applicant has, directly or indirectly, a 25% interest and every entity that has, directly or indirectly, a 25% interest in the applicant, which would be prepared in accordance with the same requirements for the preparation of financial statements submitted pursuant to the proposed rules under Regulation SB SEF relating to Core Principle 14.³⁴⁴ Such financial statements would be required to contain such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading, and be provided in eXtensible Business Reporting Language consistent with Rules 405(a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T.³⁴⁵ In addition to the foregoing, for all other affiliates of the applicant not listed, such information would be required to be made available to the Commission upon

³⁴⁴ See supra Section XX.C for a discussion of the financial statement requirements pursuant to Core Principle 14. See also proposed Rule 823.

³⁴⁵ These requirements are the same as the requirements for the preparation of financial statements for affiliated entities that would be submitted pursuant to the proposed rules under Regulation SB SEF relating to Core Principle 14. See supra Section XX.C for a discussion of the financial statement requirements pursuant to Core Principle 14.

request.³⁴⁶ The Commission preliminarily believes that the information required in this exhibit would allow the Commission to assess the SB SEF's compliance with Core Principle 12 (Financial Resources) and the proposed rules under Regulation SB SEF relating thereto. In addition, the Commission believes that the required financial statement would enable the Commission to better understand the financial resources and decisions of SB SEFs and their affiliates. Finally, while evaluating an applicant's registration application on Form SB SEF, the Commission may determine that additional affiliates of the applicant that do not meet the 25% threshold may be material to the applicant's operation as a SB SEF. Therefore, the Commission preliminarily believes that it is appropriate to require an applicant to provide financial information regarding other affiliates upon request of the Commission.

Proposed Exhibit I to Form SB SEF would require an applicant to describe the manner of operation of the System. This description would be required to include: (1) a detailed description of the manner in which the System satisfies the definition of "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act and any Commission rules, interpretations or guidelines regarding such definition, including a description of how the System displays all orders, quotes, requests for quote, responses, and trades in an electronic or other form, and the timelines in which the system does so; how trading interest interacts on the System; the ability of market participants to see and transact with orders, quotes, requests for quotes, and responses; and an explanation of the trade-matching algorithm if it is based on order priority factors other than price and time; (2) the means of access to the System, including any limitations on access; (3) procedures governing entry and display of trading interest in the System; (4) procedures

³⁴⁶ This requirement to provide the information for all other affiliates of the applicant upon request is not contained in the rules under Regulation SB SEF relating to Core Principle 14, as the financial report submitted by the SB SEF pursuant to such rules is an annual report, rather than a registration application.

governing the execution, reporting, clearance and settlement of transactions in connection with the System; (5) proposed fees; (6) procedures for ensuring compliance with System usage guidelines and rules; (7) the hours of operation of the System, and the date on which the applicant intends to commence operation of the System; (8) a copy of the users' manual or equivalent document; (9) if applicant proposes to hold funds or securities on a regular basis, a description of the controls that would be implemented to ensure safety of those funds or securities; and (10) the name of any entity, other than the SB SEF, that will be involved in operation of the System, including the execution, trading, clearing and settling of transactions on behalf of the SB SEF, and a description of the role and responsibilities of each entity.

The Commission believes that Exhibit I would allow the Commission to determine if the applicant meets the definition of SB SEF under the Exchange Act and rules and regulations hereunder, and in accordance with the guidance set forth in Section III above. In addition, Exhibit I would address the applicant's compliance with several Core Principles, including Core Principle 1 (Compliance with Rules), Core Principle 4 (Monitoring of Trade & Trade Processing), Core Principle 6 (Financial Integrity of Transactions), Core Principle 8 (Timely Publication of Trading Information), Core Principle 9 (Recordkeeping and Reporting), and Core Principle 13 (System Safeguards), and the proposed rules under Regulation SB SEF relating to such Core Principles.

Proposed Exhibit J to Form SB SEF would require an applicant to provide a complete set of all forms pertaining to: (1) applications for participation or subscription to or use of the SB SEF; (2) applications for approval as a person associated with a SB SEF participant, or user of the SB SEF; and (3) any other similar materials. The applicant would have to provide a table of contents listing the forms included. The Commission believes that the information required in

proposed Exhibit J would provide the Commission with important information on the ability of persons to directly access the SB SEF. Such information would enable the Commission to assess the applicant's compliance with Core Principle 2 (Compliance with Rules), Core Principle 5 (Ability to Obtain Information), and Core Principle 6 (Financial Integrity of Transactions) and the proposed rules under Regulation SB SEF related to such Core Principles.

Proposed Exhibit K to Form SB SEF would require an applicant to provide a complete set of all forms of financial statements, reports, or questionnaires required of SB SEF participants, subscribers or any other users relating to financial responsibility or minimum capital requirements for such participants or any other users. The applicant also would have to provide a table of contents listing the forms included. The Commission preliminarily believes that the information collected in this proposed exhibit would provide the Commission with the financial information that SB SEF's require of their participants and users and enable the Commission to assess the applicant's compliance with Core Principle 6 (Financial Integrity of Transactions) and the proposed rules under Regulation SB SEF related thereto.

Proposed Exhibit L to Form SB SEF would require an applicant to describe the applicant's criteria for participation in or use of the SB SEF. The applicant would be required to describe conditions under which SB SEF participants or persons associated with SB SEF participants may be subject to suspension or termination with regard to access to the SB SEF, and any procedures that would be involved in the suspension or termination of a SB SEF participant or person associated with a SB SEF participant. Proposed Exhibit L would require a SB SEF to provide a list of all grants of access (including, for all participants, the reasons for granting such access) and all denials or limitations of access (including, for each applicant or participant, the reasons for denying or limiting access). In addition, proposed Exhibit L would

require a SB SEF to provide a list of all disciplinary actions taken by the SB SEF. The Commission preliminarily believes that proposed Exhibit L would provide the Commission with information regarding access to, limitations of access by, and denials of access by a SB SEF, and disciplinary actions taken by a SB SEF against participants, and would allow the Commission to ascertain the applicant's compliance with Core Principle 2 (Compliance with Rules) and Core Principle 4 (Monitoring of Trading and Trade Processing) and the proposed rules under Regulation SB SEF relating to such Core Principles.

Proposed Exhibit M to Form SB SEF would require an applicant to provide an alphabetical list of all SB SEF participants or other users of the SB SEF, including the following information: name; date of acceptance as a participant or other user; principal business address and telephone number; if participant or other user is an individual, the name of the entity with which such individual is associated and the relationship of such individual to the entity (e.g., partner, officer, director, employee, etc.); a description of the type of activities primarily engaged³⁴⁷ in by the participant or other user (e.g., SB swap dealer, major SB swap participant, inter-dealer broker, non-broker dealer, non-security-based swap dealer, commercial end-user, inactive or other functions); and the class of participation or other access. The Commission preliminarily believes that this exhibit would provide the Commission with information relating to who has access to trading on the SB SEF and would enable the Commission to determine whether a SB SEF is in compliance with Core Principle 2 (Compliance with Rules), Core

³⁴⁷ A person would be "primarily engaged" in an activity or function for purposes of this item when that activity or function is the one in which that person is engaged for the majority of their time. When more than one type of person at an entity engages in any of the types of activities or functions enumerated in this item, the applicant would be required to identify each type and state the number of participants or other users in each.

Principle 6 (Financial Integrity of Transactions) and Core Principle 11 (Conflicts of Interest) and the proposed rules under Regulation SB SEF related to such Core Principles.

Proposed Exhibit N to Form SB SEF requires an applicant to provide a description of the criteria used to determine the SB swaps that may be traded on the SB SEF. The Commission preliminarily believes that this requirement would provide the Commission with information regarding the process by which a SB SEF determines what SB swaps would be traded on the SB SEF and the factors the SB SEF would consider in making such determination. Proposed Exhibit O to Form SB SEF requires an applicant to provide a schedule of the SB swaps to be traded on the SB SEF, including a description of each SB swap. The Commission believes that proposed Exhibits N and O would enable to the Commission to determine whether a SB SEF is complying with Core Principle 2 (Compliance with Rules), Core Principle 6 (Financial Integrity of Transactions) and Core Principle 3 (Security-based Swaps not Readily Susceptible to Manipulation) and the proposed rules under Regulation SB SEF relating to such Core Principles.

Proposed Exhibit P to Form SB SEF would require an applicant that is controlled by any other person to provide an opinion of counsel that any person that controls the SB SEF has consented to and can, as a matter of law, (1) provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF; and (2) submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF. Proposed Exhibit P to Form SB SEF also would require an applicant that is a non-resident person to provide an opinion of counsel that the applicant can, as a matter of law, (1) provide the Commission with prompt access to the books and records of such applicant and (2) submit to onsite inspection and examination by representatives of the Commission. As discussed in Section XXI above, these requirements

would allow the Commission to better evaluate an applicant's ability to comply with the books and records and inspection requirements set forth in proposed Rules 801(e) and (f).

A national securities exchange that seeks to operate a SB SEF would be required to separately register such SB SEF with the Commission as a SB SEF pursuant to proposed Rule 801 and proposed Form SB SEF, and would be required to comply with Section 3D of the Exchange Act, the rules and regulations thereunder, and any other provisions of the Exchange Act and rules thereunder applicable to SB SEFs with respect to the operations of such SB SEF.

National securities exchanges could, under the rules the Commission is proposing today, form subsidiaries or affiliates that operate SB SEFs. If a national securities exchange chose to form such a subsidiary or affiliate, the exchange itself could remain registered as a national securities exchange, while the subsidiary or affiliate registers and operates as a SB SEF. Section 3D(c) of the Exchange Act requires a national securities exchange to identify whether electronic trading of SB swaps is taking place on or through the national securities exchange or a SB SEF to the extent that the exchange also operates a SB SEF and uses the same electronic trade execution system for listing and executing trades of SB swaps. The Commission notes that any subsidiary or affiliate of a registered exchange could not integrate, or otherwise link the SB SEF with the exchange, including using the premises or property of such exchange for effecting or reporting a transaction, without being considered a "facility of the exchange."³⁴⁸ In the event that a national securities exchange begins trading SB swaps either on the exchange or on a facility of the exchange, it would be required to file rule filings under Rule 19b-4 under the Exchange Act in connection with the trading of SB swaps on the exchange or its facility, and

³⁴⁸ See Section 3(a)(2) of the Exchange Act, 15 U.S.C. 78c(a)(2) (defining the term "facility of the exchange"). The Commission gave a similar analysis regarding facilities of exchanges with regard to ATSS in the ATS Adopting Release, supra note 94, at note 437.

such facility would have to comply with the provisions of the Exchange Act and the rules and regulations thereunder applicable to national securities exchanges.

The Commission generally requests comments on all aspects of the proposed Form SB SEF. Is the format of the proposed Form SB SEF appropriate and sufficiently clear? If not, why not and how could it be improved? Are the instructions to the proposed Form SB SEF appropriate and sufficiently clear? If not, why not and how could they be improved? Are the defined terms included on proposed Form SB SEF appropriate and sufficiently clear? If not, why not and how could they be improved?

Are the disclosure items contained on the Execution Page of the proposed Form SB SEF appropriate? Are there other useful disclosure items that should be added? If so, please describe such items and why they should be added. Or, are there proposed items on the Execution Page that should be deleted? If so, please describe why such items are not necessary. Are the certifications contained on the Execution Page of the proposed Form SB SEF appropriate? Are there other useful certifications that the Commission should require the applicant to make? If so, please describe such items and why they should be added. Or, are there proposed certifications that should be deleted? If so, please describe why such certifications are not necessary.

Are the proposed exhibits to the Form SB SEF appropriate? Would the information requested adequately allow the Commission to determine whether to grant or deny the registration of a SB SEF pursuant to proposed Rule 801(b)? Are there other useful disclosure items that should be added to the exhibits or added as exhibits? If so, please describe such items and why they should be added. Are there any registration requirements proposed by the CFTC for SEFs that the Commission should adopt for SB SEFs?³⁴⁹ For example, should the

³⁴⁹ See Notice of proposed SEF rulemaking by the CFTC Release, supra note 17.

Commission require a SB SEF to provide a description of material pending legal proceedings?³⁵⁰ Should the Commission require a SB SEF to provide a description of the personnel qualifications for each category of professional employees employed by the applicant?³⁵¹ Should the Commission require a SB SEF to provide an analysis of the staffing requirements necessary to carry out operations of the applicant and the name and qualifications of each key staff person?³⁵² Is the information requested on Form SB SEF and the exhibits thereto overly burdensome for SB SEFs? If so, how could any such burdens be reduced? Are there proposed exhibits or items of information in proposed exhibits that should be deleted from proposed Form SB SEF? If so, please describe why such proposed exhibits would not be necessary. Should certain proposed exhibits be required to be made available to the Commission only upon request? If so, which proposed exhibits and why? For example, should an applicant be required to provide the information regarding SB SEF participants required by proposed Exhibit M upon request by the Commission following the filing of the applicant's Form SB SEF, rather than as an exhibit to the applicant's initial filing of proposed Form SB SEF? Commenters are requested to consider the totality of the information required by proposed Form SB SEF in framing their responses.

The Commission also requests that commenters address whether there are confidentiality issues with any information required by the proposed exhibits to proposed Form SB SEF? If so, what information presents issues and what are the issues? Further, the Commission notes that proposed Form SB SEF would be filed electronically and thus is expected to be made available

³⁵⁰ See proposed Exhibit H to proposed Form SEF; see also Notice of proposed SEF rulemaking by the CFTC, supra note 17.

³⁵¹ See proposed Exhibit E to proposed Form SEF; see also Notice of proposed SEF rulemaking by the CFTC, supra note 17.

³⁵² See proposed Exhibit F to proposed Form SEF; see also Notice of proposed SEF rulemaking by the CFTC, supra note 17.

publicly on the Commission's website. The Commission seeks comment on whether the information to be filed on proposed Form SB SEF would be useful to the public.

XXIII. Rule Filing Processes for Changes to a SB SEF's Rules

A. Introduction

The Commission is proposing to adopt rules requiring registered SB SEFs to comply with certain rule filing processes for any new rules or rule amendments. Specifically, the Commission is proposing new Rules 805 and 806, which set forth, respectively, a process for the voluntary submission of rules for Commission review and approval, and a self-certification rule filing process.³⁵³ The processes proposed under these rules are substantially similar to the two rule filing processes that the CFTC has in its existing rules,³⁵⁴ as modified by the new authority the CFTC has received under Section 745 of the Dodd-Frank Act.³⁵⁵ It is important for the Commission to receive notice of proposed rule changes to understand how each SB SEF operates and is governed to help the Commission with its oversight of SB SEFs. The Commission intends to coordinate efforts with the CFTC, as appropriate, to have the processes offered in proposed Rules 805 and 806 resemble the rule filings processes that the CFTC ultimately adopts for SEFs, in large part to streamline and simplify compliance for joint SEF/SB SEF entities.

B. Voluntary Submission of Rules for Commission Review and Approval

Proposed Rule 805 gives a registered SB SEF the option of voluntarily submitting a proposed new rule or rule amendment for approval by the Commission prior to its implementation. Paragraph (a) of proposed Rule 805 would require such filings to: (1) be filed

³⁵³ Proposed Rule 806(d) also provides a limited exception to the certification requirement for certain kinds of filings. See proposed Rule 806(d). See also discussion *infra* notes 382 to 384 and accompanying text.

³⁵⁴ 17 CFR 40.5 and 17 CFR 40.6.

³⁵⁵ See Pub. L. No. 111-203 § 745 (amending Section 5c of the CEA, 7 U.S.C. 7a-2).

electronically with the Commission in a format specified by the Commission; (2) set forth the text of the proposed rule or rule amendment (in the case of a rule amendment, deletions and additions must be indicated); (3) indicate the proposed effective date of the proposed rule, any action taken or anticipated to be taken to adopt the proposed rule by the SB SEF or by its governing board or by any committee thereof, and the cite for the rules of the SB SEF that authorize the adoption of the proposed rule change; (4) explain the operation, purpose, and effect of the proposed rule, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, and how the rule fits into the SB SEF's framework of regulation; (5) certify that the SB SEF posted a notice of pending rule filing and a copy of the submission, concurrent with the filing of a submission on its website; (6) include the documentation relied on to establish the basis for compliance with the applicable provisions of the Exchange Act and the Commission's regulations thereunder, including the Core Principles; (7) provide additional information which may be beneficial to the Commission in analyzing the new rule or rule amendment; (8) describe briefly any substantive opposing views expressed to the SB SEF by the Board or committee members, participants of the SB SEF, or market participants with respect to the new rule or rule amendment that were not incorporated into the new rule or rule amendment; (9) identify any Commission regulation that the Commission may need to amend, or sections of the Exchange Act or the Commission's regulations that the Commission may need to interpret, in order to approve the new rule or rule amendment; (10) in the case of proposed amendments to the terms and conditions of a SB swap product, include a written statement verifying that the registered SB SEF has undertaken a due diligence review of the legal conditions, including conditions relating

to contractual and intellectual property rights, that may materially affect the trading of the product; and (11) request confidential treatment, if appropriate.³⁵⁶

Proposed Rule 805(a) sets forth the information a SB SEF would be required to provide the Commission when seeking Commission approval of a proposed change to a SB SEF rule, or a proposed change to the terms and conditions of a SB swap that has already commenced trading. Most of the proposed items of information to be included are substantially similar to the items of information a national securities exchange is required to provide on Form 19b-4³⁵⁷ when seeking approval of a proposed rule change in accordance with Section 19(b) of the Exchange Act.³⁵⁸ Specifically, the requirements in proposed Rule 805(a)(1) through (4) regarding electronic submission, submission of proposed rule text highlighting additions and deletions, inclusion of background information on how and why a proposed change is authorized, and explanation of the operation, purpose, and effect of the proposed rule change are similar to the requirements applicable to national securities exchanges seeking to implement a proposed rule change. Further, the requirements in proposed Rule 805(a)(7) through (9) to include additional information beneficial to the Commission in analyzing the new rule or rule amendment, a description of substantive opposing views expressed to the SB SEF regarding the proposal, and to identify any Commission regulation that the Commission may need to amend or interpret in order to approve the new rule or rule amendment also are similar to the requirements of Form 19b-4 applicable to national securities exchanges. These requirements are designed to ensure that a SB SEF seeking to implement a new or proposed rule change provides all relevant

³⁵⁶ See proposed Rule 805(a).

³⁵⁷ See 17 CFR 240.19b-4.

³⁵⁸ 15 U.S.C. 78s(b).

information and context regarding the proposal that would allow the Commission to evaluate the proposal for consistency with the Exchange Act and rules and requirements thereunder.

In addition, similar to the requirements for national securities exchanges, the proposal in Rule 805(a)(5) would require a SB SEF to certify that it has posted a notice of pending rule filing and a copy of the submission, concurrent with the filing of a submission on its website. This proposal is intended to ensure that market participants would receive prompt notice of new requests for approval filed with the Commission.³⁵⁹

Proposed Rule 805(a)(6) also would require a SB SEF to include the documentation relied on to establish the basis for compliance with the applicable provisions of the Exchange Act and the Commission's regulations thereunder, including the Core Principles. In the case of proposed changes to the terms and conditions of a SB swap, this provision would require, without limitation, inclusion of documentation relied on to establish the basis for compliance with Section 3D(d)(3) of the Exchange Act and proposed Rule 812 thereunder, which would require a SB SEF's swap review committee to have determined, after taking into account all of the terms and conditions of the SB swap and the markets for the SB swap and any underlying securities, that a SB swap proposed to be traded is not readily susceptible to manipulation.³⁶⁰

Also with regard to proposed changes to the terms and conditions of a SB swap, proposed Rule 805(a) would require a SB SEF to provide a written statement verifying that it has undertaken a due diligence review of the legal conditions, including conditions relating to contractual and intellectual property rights, that may materially affect the trading the product.

This proposed requirement is designed to prevent a SB SEF from seeking to trade a proprietary

³⁵⁹ Rule 19b-4(l) under the Exchange Act requires each national securities exchange to post proposed rule changes on its website within two business days of filing with the Commission. See 17 CFR 240.19b-4(l).

³⁶⁰ See proposed Rule 812.

product of another SB SEF or other entity. The Commission preliminarily believes that the information to be included pursuant to proposed Rule 805(a) in a request for approval of a new or proposed rule change or change to the terms and conditions of a SB swap is necessary to assist the Commission in making a reasoned determination as to whether such proposed change is consistent with the Exchange Act.

Proposed Rule 805(b) would require the Commission to approve a new rule or rule amendment unless the rule or rule amendment is inconsistent with the Exchange Act or the Commission's regulations promulgated thereunder.³⁶¹ The Commission has coordinated with the CFTC and the proposed standard for approval is the same as that standard for approval under the CFTC's proposed rule approval process, which is intended to provide consistency to market participants who may operate a SB SEF and a SEF.

Proposed Rule 805(c) would give the Commission a 45-day review period, starting from the date that the filing is received by the Commission, to consider whether the proposed rule or rule amendment is consistent with the Exchange Act and the regulations thereunder.³⁶² Unless the Commission notifies the SB SEF otherwise, the proposed rule change would be deemed approved by the Commission at the end of the 45-day review period (or at the end of any extension period, as applicable), provided that: (1) the submission of the rule change complies with the requirements of paragraph (a) of proposed Rule 805, and (2) the SB SEF has not amended the filing during the review period, except as requested by the Commission during that period.³⁶³

³⁶¹ See proposed Rule 805(b).

³⁶² See proposed Rule 805(c).

³⁶³ Id. Any amendment or supplementation not requested by the Commission would be treated as the submission of a new filing.

Under paragraph (d) of proposed Rule 805, the Commission would be able to extend the review period by an additional 45 days if the proposed rule raises novel or complex issues that require additional time for review or is of major economic significance, the submission is incomplete, or the requestor does not respond completely to Commission questions in a timely manner.³⁶⁴ In this case, the Commission would be required to notify the submitting SB SEF within the initial 45 day review period and briefly describe the nature of the specific issues for which additional time for review is required. In addition, the Commission would be able to extend the review period to any period, beyond the additional 45 days initially requested, to which the SB SEF agrees in writing.³⁶⁵

Under paragraph (e) of proposed Rule 805, the Commission would have the authority to issue a notice of non-approval if it finds that the new rule or rule amendment is or appears to be inconsistent with the Exchange Act or the regulations thereunder.³⁶⁶ At any time during its review under proposed Rule 805, the Commission would be able to notify the SB SEF that it will not approve the new rule or rule amendment because it believes that the new rule or rule amendment is inconsistent with the Exchange Act or Commission rules or regulations thereunder. The Commission would provide, in its notice, the nature of the issues raised and the specific provision of the Exchange Act or the Commission's rules or regulations with which the new rule or rule amendment is or appears to be inconsistent. Pursuant to proposed Rule 805(f), the receipt of a notice of non-approval would not prevent the SB SEF from subsequently submitting a revised version of the proposed rule or rule amendment for Commission review and

³⁶⁴ See proposed Rule 805(d).

³⁶⁵ Id.

³⁶⁶ See proposed Rule 805(e).

approval, and the revised submission would be reviewed without prejudice.³⁶⁷ However, the receipt of a notice of non-approval would be presumptive evidence that the SB SEF could not truthfully submit the same, or substantially the same, proposed rule or rule amendment for self-certification under proposed Rule 806.³⁶⁸

Proposed Rule 805(g) would allow the Commission to provide for expedited approval for rule changes, including rule changes to terms and conditions of a product that are consistent with the Exchange Act and the rules and regulations thereunder, at such time and under such conditions as the Commission may specify in a written notification.³⁶⁹ However, proposed Rule 805(g) would also allow the Commission to grant expedited approval to a proposed rule or rule amendment, at any time, and also to alter or revoke the applicability of such a notice to any particular rule or rule amendment.

The Commission is proposing the time periods in paragraphs 805(c) through (g) to align its procedure for reviewing proposed rules and rule amendments with the CFTC's procedure.³⁷⁰ The Commission believes that a parallel procedure would be beneficial for SB SEFs and SEFs that are dually registered. Furthermore, the Commission believes that the proposed prior approval process would allow the SB SEF the opportunity to achieve greater certainty about the Commission's views on whether a new rule or rule amendment is consistent with the Exchange Act and the rules and regulations thereunder prior to taking steps to implement the rule or amendment.

³⁶⁷ See proposed Rule 805(f)(1).

³⁶⁸ See proposed Rule 805(f)(2). See *infra* Section XXIII for a discussion of the certification process.

³⁶⁹ See proposed Rule 805(g).

³⁷⁰ See 17 CFR 40.5 and 40.6. See also Pub. L. No. 111-203, § 745 (amending Section 5c of the Commodity Exchange Act, 7 U.S.C. 7a-2). See also 75 FR 67282 (November 2, 2010) (CFTC proposal to amend 17 CFR 40.5 and 40.6).

C. Self-Certification of Rules

Proposed Rule 806 would allow a SB SEF, as an alternative to complying with proposed Rule 805, to implement a new rule or rule amendment pursuant to self-certification.³⁷¹ This process would provide the Commission ten business days to review a self-certification filing and to stay the certification within such review period, if warranted.

Specifically, under proposed Rule 806(a), a registered SB SEFs would be required to submit the self-certification electronically at least ten business days prior to the implementation date of the new rule or rule amendment.³⁷² The proposed rule would require that the SB SEF publish on its website a notice of pending certification with the Commission and copy of the submission concurrent with the filing of a submission with the Commission.³⁷³

Similar to proposed Rule 805, proposed Rule 806 would require the submission to include certain specific items: (1) the text of the rule (in the case of a rule amendment, deletions and additions must be indicated); (2) the date of intended implementation; (3) a certification by the SB SEF that the rule complies with the Exchange Act and the Commission's regulations thereunder; (4) the documentation relied on to establish the basis for compliance with the

³⁷¹ See proposed Rule 806.

³⁷² See proposed Rule 806(a)(1) and proposed Rule 806(a)(3). Proposed Rule 806(a)(3) would provide an exception to the 10 day requirement for new rules or rule amendments that the SB SEF seeks to implement in the exercise of its emergency authority pursuant to Rule 816, requiring instead that the SB SEF file such emergency rule or rule amendment with the Commission prior to the implementation of such rule or rule amendment, or, if not practicable, within twenty-four hours after implementation of such emergency rule or rule amendment.

³⁷³ See proposed Rule 806(a)(2). The proposed Rule would require the SB SEF to provide such information in its submission to the Commission, but would permit the SB SEF to redact information that it seeks to keep confidential from the documents that it publishes on its website. If, however, a determination is made pursuant to the Freedom of Information Act that such information may not be kept confidential, the proposed rule would require the SB SEF to republish its filing on its website including such information.

applicable provisions of the Exchange Act and the Commission's regulations thereunder, including the Core Principles;³⁷⁴ (5) a brief explanation of any substantive opposing views expressed to the registered SB SEF by the Board or committee members, participants, or market participants that were not incorporated into the rule, or a statement that no such opposing views were expressed; (6) a request for confidential treatment, if appropriate; and (7) in the case of proposed amendments to the terms and conditions of a SB swap, a written statement verifying that the registered SB SEF has undertaken a due diligence review of the legal conditions, including conditions relating to contractual and intellectual property rights, that may materially affect the trading the product.³⁷⁵ The proposed Rule would also require the SB SEF to provide, if requested by Commission staff, additional evidence, information or data that may be beneficial to the Commission in conducting a due diligence assessment of the filing and the SB SEF's compliance with any of the requirements of the Exchange Act or the Commission's rules or regulations thereunder.³⁷⁶ The proposed items of information are similar to those required by proposed Rule 805(a) as well as those in CFTC Rule 40.6.³⁷⁷ The Commission preliminarily believes that inclusion of the items of information set forth in proposed Rule 806(a) would assist the Commission in considering whether a SB SEF's implementation of a new rule, rule amendment, or modification to the terms and conditions of a SB swap pursuant to self-

³⁷⁴ In the case of proposed changes to the terms and conditions of a SB swap, this provision would require, without limitation, inclusion of documentation relied on to establish the basis for compliance with Section 3D(d)(3) of the Exchange Act and proposed Rule 812 thereunder, which would require a SB SEF's swap review committee to have determined, after taking into account all of the terms and conditions of the SB swap and the markets for the SB swap and any underlying securities, that a SB swap proposed to be traded is not readily susceptible to manipulation. See proposed Rule 812.

³⁷⁵ See proposed Rule 806(a)(5).

³⁷⁶ See proposed Rule 806(a)(6).

³⁷⁷ See proposed Rule 805(a) and 17 CFR 40.6. See also Pub. L. No. 111-203, § 745 (amending Section 5c of the Commodity Exchange Act, 7 U.S.C. 7a-2).

certification is appropriate and consistent with the Exchange Act and the rules and requirements thereunder.

Under paragraph (b) of proposed Rule 806, the Commission would have 10 business days to review the submission and the self-certification would become effective at the end of the 10 business-day period, unless the Commission notifies the registered entity, during such 10 business-day period, that it intends to issue a stay of the certification.³⁷⁸ Proposed Rule 806(c)(1) would provide that the Commission would be able to stay the certification of a new rule or rule amendment by issuing a notification to the SB SEF informing it that the Commission is staying the certification and stating the grounds for doing so.³⁷⁹ The proposed rule also would provide that the certification of a rule could be stayed by the Commission on the grounds that the new rule or rule amendment presents novel or complex issues, is accompanied by an inadequate explanation, or is potentially inconsistent with the Exchange Act or the Commission's regulations thereunder. Once the Commission issues a notification of stay to the registered entity, the Commission would have 90 days to conduct a review. A stay of a rule certification may be appropriate, for example, where a registered entity certifies a rule that raises unique issues not previously reviewed by Commission staff. In addition, the Commission believes that new rules or rule amendments may raise a number of complex issues if they appear to have a material impact on other securities and financial markets. Thus, such rules are more likely to be subject to an extended review period to allow the Commission to adequately identify and address complex regulatory issues.

Proposed Rule 806(c)(2) would require the Commission to provide a 30-day public comment period within the 90-day period that the stay is in effect and to publish a notice of the

³⁷⁸ See proposed Rule 806(b).

³⁷⁹ See proposed Rule 806(c)(1).

30-day comment period on the Commission's website.³⁸⁰ Unless the Commission notifies the SB SEF that it objects to the certification within the 90-day period on the grounds that the proposed rule is inconsistent with the Exchange Act or the rules or regulations thereunder, the rule would become effective, pursuant to certification, upon the expiration of the 90-day review period.³⁸¹ If the Commission decides to lift the stay prior to the expiration of the 90-day review period, the Commission would notify the SB SEF of its action and the rule would become certified at such time.

Finally, proposed Rule 806(d) would permit SB SEFs to implement certain new rules or rule amendments on the following business day without certification to the Commission.³⁸² Pursuant to proposed Rule 806(d)(1), the rules permitted to be implemented pursuant to this summary process would be limited to rules regarding corrections of typographical errors, renumbering, periodic routine updates to identifying information about approved entities and other such non-substantive revisions of a product's terms and conditions that have no effect on the economic characteristics of the product.³⁸³ Proposed Rule 806(d)(2) would require SB SEFs to provide to the Commission electronically, in a format to be specified by the Commission, at least weekly, a summary notice of all rule amendments made effective thereunder.³⁸⁴ Such notice would not be required for weeks during which no such actions have been taken. Proposed Rule 806(e) would allow a SB SEF to implement certain other new rules or rule amendments without certification or notice to the Commission, provided that the SB SEF maintains

³⁸⁰ See proposed Rule 806(c)(2).

³⁸¹ See proposed Rule 806(c)(3).

³⁸² See proposed Rule 806(d).

³⁸³ See proposed Rule 806(d)(2).

³⁸⁴ See proposed Rule 806(d)(1).

documentation regarding all changes to rules and posts all such rule changes on its website.³⁸⁵

These rules and rule amendments would be those that govern: (1) the organization and administrative procedures of a SB SEF governing bodies such as a Board, officers, and committees, but not any of the following: voting requirements; Board or committee composition requirements or procedures; decision making procedures; use or disclosure of material non-public information gained through the performance of official duties, or requirements relating to conflicts of interest; or (2) the routine, daily administration, direction and control of employees, requirements relating to gratuity and similar funds, but not any of the following: guaranty; reserves; or similar funds; declaration of holidays; and changes to facilities housing the market.

The Commission notes that the certification process in proposed Rule 806 does not call for any final action by the Commission. In cases where a SB SEF seeks final agency action, a SB SEF could choose to file a proposed rule or rule amendment under proposed Rule 805.

The Commission intends to allow registered SB SEFs to submit filings under proposed Rules 805 and 806 electronically through a portal similar to the electronic rule filing system used for proposed rule changes by national securities exchanges and national securities associations.³⁸⁶

The Commission notes that the process under proposed Rules 805 and 806 closely parallel the CFTC's Rules 40.5 and 40.6.³⁸⁷ The Commission preliminarily believes that allowing SB SEFs to file new rules and rule amendments in this manner would simplify the filing process and also provide the Commission with prompt access for review. The

³⁸⁵ See proposed Rule 806(e).

³⁸⁶ The process for submission of rule filings would be the subject of a separate rulemaking.

³⁸⁷ See 17 CFR 40.5 and 40.6. See also Pub. L. No. 111-203, § 745 (amending Section 5c of the Commodity Exchange Act, 7 U.S.C. 7a-2). See also 75 FR 67282 (November 2, 2010) (CFTC proposal to amend 17 CFR 40.5 and 40.6).

Commission intends to propose forms for these electronic filings as part of a separate rulemaking.

D. Request for Comment

The Commission generally requests comments on all aspects of the proposed rules relating to the proposed rule filing process. Are the Commission's proposed rules for the filing process for new rules and rule amendments appropriate and sufficiently clear? If not, why not and what would be better alternatives? Is it preferable to have a rule filing process for SB SEFs that closely aligns to the process for SEFs under the CFTC's rules as proposed? By doing this, would the proposed rules achieve the goal of streamlining and simplifying the effort to have rules implemented for entities that are both SB SEFs and SEFs? If not, what other alternatives should the Commission consider? What other burdens should the Commission take account of that joint SB SEF/SEF entities would face under the proposed rules? Is the voluntary prior approval process in proposed Rule 805 a useful option for SB SEFs? If not, what would be a better alternative?

Does the automatic effectiveness for a rule or rule amendment submitted under proposed Rule 806, once the review period has expired and in the absence of non-approval, provide sufficient legal clarity and certainty about the change? Or, would an approval order by the Commission be more instructive or helpful? Are the time periods for review, and extensions for review, in proposed Rule 805 appropriate? If so, what would be more appropriate? Should the submissions for prior approval be published by the Commission for public comment? Why or why not?

Is the provision of a notice of non-approval to the SB SEF, as described under proposed Rule 805(e), a sufficient means of informing the SB SEF of the basis for non-approval? Would

more information or another form of notice be more appropriate? If so, please explain. Should such notice of non-approval be published on the Commission's website or otherwise be made publicly available? Would the proposed self-certification process in proposed Rule 806 be a useful alternative to the prior approval process for rule changes? Why or why not?

Are the proposed grounds for staying a certification under proposed Rule 806(c) appropriate? If not, why not? Are there other grounds that would also be appropriate for staying a certification? Under proposed Rule 806 (for self-certification), would the 10 business-day review period and, if a stay is put in place, the 90-day review period be appropriate timeframes for Commission review and consideration? If not, why not and what would be a better alternative? Please provide support for any alternative suggestions.

Should the 90-day review period, subsequent to a stay of a certification, in proposed Rule 806(c) include a 30-day public comment period? Why or why not? Is the means for determining whether a rule or rule amendment has been certified or objected to provided for in proposed Rule 806(c)(3) sufficiently clear? If not, how could such determination be made more clear? Should the Commission publish notice of either the effective certification or the notice of an objection for the public on its website or through other means?

Are the proposed processes for providing notice, without a certification, for certain kinds of rule changes in proposed Rule 806(d) appropriate? If not, why not? Are the proposed rule changes that would be eligible for notice without certification in proposed Rule 806(d) and (e) appropriate? If not, which ones should not be eligible for these processes? Are there other kinds of rule changes that should be eligible for these processes?

Would an electronic method for submitting all rule submissions under proposed Rules 805 and 806 be an appropriate and efficient way of making such submissions? If not, why not?

Would an electronic system such as the existing system for submitting rule changes by national securities exchanges and associations, Electronic Form 19b-4 Filing System, or “EFFS,”³⁸⁸ be a good model for the system for SB SEF submissions under these proposed rules? If not, what would be a better model for such an electronic system?

XXIV. Filing Processes for Trading Security-Based Swaps

A. Introduction

The Commission is proposing to adopt rules requiring SB SEFs to comply with certain filing processes prior to trading SB swaps. Specifically, the Commission is proposing new Rules 807 and 808 of Regulation SB SEF, which set forth filing processes for commencement or continued trading of SB swaps on a SB SEF. The processes proposed under these rules are substantially similar to the parallel processes that the CFTC has in its existing rules, 17 CFR 40.2 and 17 CFR 40.3, as modified by the new authority the CFTC has received under Section 745 of the Dodd-Frank Act.³⁸⁹

The proposed filing processes pursuant to which a SB SEF may trade a SB swap each require that a SB SEF describe the proposed product’s “terms and conditions.” The Commission is not proposing a definition of “terms and conditions,” but requests comment on whether it should adopt a definition of “terms and conditions” and, if so, what specifically should such a definition include.³⁹⁰ Specifically, should a Commission definition of “terms and conditions”

³⁸⁸ See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004) (File No. S7-18-04).

³⁸⁹ See Pub. L. No. 111-203, § 745 (amending Section 5c of the Commodity Exchange Act, 7 U.S.C. 7a-2). See also 75 FR 67282 (November 2, 2010) (CFTC proposal to amend 17 CFR 40.2 and 40.3).

³⁹⁰ The Commission notes that the CFTC, in 17 CFR 40.1, defines “terms and conditions” as referring to a description of the security underlying a swap, specification of cash settlement, and the rights and obligations of the counterparties to the swap. The CFTC’s definition also notes that whenever possible, all proposed swap terms and conditions

refer to the rights and obligations of the counterparties to a SB swap? Should it include such items as: (1) notional values; (2) relevant dates, tenor, and day count conventions; (3) index; (4) relevant prices, rates or coupons; (5) currency; (6) stub, premium, or initial cash flow components along with subsequent life cycle events; (7) payment and reset frequency; (8) business calendars; (9) accrual type; (10) spread or points; and (11) description of the underlying security or securities or reference asset(s)? Should it include other items that appear in the CFTC's definition? Are there any other items that should be included? Should the ISDA Master Agreement be referenced in a definition? If so, why and how?

B. Trading SB Swaps Pursuant to Certification

Proposed Rule 807 would require every SB SEF to comply with certain submission requirements prior to trading a SB swap product if such product has not been approved under proposed Rule 808. Pursuant to proposed Rule 807 every submission must be filed electronically in a form to be determined by the Commission and be received by the Commission by the open of business on the business day preceding the day the SB swap would commence trading. In addition, every submission would be required to include: (1) a copy of the SB swap product's terms and conditions; (2) the intended date on which the SB swap may begin trading; (3) a certification by the registered SB SEF that the SB swap to be traded complies with the Exchange Act and the rules and regulations thereunder; (4) the documentation relied on to establish the basis for compliance with the Exchange Act and the rules and regulations thereunder, including the Core Principles;³⁹¹ (5) a written statement verifying that the registered

should conform to industry standards or those terms and conditions adopted by comparable contracts. Further, the CFTC's definition sets forth a list of items covered by the phrase "terms and conditions."

³⁹¹ As discussed in note 374 *supra*, this provision would require, without limitation, inclusion of documentation relied on to establish the basis for compliance with Section

SB SEF has undertaken a due diligence review of the legal conditions, including legal conditions that relate to contractual and intellectual property rights, that may materially affect the trading of the SB swap; (6) a certification that the registered SB SEF posted on its website a notice of pending certification with the Commission and a copy of the submission, concurrent with the filing of a submission with the Commission; and (7) a request for confidential treatment, if appropriate.

Pursuant to proposed Rule 807(b), upon request of any representative of the Commission, a SB SEF would be required to provide any additional evidence, information or data demonstrating that the SB swap product meets, initially or on a continuing basis, all of the requirements of the Exchange Act and its rules.

Proposed Rule 807(c) would provide that the Commission would be able to stay the certification of a SB swap by issuing a notification to the SB SEF informing it that the Commission is staying the certification and stating the grounds for doing so.³⁹² The proposed rule also would provide that the certification could be stayed by the Commission on the grounds that the SB swap presents novel or complex issues, is accompanied by an inadequate explanation, or is potentially inconsistent with the Exchange Act or the Commission's regulations thereunder. Once the Commission issues a notification of stay to the registered entity, the Commission would have 90 days to conduct a review. A stay of a certification may be appropriate, for example, where a registered entity certifies a SB swap that raises unique issues not previously reviewed by Commission staff.

3D(d)(3) of the Exchange Act and proposed Rule 812 thereunder, which would require a SB SEF's swap review committee to have determined, after taking into account all of the terms and conditions of the SB swap and the markets for the SB swap and any underlying securities, that a SB swap proposed to be traded is not readily susceptible to manipulation.

³⁹² See proposed Rule 807(c)(1).

Proposed Rule 807(c) would require the Commission to provide a 30-day public comment period within the 90-day period that the stay is in effect and to publish a notice of the 30-day comment period on the Commission's website.³⁹³ Unless the Commission notifies the SB SEF that it objects to the certification within the 90-day period on the grounds that the proposed SB swap is inconsistent with the Exchange Act or the rules or regulations thereunder, the SB swap would become effective, pursuant to certification, upon the expiration of the 90-day review period.³⁹⁴ If the Commission decides to lift the stay prior to the expiration of the 90-day review period, the Commission would notify the SB SEF of its action and the SB swap would become certified at such time.³⁹⁵

The Commission preliminarily believes that proposed Rule 807, which closely parallels CFTC proposed new Rule 40.2, provides a reasonable process pursuant to which a SB SEF may trade SB swaps through a certification process. Any dually registered SB SEF would be following very similar procedures for certification of swaps under CFTC proposed new Rule 40.2. The proposed rule would give the Commission notice of any new SB swaps for which a SB SEF would permit trading and would allow the Commission to stay a proposed SB swap's certification in certain circumstances. In addition, because the proposed rule closely parallels the

³⁹³ See proposed Rule 807(c)(2).

³⁹⁴ See proposed Rule 807(c).

³⁹⁵ The stay provision in proposed Rule 807(c) is more similar to the stay provision in proposed Rule 806 and proposed CFTC Rule 40.6 than it is to the stay provision in proposed CFTC Rule 40.2. Proposed CFTC Rule 40.2 would permit the CFTC to stay a certification of a SB swap during the pendency of a CFTC proceeding for filing a false certification or during the pendency of a petition to alter or amend the contract terms and conditions pursuant to Section 8a(7) of the Commodity Exchange Act. The Commission notes that the Exchange Act does not provide for procedures analogous to those in proposed CFTC Rule 40.2, and thus is proposing it to align proposed Rule 807 with proposed CFTC Rule 40.2.

CFTC's proposed rule, it would provide for greater harmonization of the regulatory process applied to SEFs and SB SEFs.

The Commission also preliminarily believes that it is appropriate to include in any submissions under proposed Rule 807 documentation demonstrating that the product is in compliance with the SB SEF Core Principles – in particular, core principles that apply specifically to products, such as Core Principle 3 concerning manipulation. The Commission preliminarily believes that it is appropriate to require a SB SEF to document the basis for a determination that a SB swap is not readily susceptible to manipulation and notes that the self-certification in proposed Rule 807 is drawn from analogous processes that the CFTC currently has in place with respect to new financial futures products proposed to be traded on a designated contract market.³⁹⁶ The Commission further notes that CFTC regulations require that prior to trading a new product, a designated contract market must demonstrate that the terms and conditions of a proposed contract “will not be conducive to price manipulation or distortion.”³⁹⁷ The Commission also preliminarily believes that SB SEFs should be conducting due diligence before listing a new SB swap product. In evaluating any certification, information on such due diligence would be essential to the Commission.

The Commission preliminarily believes that SB SEFs would make use of the certification process in the same way that registered entities have been making use of the parallel process under the CFTC's existing rules. The Commission understands from CFTC staff that entities generally use the CFTC's current certification process if they reasonably believe that the new product does not raise any novel issues or questions. However, the Commission notes that the

³⁹⁶ See 17 CFR 40.2, 40.3. See also 17 CFR 40, Appendix A to Part 40—Guideline No. 1.

³⁹⁷ *Id.* The Commission understands that the CFTC expect to propose a similar requirement for SEFs.

proposed certification process does not include any final action of the Commission. In cases where a SB SEF desired final agency action, Proposed Rule 808 would be available.³⁹⁸

The Commission requests comment on all aspects of Proposed Rule 807. Is the proposed rule text clear? Should a SB SEF be required to include in its certification disclosure of whether a proposed product is or is not subject to mandatory clearing? Should a SB SEF be required to include additional information when certifying a new SB swap product? If so, what additional information should be included? Should the proposed rule enumerate what additional evidence, information or data would need to be provided pursuant to proposed paragraph (a) of Rule 807, or what the time frame for such a request should be? Is the proposed stay of certification process clear? Should the Commission consider adopting another stay procedure? If so, what should that process be?

C. Trading SB swaps pursuant to Commission review and approval

Proposed Rule 808 would permit a SB SEF to request that the Commission approve a SB swap prior to permitting trading of the SB swap, or if a SB swap product was initially submitted under Rule 807, subsequent to commencement of trading of the SB swap. Under proposed Rule 808, a submission requesting approval would be required to be submitted electronically in a form to be determined by the Commission and include: (1) a copy of the SB swap product's terms and conditions; (2) the documentation relied on to establish the basis for compliance with the Exchange Act and rules and regulations thereunder, including the Core Principles;³⁹⁹ (3) a written statement verifying that the registered SB SEF has undertaken a due diligence review of the legal conditions, including legal conditions that relate to contractual and intellectual property

³⁹⁸ See infra Section XXIV, discussing trading of SB swaps pursuant to Commission review and approval.

³⁹⁹ See supra note 374.

rights, that may materially affect the trading of the SB swap; (4) if appropriate, a request for confidential treatment as permitted pursuant to the applicable provisions of FOIA⁴⁰⁰ and applicable Commission regulations;⁴⁰¹ and (5) a certification that the registered SB SEF has published on its website a notice of pending request for approval with the Commission and a copy of the submission, concurrent with the filing of a submission with the Commission.

In addition, under proposed Rule 808(b), if requested by a representative of the Commission, a SB SEF would be required to provide additional evidence, information or data that demonstrates that the SB swap product meets, initially and on a continuing basis, all of the requirements of the Exchange Act and any applicable rules and regulations. Under proposed Rule 808(c) the Commission would approve a new SB swap product unless the terms and conditions of such product were inconsistent with the Exchange Act or rules and regulations thereunder.⁴⁰²

Under proposed Rule 808(d), all products submitted for Commission approval under the proposed section would be deemed approved by the Commission 45 days after receipt by the Commission, or at the conclusion of an extended period as provided under proposed Rule 808(e),

⁴⁰⁰ 5 U.S.C. 552.

⁴⁰¹ 17 CFR 200.83.

⁴⁰² The standard for approval in proposed Rule 808 would differ from the standard for approval in proposed CFTC Rule 40.3. Proposed CFTC Rule 40.3 provides that the CFTC shall approve a new swap product unless the terms and conditions of such product “violate” the Commodity Exchange Act. *See* 75 FR 67282 (November 2, 2010) (CFTC proposal to amend 17 CFR 40.2-40.5). Notably, proposed CFTC Rule 40.5 provides that the CFTC shall approve an amendment to the terms and conditions of a swap product unless the amended product would be “inconsistent” with the Commodity Exchange Act. *See id.* The Commission believes that it is preferable to have the same standard for approval in proposed Rules 805 and 808 and therefore proposes that the standard for approval in proposed Rule 808 be the same as the standard for proposed CFTC Rule 40.5. The Commission notes that the proposed standard is similar to the standard for Commission approval of a proposed rule change filed under Section 19(b)(2) of the Exchange Act. *See* 15 U.S.C. 78s(b)(2).

provided that: (1) the submission complied with the requirements of proposed Rule 808(a); and (2) the SB SEF making the submission did not amend the terms and conditions of the proposed SB swap product or supplement its request for approval during that period, except in response to a request by the Commission or for correction of typographical errors, renumbering or other non-substantive revisions. In addition, under proposed Rule 808(d), any voluntary, substantive amendment by the SB SEF would be treated as a new submission.

Under proposed Rule 808(e) the Commission would be able to extend the 45-day review period for an additional 45 days, if the proposed SB swap product raised novel or complex issues that required additional time for review. In that event, the Commission would need to notify the SB SEF within the initial 45 day review period and would need to briefly describe the nature of the specific issues. Alternatively, the SB SEF could agree to any extended review period in writing.

Under proposed Rule 808(f), the Commission could notify the SB SEF at any time during its review of the submission that the Commission will not or is unable to approve the proposed SB swap product. Such notification would be required to specify the nature of the issues raised by the proposed SB swap product and the specific provisions of the Exchange Act rules and regulations involved.

Proposed Rule 808(g) would address the effect of non-approval by the Commission. Under proposed paragraph (g) notification to a SB SEF of the Commission's determination not to approve a proposed SB swap product would not prejudice the SB SEF from subsequently submitting a revised version of the proposed product for Commission approval or from submitting the product as initially proposed pursuant to a supplemented submission. However, notification to a SB SEF of the Commission's refusal to approve SB swap would be presumptive

evidence that the entity would not be able to truthfully certify under Rule 807 that the same, or substantially the same, SB swap complies with the Exchange Act or the rules thereunder.

As with proposed Rule 807, proposed Rule 808 is substantially similar to the applicable CFTC proposed rule, new proposed Rule 40.3. The Commission believes that this approach would allow dually registered entities to more easily comply with applicable rules and regulations. The Commission expects that the SB SEF would include in its submission all documentation relied upon to determine that the new product complies with applicable core principles – in particular, core principles that apply specifically to products, such as Core Principle 3 concerning manipulation. The Commission preliminarily believes that it is appropriate to require a SB SEF to document the basis for a determination that a SB swap is not readily susceptible to manipulation and notes that the proposed certification in proposed Rule 808 is drawn from analogous processes that the CFTC currently has in place with respect to new financial futures products proposed to be traded on a designated contract market.⁴⁰³ The Commission further notes that the CFTC regulations require that prior to trading a new product, a designated contract market must demonstrate that the terms and conditions of a proposed contract “will not be conducive to price manipulation or distortion.”⁴⁰⁴ The Commission also preliminarily believes that SB SEFs should be conducting due diligence before permitting trading of a new SB swap product. In evaluating any certification, information on such due diligence would be essential to the Commission.

As noted above in the discussion concerning self-certification of new SB swaps, the Commission preliminarily believes that SB SEFs would use the product approval process in

⁴⁰³ See 17 CFR 40.2, 40.3. See also 17 CFR 40, Appendix A to Part 40 — Guideline No. 1.

⁴⁰⁴ Id.

instances where they believe novel or difficult issues are presented and they desire final agency action.

The Commission intends to allow registered SB SEFs to submit filings under proposed Rules 807 and 808 electronically through a portal similar to the electronic rule filing system used for proposed rule changes by national securities exchanges and national securities associations.⁴⁰⁵ The Commission preliminarily believes that allowing SB SEFs to file new rules and rule amendments in this manner would simplify the filing process and also provide the Commission with prompt access for review. The Commission intends to propose forms for these electronic filings as part of a separate rulemaking.

The Commission requests comment on all aspects of proposed Rule 808. Is the process required by proposed Rule 808 clear? If not, what elements of the process need to be added to the proposed rule? Under what circumstances would a SB SEF that had already certified a new SB swap product request approval of the product pursuant to the proposed rule? Should product approval be mandatory for certain types of SB swaps, as opposed to certification? If so, what products? Please be specific. Is the proposed standard for approval of a SB swap appropriate? If not, why not?

XXV. Discussion of Exemptive Authority Pursuant to Section 36 of the Exchange Act and Compliance Matters

Pursuant to Section 36 of the Exchange Act, the Commission may grant an exemption from any provision of Section 3D of the Exchange Act, any rule or any provision of any rule under Regulation SB SEF, or any provision of the definition of "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act and any Commission rules regarding such definition to the extent that such exemption is necessary or appropriate in the public interest and

⁴⁰⁵ The process for submission of rule filings will be the subject of a separate rulemaking.

is consistent with the protection of investors. Any such exemption could be subject to conditions and could be revoked by the Commission at any time. Generally, the Commission would consider entertaining an application for an exemption where the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. 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 a SB SEF 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 the Dodd-Frank Act? If so, in what circumstances should the Commission grant exemptions? Should exemptions only be granted in limited circumstances? Should the Commission consider granting exemptions from all rules under Regulation SB SEF or are exemptions only warranted for specific rules or specific entities? For example, should exemptions only be available with respect to certain Core Principles? Should the Commission consider granting exemptions from all provisions of Section 3(a)(77) of the Exchange Act, or should exemptions only be available with respect to certain aspects of the definition of "security-based swap execution facility?" 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?

The Commission acknowledges that it may take a period of time, as well as require the expenditure of resources, for an SB SEF to implement a number of the requirements set forth in proposed Regulation SB SEF, should those requirements be part of any final rules the Commission may adopt. A potential SB SEF would not be able to determine the final rules

governing SB SEFs with which it would need to comply until the Commission adopts those rules. While the Commission is committed to implementing Congress's directive to require SB SEFs to register with the Commission and comply with the Core Principles, the Commission understands that some or all potential SB SEFs may need a period of time in which to acquire or configure the necessary systems, engage and train the necessary staff, and develop and implement the necessary policies and procedures in order to comply with any final rules that the Commission may adopt.

The Commission requests comment as to whether it should provide a SB SEF a certain amount of time to comply with the proposed requirements of Regulation SB SEF applicable to a registered SB SEF once the SB SEF has become registered, and, if so, which provisions, why, and how much time should be provided. For example, proposed Rule 820 relates to the fair representation of participants on the SB SEF's Board. Should the Commission provide for a delayed compliance date for this provision to allow the SB SEF sufficient time to establish the requisite procedures relating to the election of fair representation candidates, including through a petition process, and to align compliance with the date of its election of other directors?⁴⁰⁶ Should the Commission consider a delayed compliance date for the CCO's annual report required by proposed Rule 823, for example, if the SB SEF's fiscal year ended shortly after the SB SEF's registration application was approved by the Commission? Are there other proposed rules or provisions of such rules for which a SB SEF should be provided more time to comply after becoming registered? If so, which ones and under what conditions should the Commission permit a delayed compliance date? For example, would it be appropriate to delay the date for an SB SEF to comply with the automated surveillance requirements of proposed Rule 813, as long

⁴⁰⁶ See Regulation MC Proposing Release, supra note 82.

as the SB SEF had other means to satisfy its surveillance obligations? If so, how long of a delay would be appropriate?

The Commission notes that, under the proposed rules, it would have the authority to temporarily register a SB SEF and, under proposed Regulation SB SEF, a temporarily registered SB SEF would need to comply with Regulation SB SEF, including the rules implementing the Core Principles. Should a phased-in compliance approach apply only with respect to those SB SEFs that are temporarily registered with the Commission? Should phased-in compliance be built into the temporary registration process? Alternatively, should the Commission consider using its Section 36 exemptive authority to exempt SB SEFs from certain of the requirements of Regulation SB SEF on a case-by-case basis? If commenters favor a phased-in compliance approach for certain proposed rules, they should provide specific recommendations, a rationale for each such recommendation, and the conditions under which any such phased-in approach should be granted.

The Commission also seeks comment on whether it is necessary or appropriate for SB SEFs that do not meet certain objective thresholds, such as a trading or volume threshold, to comply with all of the requirements of proposed Regulation SB SEF. To avoid unnecessary barriers to entry that could preclude small SB SEFs from entering this market and better facilitate competition and innovation in the SB swap markets that could be used to promote more efficient trading in organized, transparent and regulated venues, would it be necessary or appropriate to except an SB SEF from certain requirements of proposed Regulation SB SEF under certain conditions, e.g., if the SB SEF does not reach a specified volume or liquidity threshold with respect to the trading of SB swaps. For example, should a SB SEF be excepted from provisions of proposed Rule 816 regarding emergency authority and proposed Rule 822 regarding systems

safeguards if the SB SEF does not reach a specified volume or liquidity threshold with respect to the trading of SB swaps? Are there circumstances when it would be burdensome for a SB SEF to undertake electronic surveillance of SB swaps, e.g., if the SB SEF had a low threshold of trading in SB swaps? In that case, would it be appropriate to except the SB SEF from the automated surveillance requirements of proposed Rule 813, as long as the SB SEF had other means to satisfy its surveillance obligations? How should any low volume or other liquidity-based exception be measured, particularly at the outset of trading of SB swaps on registered SB SEFs? Are there other conditions that should be considered in any Commission determination that a SB SEF need not comply with certain provisions of SB SEF and, if so, what are those conditions? In lieu of granting exceptions from certain proposed rules under certain conditions on an omnibus basis, should the Commission instead consider granting exemptions from the provisions of Regulation SB SEF on a case-by-case basis?

XXVI. General Request for Comments

The Commission seeks comment on the proposed interpretation of the definition of SB SEF; creation of a registration framework for SB SEFs; and establishment of rules with respect to the Dodd-Frank Act requirement that a SB SEF must comply with the enumerated fourteen Core Principles and enforce compliance with those principles. The Commission particularly requests comment on possible alternatives to the proposals in this release. The Commission also seeks comments on the general impact the proposals would have on the market for SB swaps.

The Commission invites commenters to address whether the proposed rules are appropriately tailored to achieve the goal of transparency, competition, and efficiency in the SB swap market, including with respect to the administration of the SB SEFs' regulatory activities. The Commission also requests comment on the necessity and appropriateness of mandating the

proposed requirements set forth in this release. The Commission seeks comment on the proposals as a whole, including their interaction with the other provisions of the Dodd-Frank Act. The Commission further seeks comment on whether the proposals would help achieve the broader goals of increasing transparency and accountability in the SB swap market.

Commenters should, where 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 763 of the Dodd-Frank Act.

In considering the proposal, the Commission requests that commenters consider not only each individual proposal contained in proposed Regulation SB SEF but also the totality of the Commission's proposals relating to SB SEFs, including the proposed interpretation of the definition of SB SEF, the proposed rules relating to SB SEFs, and the proposed registration requirements for SB SEFs. Do the proposed interpretation of the definition of SB SEF and proposed Regulation SB SEF in their entirety provide an efficient and effective way to implement the requirements of the Dodd-Frank Act relating to SB SEFs? Are the proposed interpretation of the definition of SB SEF and proposed Regulation SB SEF in their entirety properly tailored so that a SB SEF can meet the proposed regulatory requirements and yet be an economically viable business? Are there aspects of the Commission's proposals relating to the regulation of SB SEFs that, when viewed as a whole, are too burdensome, especially in light of the nascent stage of the SB swap market? If so, what are those features and are there ways in which they can be revised? With respect to the proposed rules to implement the Core Principles, commenters are invited to consider, in addition to the costs of each proposed rule, the totality of

the costs of all of the proposed rules taken as a whole. Are there any instances in which aspects of the Commission's proposals should not apply? For example, should a system or platform that otherwise would meet the proposed interpretation of the definition of SB SEF, but that does a minimal business in the SB swap market, be exempt from all or some of the requirements of Regulation SB SEF either temporarily or permanently? In general, are there additional steps that the Commission could take that would implement the requirements of the Dodd-Frank Act that apply to SB SEFs and at the same time allow the SB swap market to continue to develop?

Title VII of the Dodd-Frank Act requires that the SEC consult and coordinate to the extent possible with the CFTC for the purposes of assuring regulatory consistency and comparability, to the extent possible,⁴⁰⁷ and states that in adopting rules, the CFTC and SEC shall treat functionally or economically similar products or entities in a similar manner.⁴⁰⁸

The CFTC is adopting rules relating to SEFs as required under Section 733 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 regulation of SB SEFs and SEFs. Specifically, do the regulatory approaches under the Commission's proposed rulemaking pursuant to Section 763 of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Section 733 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 SB SEFs and

⁴⁰⁷ See Pub. L. No. 111-203, § 712(a)(2).

⁴⁰⁸ See Pub. L. No. 111-203, § 712(a)(7).

SEFs are comparable? If not, why? Do commenters believe there are approaches that would make the regulation of these facilities more comparable? If so, what are those approaches? 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? If so, which one? The Commission requests commenters to provide data, to the extent possible, supporting any such suggested approaches.

The Commission seeks comment on whether its proposed rules, either individually or collectively, could permit regulatory arbitrage or have the effect of driving SB swaps and other derivatives transactions to financial centers in other jurisdictions. In this regard, how do the proposed rules compare with comparable existing or proposed rules of other jurisdictions? If the Commission were to adopt the proposed rules, would market participants, end users, and others find it less costly to transact their SB swaps and other derivatives transactions in other jurisdictions? If so, please provide specific details on those jurisdictions that could be regarded as having preferential regulation for trading SB swaps and please identify all the specific rules and circumstances that could lead to such preferences. The Commission also seeks comment on specific actions that it could take to harmonize its proposed rules with those of other jurisdictions consistent with the mandates and goals of the Dodd-Frank Act.

XXVII. Paperwork Reduction Act

Certain provisions of the proposed rules contain new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").⁴⁰⁹ The Commission is submitting the proposed collection of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The

⁴⁰⁹ 44 U.S.C. 3501 et seq.

title of the new collection of information is Regulation SB SEF. As proposed, Regulation SB SEF would implement the provisions of Title VII of the Dodd-Frank Act relating to the registration and regulation of SB SEFs. Proposed Regulation SB SEF would include rules regarding the registration of a prospective SB SEF on Form SB SEF, rule-writing, reporting, recordkeeping, timely publication of trading information, the filing of new or amended rules or new products with the Commission, reports of the SB SEF's CCO, surveillance systems to capture certain required information and access to SB SEFs by ECPs.⁴¹⁰ 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.

A. Summary of Collection of Information

1. Registration Requirements for SB SEFs and Form SB SEF

A number of the proposed rules under Regulation SB SEF relate to registration with the Commission by an applicant that seeks status as a registered SB SEF. Proposed Rules 801, 802, 803, 804, and proposed Form SB SEF each would contain requirements relating to registration with the Commission by an applicant seeking to register as a SB SEF that would result in a paperwork burden.

Proposed Rule 801(a) would require an applicant to apply for registration with the Commission as a SB SEF by filing electronically, in a tagged data format, a registration application on Form SB SEF in accordance with the instructions contained therein. Under proposed Rule 801(d), an applicant would be required to designate and authorize on Form SB

⁴¹⁰ As proposed, Regulation SB SEF would contain 24 rules that are designated Rule 800 through Rule 823 inclusive; not all of these proposed rules would include a collection of information. The proposed form for registering as a SB SEF under Regulation SB SEF is Form SB SEF. This collection of information includes any collections of information required by proposed Form SB SEF. Unless identified otherwise, all proposed rules referred to in this section would be contained in Regulation SB SEF.

SEF an agent in the United States to accept notice or service of process, pleadings, or other documents in any suit, action or proceedings brought against it to enforce the federal securities laws or the rules or regulations thereunder. Under proposed Rule 801(e), an applicant that is controlled by any other person⁴¹¹ would be required to certify on Form SB SEF and provide an opinion of counsel that any person that controls such SB SEF will consent to and can, as a matter of law, provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, and submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF. Under proposed Rule 801(f), a non-resident person applying for registration would be required to certify on Form SB SEF and provide an opinion of counsel that it can, as a matter of law, provide the Commission with prompt access to its books and records and submit to onsite inspection and examination by representatives of the Commission. In addition, proposed Rule 814(b)(4) would require the applicant to certify at the time of registration on Form SB SEF that the SB SEF has the capacity to fulfill its obligations under international information sharing agreements to which it is a party as of the date of such certification.

Proposed Rule 802 relates to amendments to Form SB SEF. Proposed Rule 802(a) would require a SB SEF to file an amendment to Form SB SEF promptly, but in no case later than 5 business days, after the discovery that any information filed on Form SB SEF, any statement therein, or any exhibit or amendment thereto, was inaccurate when filed. Proposed Rule 802(b) would require a SB SEF to file an amendment, on Form SB SEF, within 5 business days after any action is taken that renders inaccurate, or causes to be incomplete, information filed on the

⁴¹¹ See supra note 319 and accompanying text regarding the definition of "control."

Execution Page of the Form SB SEF or as part of Exhibits C, E, G or N,⁴¹² or any amendments thereto. Proposed Rule 802(c) would require a SB SEF that is controlled by any other person to file an amendment to Exhibit P on Form SB SEF within 5 business days after any changes in the legal or regulatory framework of any person that controls the SB SEF that would impact the ability of or the manner in which any such person consents to or provides the Commission prompt access to its books and records, to the extent such books and records relate to the activities of the SB SEF, or impacts the Commission's ability to inspect and examine any such person with respect to the activities of the SB SEF. Proposed Rule 802(d) would require a non-resident SB SEF to file an amendment to Exhibit P on Form SB SEF within 5 business days after any changes in the legal or regulatory framework that would impact the SB SEF's ability to or the manner in which it provides the Commission with prompt access to its books and records or impacts the Commission's ability to inspect and examine the SB SEF. Proposed Rule 802(f) would require a SB SEF to file an annual update to Form SB SEF within 60 days of the end of its fiscal year.

Proposed Rule 803(a) would require a registered SB SEF to provide to the Commission material relating to the trading of SB swaps (including notices, circulars, bulletins, lists, and periodicals) issued or made generally available to SB SEF participants. If the information required to be filed pursuant to proposed Rule 803(a) is available continuously on an Internet website controlled by a SB SEF, proposed Rule 803(b) would allow the SB SEF to indicate the location of the website where the information may be found and certify that the information

⁴¹² These Exhibits pertain to the list of officers, directors and committees of the SB SEF (Exhibit C); ownership of the SB SEF (Exhibit E); certain material operating agreements (Exhibit G); and criteria for determining what securities may be traded (Exhibit N).

available at such website is accurate as of its date in lieu of filing such information with the Commission pursuant to proposed Rule 803(a).

Proposed Rule 804(a) would allow a SB SEF to withdraw from registration by filing with the Commission a written notice of withdrawal and an amended Form SB SEF to update any inaccurate information.

Proposed Rules 811(b)(4) and 811(h)(2) would require a SB SEF to report information regarding grants, denials and limitations of access on Form SB SEF and to disclose all disciplinary actions taken annually on its annual update to Form SEF, respectively.

2. Rule-writing Requirements for SB SEFs

A number of the proposed rules under Regulation SB SEF would require a SB SEF to establish rules, policies and procedures with respect to various matters. These are proposed Rules 809(c), 810(b), 811(a)(2), 811(a)(3), 811(b)(1), 811(b)(5), 811(c), 811(d), 811(f), 811(g) 811(i), 813(a), 813(c), 813(d), 814(a), 815(a), 816(a), 816(b), 818(d), 820(a), 820(c) and 822(a)(1).

Proposed Rule 809(c) would require a SB SEF to establish rules setting forth requirements for an eligible person to become a participant in the SB SEF. Such rules would require a participant, at a minimum, to: (1) be a member of, or have an arrangement with a member of, a registered clearing agency to clear trades in the SB swaps that are subject to mandatory clearing and entered into by the participant on the SB SEF; (2) (i) meet the minimum financial responsibility and recordkeeping and reporting requirements imposed by the Commission by virtue of its registration as a SB swap dealer, major SB swap participant, or broker; or (ii) in the case of an eligible contract participant, meet the recordkeeping and reporting requirements that the SB SEF would establish pursuant to proposed Rule 813; (3) agree to

comply with the rules, polices, and procedures of the SB SEF; and (4) consent to the disciplinary procedures of the SB SEF for violations of the SB SEF's rules.

Proposed Rule 810(b) would require a SB SEF to establish: (1) rules that provide for the equitable allocation of reasonable dues, fees, and other charges among its participants and any other users of its system; (2) rules and systems that are not designed to permit unfair discrimination among participants and any other users of the SB SEF's system; (3) rules that promote just and equitable principles of trade; and (4) rules to provide, in general, a fair procedure for disciplining participants for violations of the rules of the SB SEF.

Proposed Rule 811(a)(2) would require a SB SEF to establish and enforce trading, trade processing, and participation rules that would deter abuses and have the capacity to detect, investigate, and enforce those rules, including means to provide market participants with impartial access to the market and to capture information that may be used in establishing whether rule violations have occurred. Proposed Rule 811(a)(3) would require a SB SEF to establish rules governing the operation of the SB SEF, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the SB SEF, including block trades. Proposed Rule 811(b)(1) would require a SB SEF to establish fair, objective and not unreasonably discriminatory standards for granting impartial access to trading on the SB SEF. Proposed Rule 811(b)(5) would require a SB SEF to establish a fair process for the review of any prohibition or limitation on access with respect to a participant or any refusal to grant access with respect to an applicant. Proposed Rule 811(c) would require a SB SEF to establish rules concerning the terms and conditions of the SB swaps traded on the SB SEF and to have rules stipulating the method by which representation on the swap review committee of the SB SEF shall be chosen by the Board.

Proposed Rule 811(d) would require a SB SEF to establish rules governing the procedures for trading on the SB SEF including, but not limited to: (1) doing business on the SB SEF; (2) the types of trading interest⁴¹³ that would be available on the SB SEF; (3) the manner in which trading interest would be handled on the SB SEF and a requirement for fair treatment of all trading interest; (4) the manner in which price transparency for participants entering trading interest into the system would be promoted; (5) the manner in which trading interest and transaction data, would be disseminated, whether to the SB SEF's participants or otherwise, and whether for a fee or otherwise; (6) prohibited trading practices; (7) the prevention of the entry of orders, requests for quotations, responses, quotations, or other trading interest that might result in a trade that is clearly erroneous with respect to the terms of the trade, a fair and non-discriminatory manner of handling any trade that is clearly erroneous, and resolution of any disputes concerning a clearly erroneous trade; (8) trading halts in any SB swap, which rules would be required to include procedures for halting trading in a SB swap when trading has been halted or suspended in the underlying security or securities pursuant to the rules or an order of a regulatory authority with authority over the underlying security or securities; (9) the manner in which block trades would be handled, if different from the handling of non-block trades; and (10) any other rules concerning trading on the SB SEF.

Proposed Rule 811(f) would require a SB SEF to establish rules concerning the reporting of trades executed on the SB SEF to a clearing agency if the transaction is subject to clearing and the procedures for the processing of transactions in SB swaps that occur on or through the SB SEF including, but not limited to, procedures to resolve any disputes concerning the execution of a trade.

⁴¹³ For purposes of this PRA, references to "trading interest" includes any order, request for quotation response, quotation, or any other trading interest on the SB SEF.

Proposed Rule 811(g) would require a SB SEF to establish rules and procedures concerning the disciplining of participants including, but not limited to, rules authorizing its staff to recommend and take disciplinary action for violations of the rules of the SB SEF; specifying the sanctions that may be imposed upon participants for violations of the rules of the SB SEF such that each sanction is commensurate with the corresponding violation; and establishing fair and non-arbitrary procedures for any disciplinary process and appeal thereof.

Proposed Rule 811(i) would require a SB SEF to establish rules and procedures to assure that information to be used to determine whether rule violations have occurred is captured and retained in a timely manner.

Proposed Rule 813(a) would require a SB SEF to establish and enforce rules or terms and conditions defining, or specifications detailing trading procedures to be used in entering and executing orders traded on or through the facilities of the SB SEF and procedures for trade processing of SB swaps on or through the facilities of the SB SEF. Proposed Rule 813(c) would require a SB SEF to establish rules requiring any participant that enters any order or trading interest or executes any transaction on the SB SEF to maintain books and records of any such trading interest or transaction and of any position in any SB swap that is the result of any such trading interest or transaction and to provide prompt access to such books and records to the SB SEF and to the Commission.

Proposed Rule 813(d) would require a SB SEF to establish and maintain procedures to investigate possible rule violations, to prepare reports concerning the findings and recommendations of investigations, and to take corrective action, as necessary.

Proposed Rule 814(a) would require a SB SEF to establish and enforce rules requiring its

participants⁴¹⁴ to furnish to the SB SEF, upon request, and in the form and manner prescribed by the SB SEF, any information necessary to permit the SB SEF to perform its responsibilities, including, without limitation, surveillance, investigations, examinations and discipline of participants; such information may include, without limitation, financial information, books, accounts, records, files, memoranda, correspondence, and any other information pertaining to trading interest entered and transactions executed on or through the SB SEF, and to cooperate with and allow access by the SB SEF and representatives of the Commission.

Proposed Rule 815(a) would require a SB SEF to establish and enforce rules and procedures for ensuring the financial integrity of SB swaps entered on or through the facilities of such SB SEF, including the clearance and settlement of SB swaps pursuant to new section 3C(a)(1) of the Exchange Act.

Proposed Rule 816(a) would require a SB SEF to establish rules and procedures to provide for the exercise of emergency authority in consultation or cooperation with the Commission as necessary or appropriate. Proposed Rule 816(b) would require a SB SEF to establish rules and procedures that would specify: (1) the person or persons authorized by the SB SEF to declare an emergency; (2) how the SB SEF would notify the Commission of its decision to exercise its emergency authority; (3) how the SB SEF would notify the public of its decision to exercise its emergency authority; (4) the processes for decision making by the SB SEF personnel with respect to the exercise of emergency authority, including alternate lines of communication and guidelines to avoid conflicts of interest in the exercise of such authority; and (5) the processes for determining that an emergency no longer exists and notifying the Commission and the public of such decision.

⁴¹⁴ See supra note 227 and accompanying text regarding the definition of “participant.”

Proposed Rule 818(d) would require a SB SEF to establish, maintain, and enforce written policies and procedures to verify the accuracy of the transaction data that it collects and reports.

Proposed Rule 820(a) would require the rules of a SB SEF to assure fair representation of participants in the selection of the SB SEF's Board. Proposed Rule 820(c) would require the rules of a SB SEF to include a fair process for participants to nominate an alternative candidate or candidates to the Board by petition.

Proposed Rule 822(a)(1) would require a SB SEF, with respect to those systems that support or are integrally related to the performance of its activities, to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security. These policies and procedures would, at a minimum, require the security-based swap execution facility to: (1) establish reasonable current and future capacity estimates, including quantifying in appropriate units of measure the limits of the SB SEF's capacity to receive (or collect), process, store or display (or disseminate for display or other use) the data elements included within each function, and identifying the factors (mechanical, electronic, or other) that account for the current limitations; (2) conduct periodic capacity stress tests of critical systems to determine such systems' ability to process transactions in an accurate, timely, and efficient manner; (3) develop and implement reasonable procedures to review and keep current its system development and testing methodology; (4) review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters, and; (5) establish adequate contingency and disaster recovery plans which shall include plans to resume trading of security-based swaps by the SB SEF no later than the next business day following a wide-scale disruption.

3. Reporting Requirements for SB SEFs

A number of the proposed rules under Regulation SB SEF would require SB SEFs, SB SEF participants and other persons to report or provide information to the Commission or to a SB SEF. Proposed Rules 814, 816(d), 818(a)(3), 818(e), 818(f), 822(a)(2), 822(a)(3), and 822(a)(4) each would contain a reporting requirement.⁴¹⁵ These requirements to report or provide information to the Commission would result in a paperwork burden.

Proposed Rule 814 addresses the ability of a SB SEF to obtain information from its participants, and the ability of Commission representatives to obtain information from a SB SEF and its participants. Proposed Rule 814(a) would require a SB SEF to establish and enforce rules requiring its participants to provide information or documents to the SB SEF upon request. The information or documents requested may include any information that is necessary to permit the SB SEF to perform its regulatory responsibilities, including, without limitation, any financial information, books, accounts, records, files, memoranda, correspondence, and any other information pertaining to trading interest entered and transactions executed on or through the SB SEF. Proposed Rule 814(a) also would direct a SB SEF to require its participants to allow access by any Commission representative to examine the participant's books and records and to obtain or verify information related to trading interest entered or transactions executed on or through the SB SEF.⁴¹⁶ Proposed Rule 814(b) would direct a SB SEF to allow access by any Commission

⁴¹⁵ In addition, proposed Rule 823 would require the SB SEF's CCO to submit to the Commission an annual compliance report, along with a financial report. The paperwork burden associated with the CCO's reports, including for proposed Rules 811(b)(4) and 811(g), and 814(b) that set forth certain items to be addressed in the CCO's reports, is addressed separately in Section XXVII.A.7., below.

⁴¹⁶ The Commission notes that proposed Rule 813(c)(2) similarly requires a SB SEF to establish and enforce rules that require any participant that enters any trading interest or executes any transaction on the SB SEF to provide the Commission with prompt access to its books and records. The Commission considers the prompt access requirement of proposed Rule 813(c)(2) to be included in the burden estimates of proposed Rule 814(a) for purposes of this PRA analysis.

representative to examine the SB SEF's books and records and to obtain or verify information related to trading interest entered or transactions executed on or through the SB SEF. Proposed Rule 814(b)(3) would require a SB SEF to have the capacity to carry out such international information-sharing agreements as the Commission may require.

Proposed Rule 816(d) would require a SB SEF to notify the Commission promptly of any exercise of its emergency authority, and within two weeks following cessation of an emergency, submit to the Commission a report explaining the basis for declaring an emergency, how conflicts of interest were minimized in the SB SEF's exercise of its emergency authority, and the extent to which the SB SEF considered the effect of its emergency action on the markets for the SB swap and any security or securities underlying the SB swap.

Proposed Rule 818 would establish both recordkeeping and reporting obligations for SB SEFs. Proposed Rule 818(e) would require a SB SEF to report to the Commission such information as the Commission may, from time to time, determine to be necessary to perform the duties of the Commission under the Exchange Act. Proposed Rule 818(f) would require a SB SEF to provide to any representative of the Commission, upon request, copies of documents required to be kept and preserved pursuant to the recordkeeping requirements of proposed Rules 818(a) and (b).

Proposed Rule 822 addresses system safeguards for the SB SEF. Proposed Rule 822(a)(2) would require a SB SEF to submit to the Commission on an annual basis an objective review with respect to those systems that support or are integrally related to the performance of the SB SEF's activities. If the objective review is performed by an internal department, an objective, external firm would be required to assess the internal department's objectivity,

competency, and work performance. Proposed Rule 822(a)(3) would require a SB SEF to promptly notify the Commission in writing of material systems outages and any remedial measures implemented or contemplated and submit to the Commission within five business days of when the outage occurred a written description and analysis of the outage and any remedial measures that have been implemented or are contemplated. Proposed Rule 822(a)(4) would require a SB SEF to notify the Commission in writing at least thirty calendar days before implementation of any planned material systems changes.

4. Recordkeeping Required Under Regulation SB SEF

Proposed Rule 818(a) would require a SB SEF to keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records, including the audit trail records required pursuant to proposed Rule 818(c), as shall be made and received in the conduct of its business. Proposed Rule 818(b) would require SB SEFs to keep and preserve such documents and other records for a period of not less than five years, the first two years in an easily accessible place. Proposed Rule 818(c) would require SB SEFs to establish and maintain accurate, time-sequenced records of all trading interest and transactions received by, originated on, or executed on the SB SEF. In addition, proposed Rule 811(b)(3) would require that a SB SEF make and keep records relating to all grants of access and the basis for such grant, and all denials or limitations of access to the SB SEF and the reasons for such denial or limitation. Proposed Rule 811(h) would require a SB SEF to make and keep records relating to all disciplinary proceedings, sanctions imposed, and appeals thereof.⁴¹⁷

⁴¹⁷ The records required by proposed Rules 811(b)(3) and 811(g) would be included in the business records required to be kept pursuant to proposed Rule 818. Therefore, the Commission preliminarily believes that the paperwork burden for these rules would be included in the estimated burden for proposed Rule 818. See *infra* note 493 and accompanying text.

5. Timely Publication of Trading Information Requirement for SB SEFs

Proposed Rule 817(a)(1) would require a SB SEF to have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF.⁴¹⁸

6. Rule Filing and Product Filing Processes for SB SEFs

Proposed Rules 805 and 806 relate to the submission to the Commission of filings of new or amended rules, while proposed Rules 807 and 808 relate to the submission to the Commission of filings to make SB swap products available to trade. Proposed Rules 805, 806, 807, and 808 would impose a collection of information burden on SB SEFs.⁴¹⁹

Rule Filings: Proposed Rules 805 and 806 would require a SB SEF to submit rule filings for new rules or rule amendments, including changes to an existing product's terms or conditions.⁴²⁰ Under proposed Rules 805(a) and 806(a), a SB SEF could submit either a voluntary request for prior approval or a self-certified rule filing, respectively, for any new rules or rule amendments. Under both proposed rules, a SB SEF would be required to submit the rule

⁴¹⁸ Proposed Rule 817(a)(2) requires every SB SEF to make public timely information on price, trading volume, and other trading data on SB swaps to the extent required by the Commission. The Commission notes that proposed Rule 817(a)(2) does not require a SB SEF to make public timely information on price, trading volume, and other trading data on SB swaps. Rather, the Commission has proposed that other parties be responsible for timely publication of trading information. See Reporting and Dissemination Release supra note 6.

⁴¹⁹ The Commission expects to conduct a separate rulemaking that would propose the form for the electronic submission of such filings to the Commission and the procedures pertinent to such form. Should the Commission propose any such form and associated procedures, it would include a collection of information burden as part of that proposed rulemaking.

⁴²⁰ Filings that relate to proposed changes to an existing SB swap's terms or conditions would be submitted under proposed Rules 806 or 807.

filings electronically to the Commission in a format to be specified by the Commission.⁴²¹ Both proposed Rules 805(a) and 806(a) would require the SB SEF to include the following information in the requisite rule filings: (1) the text of the proposed rule or rule amendment (in the case of a rule amendment, deletions and additions would need to be indicated); (2) the proposed effective date or intended date of implementation, as applicable; (3) the documentation relied on by the SB SEF to establish the basis for compliance with the applicable provisions of the Exchange Act and the rules and regulations thereunder (including Section 3D(d) of the Exchange Act and the rules and regulations thereunder); (4) a certification or written statement, as applicable, that the SB SEF has published a notice of pending new rule or rule amendment, or a notice of pending certification, as applicable, on the SB SEF's website and a copy of the submission, concurrent with its filing with the Commission; (5) a description of any substantive opposing views on the rule that were expressed to the SB SEF by the Board or committee members, participants or market participants that were not incorporated into the rule (or, with respect to a self-certification filing under Rule 806(a), a statement that no such opposing views were expressed, if applicable); (6) a request for confidential treatment, if appropriate; and (7) for proposed amendments to a product's terms and conditions, a written statement that the SB SEF has undertaken a due diligence review of the legal conditions, including conditions relating to contractual and intellectual property rights, that may materially affect the trading of the product.

In addition, for voluntary requests for prior approval rule filings, proposed Rule 805(a) would also require SB SEFs to include: (1) a description of any action taken or anticipated to be taken to adopt the proposed rule by the SB SEF or its Board, or by any committee thereof, and a citation to the rules of the SB SEF that authorize the adoption of the proposed rule change; (2) an

⁴²¹ See supra Section XXIII.

explanation of the operation, purpose and effect of the proposed new rule or rule amendment, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, and how the rule fits into the SB SEF's framework of regulation; (3) any additional information that may be beneficial to the Commission in analyzing the new rule or rule amendment (and if the proposed rule affects, directly or indirectly, the application of any other rule of the SB SEF, the pertinent text of any such rule must be set forth and the anticipated effect described); and (4) and the identification of any Commission rule or regulation that Commission may need to amend or interpret in order to approve the new rule or rule amendment and, to the extent that such an amendment or interpretation is necessary to accommodate the new rule or rule amendment, a reasoned analysis supporting the proposed amendment or interpretation.

For self-certification rule filings, proposed Rule 806(a) also would require a SB SEF to include: (1) a certification by the SB SEF that the rule complies with the Exchange Act and Commission rules and regulations thereunder; and (2) upon request of any representative of the Commission, additional evidence, information, or data that may be beneficial to the Commission in conducting a due diligence assessment of the filing and the SB SEF's compliance with any of the requirements of the Exchange Act or the rules and regulations thereunder.

Product Filings: Proposed Rules 807 and 808 would require SB SEF to submit product filings prior to trading a SB swap. Under proposed Rules 807(a) and 808(a), a SB SEF could submit either a self-certified product submission or voluntary request for prior approval product filing, respectively, before trading a SB swap. Under both proposed rules, a SB SEF would be required to submit the product filings electronically to the Commission in a format specified by the Commission. Both proposed Rules 807(a) and 808(a) would require SB SEFs to include the

following information in the product filings: (1) a copy of the SB swap's terms and conditions, (2) the documentation relied on to establish the basis for compliance with the Exchange Act and rules and regulations thereunder (including Section 3D(d) of the Exchange Act and the rules and regulations thereunder); (3) a written statement verifying that the SB SEF has undertaken a due diligence review of the legal conditions, including legal conditions that relate to contractual and intellectual property rights, that may materially affect the trading of the SB swap; (4) a request for confidential treatment, if appropriate; and (5) a certification that the SB SEF has published on its website a notice of pending request for approval, or a notice of pending certification, as applicable, and a copy of the submission, concurrent with the filing of the submission with the Commission. In addition, for self-certification product filings, proposed Rule 807(a) also would require a SB SEF to include the following information: (1) the intended date on which the SB swap may begin trading, and (2) a certification by the SB SEF that the SB swap to be traded complies with the Exchange Act and the rules and regulations thereunder, including Section 3D(d) of the Exchange act and the rules and regulations thereunder.

In addition, proposed Rules 807(b) and 808(b) would require a SB SEF to provide, upon request of any representative of the Commission, additional evidence, information, or data that demonstrates that the SB swap meets, initially or on a continuing basis, all of the requirements of the Exchange Act and rules and regulations thereunder.

7. Requirements Relating to the SB SEF's Chief Compliance Officer

Proposed Rule 823 addresses the obligations of the SB SEF's CCO, including the CCO's performance of his or her statutory duties with respect to the SB SEF and its statutory requirement to prepare and submit to the Commission annual compliance and financial reports.

Proposed Rule 823(a) would require the SB SEF's Board to designate a CCO to perform the duties identified in proposed Rule 823(b) through (e). Under proposed Rule 823(b)(6) and (7), the CCO would be responsible for establishing procedures for the remediation of noncompliance issues identified by the CCO identified through any compliance office review, look-back, internal or external audit finding, self-reported error or validated complaint, and establishing appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

The CCO also would be required under proposed Rule 823(c) and (d) to prepare and submit annual compliance reports to the Commission and the SB SEF's Board containing, at a minimum: (1) a description of the SB SEF's enforcement of its policies and procedures; (2) information on all investigations, inspections, examinations, and disciplinary cases opened, closed, and pending during the reporting period; (3) all grants of access (including, for all participants, the reasons for granting such access) and all denials or limitations of access (including for each applicant, the reasons for denying or limiting access), consistent with proposed Rule 811(b)(3); (4) any material changes to the policies and procedures since the date of the preceding compliance report; (5) any recommendation for material changes to the policies and procedures as a result of the annual review, the rationale for such recommendation, and whether such policies and procedures were or will be modified by the SB SEF to incorporate such recommendation; (6) the results of the SB SEF's surveillance program, including information on the number of reports and alerts generated, and the reports and alerts that were referred for further investigation or for an enforcement proceeding; (7) any complaints received regarding the SB SEF's surveillance program; and (8) any material compliance matters identified since the date of the preceding compliance report.

The CCO is required under proposed Rule 823(e)(1) and (2) to submit annually a financial report for the SB SEF and for certain affiliated entities of the SB SEF. Among other things, the annual financial report for the SB SEF must be audited by a registered public accounting firm that is qualified and independent in accordance with Rule 2-01 of Regulation S-X (17 CFR 210.2-01), be a complete set of financial statements of the SB SEF that are prepared in accordance with U.S. generally accepted accounting principles for the two most recent fiscal years of the SB SEF. For certain affiliated entities (every subsidiary in which the applicant has, directly or indirectly, a 25% interest and for every entity that has, directly or indirectly, a 25% interest in the applicant), the SB SEF must provide a financial report consisting of a complete set of unconsolidated financial statements (in English) for the latest two fiscal years and include such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading. As proposed, the reports for the SB SEF and for the SB SEF's affiliated entities would be provided in XBRL consistent with Rules 405(a)(1), (a)(3), (b), (c), (d) and (e) of Regulation S-T.⁴²² The Commission notes that these annual financial reports are the same as those required to be produced upon registration and annually pursuant to Exhibits F and H to proposed Form SB SEF for the SB SEF. In addition, pursuant to Exhibit H to proposed Form SB SEF, the Commission may request unaudited financial information for any other affiliated entity not covered by the 25% interest threshold discussed above.

8. Surveillance Systems Requirements for SB SEFs

Several proposed rules under Regulation SB SEF would require a SB SEF to electronically surveil its market and to maintain an automated surveillance system. To the extent

⁴²² See 17 CFR 232.405.

that such surveillance and systems would require a SB SEF to collect and assess data and other information, such rules would result in a collection of information.

Proposed Rule 811(j) would require a SB SEF to have the capacity to capture information that may be used in establishing whether rule violations have occurred, including through the use of automated surveillance systems as set forth in proposed Rule 813(b).

Proposed Rule 813(a)(2) would require a SB SEF to monitor trading in SB swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions. Proposed Rule 813(b) would require a SB SEF to have the capacity and appropriate resources to electronically monitor trading in SB swaps on its market by establishing an automated surveillance system, including through real-time monitoring of trading and use of automated alerts.⁴²³

9. Access by Non-Registered Eligible Contract Participants

Proposed Rule 809(d)(1) would require a SB SEF that provides direct access to non-registered ECPs as participants to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.⁴²⁴ Proposed Rule 809(d)(2) would require that the risk management controls and supervisory procedures for granting access to ECPs as

⁴²³ The collection of information burdens associated with the audit trail provisions of proposed Rule 818(a) and (c) are discussed in the sections of this PRA analysis relating to recordkeeping.

⁴²⁴ See proposed Rule 809(d)(1). Non-registered ECPs are eligible contract participants that are not registered with the Commission as a SB swap dealer, major SB swap participant, or broker (as defined in section 3(a)(4) of the Exchange Act).

participants of the SB SEF to be reasonably designed to ensure compliance with all regulatory requirements.⁴²⁵

10. Composite Indicative Quote and Executable Bids and Offers

Proposed Rule 811(e) would require a SB SEF that operates an RFQ platform to create and disseminate through the SB SEF a composite indicative quote, made available to all participants, for SB swaps traded on or through the SB SEF. The Commission's proposed interpretation of SB SEF would require each SB SEF, at the minimum, to provide any participant with the ability to make and display executable bids or offers accessible to all participants on the SB SEF, if the participant wishes to do so.

B. Proposed Use of Information

1. Registration Requirements for SB SEFs and Form SB SEF

As discussed above, proposed Rules 801, 802, 803 and 804 would require an applicant to register on Form SB SEF, file certain amendments and updates to Form SB SEF, file other supplemental information with the Commission with respect to the trading of SB swaps, and provide notice to the Commission of the SB SEF's withdrawal of registration. The information collected pursuant to these proposed rules would enhance the ability of the Commission to determine whether to approve the registration of an entity as a SB SEF; to monitor and oversee SB SEFs; to determine that SB SEFs initially comply, and continue to operate in compliance, with the Exchange Act, including the Core Principles applicable to SB SEFs, and the rules and regulations thereunder; to carry out its statutorily mandated oversight functions; and to maintain accurate and updated information regarding SB SEFs. Because the registration information

⁴²⁵ See proposed Rule 809(d)(2).

would be publicly available, it could also be useful to SB SEF's participants, other market participants, other regulators, and the public generally.

2. Rule-writing Requirements for SB SEFs

The proposed provisions of Regulation SB SEF requiring that SB SEFs establish certain rules, policies and procedures would help SB SEFs comply with the Exchange Act, including the Core Principles applicable to SB SEFs, and the rules and regulations thereunder. The rules also would be useful to the SB SEF's participants in understanding and complying with the requirements of the SB SEF and to other market participants, other regulators, and the public generally.

3. Reporting Requirements for SB SEFs

The information that would be collected under the proposed provisions of Regulation SB SEF requiring SB SEFs, SB SEF participants, and other persons to submit certain reports and provide certain information upon request would be used by the Commission to assist in its oversight of SB SEFs and the SB swap markets.

4. Recordkeeping Required Under Regulation SB SEF

Proposed Rule 813(c) would aid the SB SEF in detecting and deterring fraudulent and manipulative acts with respect to trading on its market, as well as help it to fulfill the statutory requirement in Core Principle 4 that a SB SEF monitor trading in SB swaps, including through comprehensive and accurate trade reconstructions. The proposed rule also would aid the Commission in carrying out its responsibility to oversee SB SEFs.

Proposed Rules 818(a) and (b) would help to ensure that records exist, and thus would be available to the Commission pursuant to the proposed reporting requirements. Access to these

records would provide a valuable tool to help the Commission carry out its oversight responsibility over SB SEFs and the SB swap markets in general.

The audit trail information required to be maintained under the proposed Rule 818(c) would facilitate the ability of the SB SEF and the Commission to carry out their respective obligations under the Exchange Act, by providing a record of the complete history of all trading interest entered and transactions executed on the SB SEF, which data could be used to help detect abusive or manipulative trading activity, prepare reconstructions of activity on the SB SEF or in the SB swaps market, and generally to understand the causes of unusual market activity. In addition, proposed Rule 811(b)(3) would require every SB SEF to make and keep records of all grants, denials, or limitations of access to the SB SEF, which would provide the Commission an important tool to help it assess whether the SB SEF is meeting its duty to provide fair and impartial access to its facility. Further, proposed Rule 811(h) would require the SB SEF to make and keep records specifically of all disciplinary proceedings and appeals, which would allow the Commission to review the disciplinary process at a SB SEF and would provide the Commission an additional tool to carry out its oversight responsibilities.

5. Timely Publication of Trading Information Requirement for SB SEFs

The requirement contained in proposed Rule 817 that a SB SEF have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF, would assist the SB SEF in carrying out its regulatory responsibilities under the Exchange Act, including, without limitation, the proposed requirements that every SB SEF must keep and preserve books and records of activities related to its business, and allow access by the Commission to obtain or verify other information related to orders entered and transactions executed on or through the SB SEF's

facilities. In addition, the Commission believes that every SB SEF must have the capacity to capture this information to enable the SB SEF to comply with reasonable requests to provide information to others, including, SB SEF participants, counterparties, registered SDRs, or regulatory authorities.

6. Rule Filing and Product Filing Processes for SB SEFs

Proposed Rules 805 and 806 would require a SB SEF to submit new rule or rule amendments as rule filings either through a voluntary prior approval process or a self-certification process. The information that would be collected under these proposed rules would help ensure compliance by the SB SEF with the provisions of the Exchange Act, including the Core Principles applicable to SB SEFs, and the rules and regulations thereunder, as well as assist the Commission in overseeing the SB SEF's compliance with its regulatory obligations. This information also would be useful to the SB SEF's participants, because they would be subject to such new or amended rules and thus would have an interest in learning about those rules and potentially in submitting to the Commission comments on any proposed new or amended rules. Other market participants, other SB SEFs, and other regulators, as well as the public generally, may find information about proposed new or amended rules useful.

Proposed Rules 807 and 808 would require a SB SEF to submit filings for new products that they make available for trading either through a self-certification process or a voluntary prior approval process. The information that would be collected under these proposed rules would help ensure that any SB swap that is available to trade on the SB SEF would comply with the provisions of the Exchange Act, including the Core Principles applicable to SB SEFs, and the rules and regulations thereunder, as well as assist the Commission in overseeing the SB SEF's compliance with its regulatory obligations. In particular, the requirements of proposed Rules

807(a) and 808(a) should help the Commission determine the SB SEF's compliance with the Core Principles that apply specifically to products, such as Core Principle 3 which would require a SB SEF to ensure that a SB swap trading on its facility is not readily susceptible to manipulation. Other market participants, other SB SEFs, and other regulators, as well as the public generally, may find information about the new products useful.

7. Requirements Relating to the SB SEF's CCO

As discussed above, proposed Rule 823 would require that a SB SEF's CCO establish certain policies relating to noncompliance issues as well as prepare and submit to the Commission both an annual compliance report and an annual financial report. The information that would be collected under this proposed rule would help ensure compliance by SB SEFs with the provisions of the Exchange Act, including the Core Principles applicable to SB SEFs, and the rules and regulations thereunder, as well as assist the Commission in overseeing the SB SEFs. The Commission could use the annual compliance report to help it evaluate whether the SB SEF is carrying out its statutorily-mandated regulatory obligations and, among other things, to discern the scope of any denials of access or refusals to grant access by the SB SEF and to obtain information on the status of the SB SEF's regulatory compliance program. The annual financial report would provide the Commission with important information on the financial health of the SB SEF.

8. Surveillance Systems Requirements for SB SEFs

The proposed rules requiring a SB SEF to maintain certain surveillance systems and monitor trading would enable the SB SEFs to have the capacity and resources to fulfill its obligations under the Exchange Act to oversee trading on its market, and to prevent manipulation and other unlawful activity or disruption of the market. These systems would help the SB SEF to

identify and investigate market behavior that may be improper and bring any necessary disciplinary actions.

9. Access by Non-Registered Eligible Contract Participants

Proposed Rule 809 would permit a SB SEF to provide access to the SB SEF by non-registered ECPs, provided that the conditions of the proposed rule relating to such access would be satisfied. Proposed Rule 809(d) would require a SB SEF that would permit access to non-registered ECPs⁴²⁶ to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. The risk management controls and supervisory procedures for granting access to non-registered ECPs would be required to be reasonably designed to ensure compliance with all regulatory requirements. Since non-registered ECPs are not directly subject to capital or other financial requirements, there is a concern that, in the absence of risk management controls and supervisory procedures, they could enter into trades that exceed appropriate capital or credit limits. The proposal relating to risk management controls and supervisory procedures is intended to help manage these risks associated with allowing non-registered ECPs to have direct access to an SB SEF's market.

10. Composite Indicative Quote and Executable Bids and Offers

As discussed above, proposed Rule 811(e) would require a SB SEF that operates an RFQ platform to create and disseminate through the SB SEF a composite indicative quote, made available to all participants, for SB swaps traded on or through the SB SEF. The Commission preliminarily believes that a composite indicative quote would provide a certain level of pre-trade transparency for an RFQ platform. In addition, the Commission's proposed interpretation

⁴²⁶ See proposed Rule 809.

of SB SEF would require each SB SEF, at the minimum, to provide any participant with the ability to make and display executable bids or offers accessible to all participants on the SB SEF, if the participant wishes to do so. The Commission preliminarily believes that this functionality would provide greater access to the SB SEF for participants.

C. Respondents

The collection of information associated with the proposed Regulation SB SEF would apply to entities seeking to register as, and to registered, SB SEFs. In the Dodd-Frank Act, Congress incorporated into the Exchange Act a definition of SB SEF and mandated the registration and regulation of these new facilities.⁴²⁷ There currently are no registered SB SEFs. Based on conversations with the CFTC and industry sources, the Commission preliminarily believes that approximately 10 to 20 entities could seek to register as SB SEFs and thus be subject to the collection of information requirements of these proposed rules. The Commission is using the higher estimate of 20 SB SEFs for this PRA analysis.⁴²⁸

In addition, proposed Rules 813(c) and 814(a) would impose collection of information burdens on SB SEF participants. Based on conversations with industry sources, the Commission preliminarily believes that there could be a total of 275 persons that could become SB SEF participants and would thus be subject to the collection of information requirements of the proposed rules.⁴²⁹

⁴²⁷ See Pub. L. No. 111-203, § 761(a) (adding Section 3(a)(77) of the Exchange Act), defining the term “security-based swap execution facility.” See also Pub. L. No. 111-203, § 763(c) (adding Section 3D of the Exchange Act).

⁴²⁸ This estimate comports with the estimated number of SB SEFs contained in the Regulation MC Proposing Release, supra note 82.

⁴²⁹ $275 = 50$ (estimated number of SB swap dealers that would be SB SEF participants) + 5 (estimated number of major SB swap participants that would be SB SEF participants) + 10 (estimated number brokers that would be SB SEF participants) + 210 (estimated number of ECPs that would be SB SEF participants). The Commission recently proposed

Except with regard to the collection of information burdens imposed on SB SEF participants pursuant to proposed Rules 813(c) and 814(a), as discussed further in the sections of this PRA discussing the reporting and recordkeeping requirements of Regulation SB SEF, the respondents subject to the collection of information burdens associated with proposed Regulation SB SEF would be SB SEFs.

D. Total Annual Reporting and Recordkeeping Burden

1. Registration Requirements for SB SEFs and Form SB SEF

Initial filings on Form SB SEF by a prospective SB SEF seeking to register with the Commission pursuant to proposed Rule 801 would be made on a one-time basis. As discussed above, no SB SEFs currently are registered with the Commission and the Commission preliminarily estimates that 20 entities initially would seek to register with the Commission as SB SEFs. The Commission's estimate regarding the initial burden that a SB SEF would incur to file a Form SB SEF is informed by its estimate of the number of hours necessary to complete a Form 1 for registration of a national securities exchange. The Commission calculated in 2010 that Form 1 takes 47 hours to complete.⁴³⁰ Although the requirements of Form 1 are not identical to the requirements of proposed Form SB SEF, the Commission preliminarily believes

rules to define a number of terms used in Title VII, including, among others, "security-based swap dealer" and "major security-based swap participant." See Securities Exchange Act Release No. 63452 (December 7, 2010), 75 FR 80174 (December 21, 2010). As part of that proposal, the Commission preliminarily estimated that approximately 50 entities may be required to register as SB swap dealers under the proposed rules. See 75 FR at 80209 n.188. The Commission further estimated that no more than ten entities would have SB swap positions large enough that they would have to monitor whether they meet the thresholds defining a major SB swap participant. See 75 FR at 80207-08. For purposes of these proposed rules, the Commission conservatively assumes that there would be a total of five major SB swap participants, while recognizing that in fact there may be fewer than five.

⁴³⁰ See 75 FR 32824 (June 9, 2010) (outlining the most recent Commission calculations regarding the PRA burdens for Form 1 and Rules 6a-1 and 6a-2 under the Exchange Act).

that they are substantially similar for PRA purposes. Similar to Form 1, the information that would be required on Form SB SEF generally would consist of copies of existing documents that would be prepared by a SB SEF in the ordinary course of its business. As noted above, no SB SEFs currently are registered with the Commission and no framework for registration of SB SEFs currently exists. Therefore, the Commission preliminarily believes that, during the initial implementation period of Regulation SB SEF, it could take a SB SEF more time to compile the necessary documents and information required by the exhibits to Form SB SEF than it would for an applicant to become a national securities exchange to compile documents and information to comply with requirements of Form 1. The procedures for registration as a national securities exchange are well-settled and, therefore, an entity that intends to register as national securities exchange could anticipate the form of the documents and other information that it would need to compile to register on Form 1.⁴³¹ Based on these factors, the Commission preliminarily estimates that an applicant would incur an average burden of 100 hours to prepare and file an initial Form SB SEF, including all exhibits thereto, except Exhibits F and H requiring certain financial reports, and Exhibit P requiring certain opinions of counsel, which are discussed separately below.⁴³² Therefore, the Commission preliminarily estimates that the aggregate one-

⁴³¹ For example, because an entity seeking to register as a national securities exchange would know that Exhibit E to Form 1 requires an applicant to describe the manner and operation of the electronic trading system to be used to effect transactions on the exchange, such entity likely would prepare such a description in the ordinary course of its business in anticipation of applying for registration as a national securities exchange on Form 1. However, because the requirements of Form SB SEF would be set forth for the first time in connection with this proposed rulemaking, a SB SEF previously may not have prepared a description of the manner and operation of its trading system in the ordinary course of business and would have to do so to comply with Exhibit I to Form SB SEF.

⁴³² As discussed above, proposed Rule 801(d) would require a SB SEF to designate and authorize on Form SB SEF an agent in the U.S. to accept notice or service of process, pleadings, or other documents in any action or proceedings brought against it to enforce

time burden for all respondents to file the initial Form SB SEF, including all exhibits thereto, except Exhibits F and H requiring certain financial reports and Exhibit P requiring opinions of counsel, would be 2,000 hours.⁴³³ The Commission preliminarily believes that SB SEFs would prepare Form SB SEF internally. The Commission requests comment on the accuracy of this estimate.

Exhibits F and H to proposed Form SB SEF would require an applicant to submit an annual financial report that would have to satisfy a number of requirements, including the requirement that a registered public accounting firm that is qualified and independent in accordance with Rule 2-01 of Regulation S-X⁴³⁴ audit each financial report relating to the SB SEF (unaudited for certain affiliated entities). The Commission preliminarily believes that it is

the federal securities laws and the rules and regulations thereunder. Proposed Rule 801(e) would require an applicant that is controlled by any other person to certify on Form SB SEF that any person that controls such SB SEF would consent to and could, as a matter of law, provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, and submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF. Proposed Rule 801(f) would require a non-resident person applying for registration to certify on Form SB SEF that it could, as a matter of law, provide the Commission with prompt access to its books and records and submit to onsite inspection and examination by representatives of the Commission. Proposed Rule 814(b)(4) would require a SB SEF to certify at the time of registration on Form SB SEF that the SB SEF would have the capacity to fulfill its obligations under international information sharing agreements to which it is a party. The Commission preliminarily believes that the burden associated with these requirements would be included in the 100-hour burden associated with the initial registration on Form SB SEF required by proposed Rule 801(a). These proposed requirements currently are not included on Form 1. In addition, proposed Rules 801(e) and (f) would require SB SEFs that are controlled by other persons and non-resident SB SEFs to provide certain opinions of counsel. The Commission preliminarily believes that the burden associated with these requirements would be included in the burden associated with Exhibit P to Form SB SEF discussed below.

⁴³³ 2,000 hours = 20 (number of SB SEF respondents) x 100 hours (initial hourly burden to comply with Form SB SEF, except for Exhibits F, H and P).

⁴³⁴ See 17 CFR 210.2-01.

unlikely that, during the initial implementation period of Regulation SB SEF, a SB SEF would have prepared such reports in the ordinary course of business prior to applying for registration on Form SB SEF. Therefore, in connection with its efforts to register as a SB SEF with the Commission on proposed Form SB SEF, an applicant would incur an initial burden to generate such financial reports. Based on conversations with operators of current trading platforms and the Commission's experience with entities of similar size, the Commission preliminarily estimates that the financial reports relating to the SB SEF would generally require, on average, 500 hours per respondent to complete and cost \$500,000 for independent public accounting services per respondent.

The Commission believes that the unaudited reports required for certain affiliated entities and to be made available upon request by the Commission for other affiliated entities would not be overly time consuming to produce because, based on the Commission's experience with Form 1 filers, a respondent's accounting system should have this information available. Furthermore, because the information would not have to be audited, a respondent would be able to compile the required information using a computer and commercially available software that it generally would own for pre-existing accounting purposes and then would submit the information to the Commission. Based on the number of unaudited financial statements the Commission receives from filers of Form 1 and the substance contained in these reports, the Commission estimates that it would take 40 hours to compile, review, and submit these reports.

However, as proposed, all of these reports would be required to be provided in XBRL, as required in Rules 405(a)(1), (a)(3), (b), (c), (d) and (e) of Regulation S-T.⁴³⁵ This would create an additional burden on respondents. The Commission preliminarily estimates, based on its

⁴³⁵ See 17 CFR 232.405.

experience with other data tagging initiatives, that these requirements would add an additional burden of an average of 54 hours and \$23,000 in outside software and other costs per respondent. Thus, for complying with the financial statement requirements under Exhibits F and H in connection with an initial application on proposed Form SB SEF, the Commission estimates an aggregate total initial burden of 11,880 hours⁴³⁶ and \$10,460,000 for all respondents.⁴³⁷ The Commission solicits comments as to the accuracy of these estimates.

Pursuant to the requirements of proposed Rule 801(e), Exhibit P to proposed Form SB SEF would require an applicant that is controlled by any other person to provide an opinion of counsel that any person that controls such SB SEF has consented to and can, as a matter of law, provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the SB SEF, and submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the SB SEF. This creates an additional burden for SB SEFs controlled by other persons. Based on similar requirements on Form 20-F, the Commission preliminarily estimates that this additional burden would add 1 hour and \$900 in outside legal costs for each affected SB SEF.⁴³⁸ For PRA

⁴³⁶ 11,880 hours = 20 (number of SB SEF respondents) x 594 hours (500 hours for audited SB SEF financial statements + 40 hours for unaudited financial statements of affiliated entities + 54 hours for XBRL formatting of submission).

⁴³⁷ \$10,460,000 = 20 (number of SB SEF respondents) x \$523,000 (\$500,000 for outside accounting services for auditing SB SEF's financial statements + \$23,000 in outside software and other cost for formatting financial statement submissions in XBRL format).

⁴³⁸ See Securities Exchange Act Release No. 49616 (Apr. 26, 2004), 69 FR 24016 (Apr. 30, 2004) (outlining the Commission's calculations regarding the PRA burdens resulting from having to provide a legal opinion and additional disclosure required by Instruction 3 to Item 7.B to Form 20-F). The Commission calculated that such requirements would result in an additional burden to affected foreign private issuers of 3 hours, of which 25%, or approximately 1 hour, would be incurred by the foreign private issuers themselves, and 75% would be incurred by outside firms, including legal counsel, which would cost approximately \$900 (\$900 = 3 hours (estimated burden to comply with proposed Rule 801(f)) x 0.75 (portion of estimated burden incurred by outside legal

purposes and in order to provide an estimate that is not under-inclusive, the Commission preliminarily estimates that all respondents applying for registration as a SB SEF pursuant to proposed Rule 801, or 20 SB SEFs, may be controlled by other persons and therefore subject to the additional burden imposed on SB SEF's controlled by other persons by Exhibit P. Thus, the Commission preliminarily estimates a total additional burden for all SB SEFs that are controlled by other persons to comply with the opinion of counsel requirements of Exhibit P of 20 hours⁴³⁹ and \$18,000.⁴⁴⁰ The Commission solicits comments as to the accuracy of these estimates.

Pursuant to the requirements of proposed Rule 801(f), Exhibit P to proposed Form SB SEF would require a non-resident SB SEF to provide an opinion of counsel that the SB SEF can, as a matter of law, provide the Commission with access to the books and records of the SB SEF and submit to onsite inspection and examination by representatives of the Commission. This creates an additional burden for non-resident SB SEFs. Based on similar requirements on Form 20-F, the Commission preliminarily estimates that this additional burden would add 1 hour and \$900 in outside legal costs per respondent.⁴⁴¹ For PRA purposes, the Commission preliminarily estimates that one out of the 20 estimated persons applying for registration as a SB SEF pursuant to proposed Rule 801 may be "non-resident" SB SEFs and therefore subject to the additional burden imposed on non-resident SB SEFs by Exhibit P. Thus, the Commission preliminarily

counsel x \$400 (hourly rate for an outside attorney)). The Commission preliminarily continues to estimate the hourly rate for an outside attorney at \$400 per hour, based on industry sources. See Securities Exchange Act Release No. 62184A (May 27, 2010), 75 FR 33100 at note 505 (June 10, 2010) ("Municipal Securities Disclosure Release").

⁴³⁹ 20 hours = 20 (number of SB SEF respondents controlled by other persons) x 1 (hourly burden to comply with Exhibit P).

⁴⁴⁰ \$18,000 = 20 (number of SB SEF respondents controlled by other persons) x \$900 (cost for outside legal services to comply with Exhibit P).

⁴⁴¹ See supra note 438.

estimates a total additional burden for all non-resident SB SEFs to comply with the opinion of counsel requirements of Exhibit P of 1 hour⁴⁴² and \$900.⁴⁴³

Therefore, the Commission preliminarily estimates that the total one-time burden for a SB SEF to prepare and file the initial Form SB SEF, including all exhibits thereto except for Exhibit P, would be 694 hours⁴⁴⁴ and \$523,000.⁴⁴⁵ In addition, SB SEFs controlled by other persons and non-resident SB SEFs would incur an additional one-time burden of 1 hour and \$900 to prepare and file Exhibit P to proposed Form SB SEF. This would result in a total initial burden for all SB SEFs of 13,901 hours⁴⁴⁶ and \$10,478,900.⁴⁴⁷ The Commission requests comment on the accuracy of these estimates.

The Commission preliminarily estimates that each SB SEF would file four amendments to Form SB SEF pursuant to proposed Rules 802(a) and (b) per year, and that each SB SEF would incur an average burden of 25 hours to prepare each amendment pursuant to proposed

⁴⁴² 1 hour = 1 (number of non-resident SB SEF respondents) x 1 (hourly burden to comply with Exhibit P).

⁴⁴³ \$900 = 1 (number of non-resident SB SEF respondents) x \$900 (cost for outside legal services to comply with Exhibit P).

⁴⁴⁴ 694 hours = 100 hours to comply with Form SB SEF except for Exhibits F, H and P + 500 hours for audited SB SEF financial statements + 40 hours for unaudited financial statements of affiliated entities + 54 hours for XBRL formatting of submission.

⁴⁴⁵ \$523,000 = \$500,000 for outside accounting services for auditing SB SEF's financial statements + \$23,000 in outside software and other cost for formatting financial statement submission in XBRL format.

⁴⁴⁶ 13,901 = (20 (number of SB SEF respondents) x 694 hours (total initial burden to comply with Form SB SEF except for Exhibit P)) + (20 (number of SB SEF respondents controlled by other persons) x 1 hour (total initial burden to comply with Exhibit P)) + (1 (number of non-resident SB SEF respondents) x 1 hour (total initial burden to comply with Exhibit P)).

⁴⁴⁷ \$10,478,900 = (20 (number of SB SEF respondents) x \$523,000 (total initial cost to comply with Form SB SEF except for Exhibit P)) + (20 (number of SB SEF respondents controlled by other persons) x \$900 (total initial cost to comply with Exhibit P)) + (1 (number of non-resident SB SEF respondents) x \$900 (total initial cost to comply with Exhibit P)).

Rules 802(a) and (b), for a total annual burden of 100 hours. The Commission bases this estimate on previous Commission estimates relating to amendments to Form 1 filed by national securities exchanges pursuant to Rule 6a-2 under the Exchange Act.⁴⁴⁸ The Commission preliminarily believes that SB SEFs would prepare these amendments to Form SB SEF internally.

The Commission preliminarily believes that two registered SB SEFs that are controlled by other persons out of all registered SB SEFs that are controlled by other persons per year would be required to file an amendment to Exhibit P to Form SB SEF pursuant to proposed Rule 802(c) due to changes in the legal or regulatory framework of any person that controls such SB SEFs. The Commission preliminarily believes that a SB SEF controlled by another person would incur the same burden to prepare an amended Exhibit P as it would to prepare the initial Exhibit P. Therefore, the Commission preliminarily estimates that a SB SEF controlled by another person would incur an average burden of 1 hour and \$900 to prepare an amended Exhibit P pursuant to proposed Rule 802(c) per year,⁴⁴⁹ and that all SB SEFs controlled by other persons would incur an aggregate burden of 2 hours⁴⁵⁰ and \$1,800 per year⁴⁵¹ to prepare amended Exhibit Ps pursuant to proposed Rule 802(c).

⁴⁴⁸ The Commission calculated in 2010 that national securities exchanges file four amendments or periodic updates to Form 1 per year, incurring an average burden of 25 hours per amendment to comply with Rule 6a-2. See 75 FR 32824, *supra* note 430. While the requirements of Rule 6a-2 are not identical to the requirements of proposed Rules 802(a) and (b), the Commission believes that there is sufficient similarity for PRA purposes that the burden would be equivalent.

⁴⁴⁹ See *supra* note 438 and accompanying text.

⁴⁵⁰ $2 = 2$ (number of SB SEFs controlled by other persons required to file an amended Exhibit P pursuant to proposed Rule 802(c) per year) x 1 hour (total annual burden to file an amended Exhibit P).

The Commission preliminarily believes that one non-resident SB SEF would be required to file one amendment to Exhibit P to Form SB SEF pursuant to proposed Rule 802(d) per year. The Commission preliminarily believes that a non-resident SB SEF would incur the same burden to prepare an amended Exhibit P as it would to prepare the initial Exhibit P. Therefore, the Commission preliminarily estimates that a non-resident SB SEF would incur an average burden of 1 hour and \$900 to prepare each amended Exhibit P pursuant to proposed Rule 802(d) per year,⁴⁵² and that this estimate represents the aggregate burden for all non-resident SB SEFs per year.

The Commission believes that each SB SEF would file one update to Form SB SEF pursuant to proposed Rule 802(f) per year, and that it would take a SB SEF a longer time to file an annual update to Form SB SEF pursuant to proposed Rule 802(f) than it would take a SB SEF to file an amendment to Form SB SEF pursuant to proposed Rules 802(a) and (b), but less time than it would take a SB SEF to prepare an initial application on Form SB SEF. For each annual update to Form SB SEF, the SB SEF should be able to compile and submit the information more readily than it would take for the initial Form SB SEF submission because the SB SEF should already have much of the information required by the annual update in its possession. Therefore, the Commission preliminarily estimates that each SB SEF would incur an average burden of 50 hours to prepare each annual update to the Form SB SEF pursuant to proposed Rule 802(f).⁴⁵³

⁴⁵¹ \$1,800 = 2 (number of SB SEFs controlled by other persons required to file an amended Exhibit P pursuant to proposed Rule 802(c) per year) x \$900 (total annual cost burden to file an amended Exhibit P).

⁴⁵² See supra note 441 and accompanying text.

⁴⁵³ Proposed Rules 811(b)(4) and 811(g)(2) would require SB SEFs to report information regarding grants, denials and limitations of access on Form SB SEF and to disclose all disciplinary actions taken annually on an amendment to Form SB SEF, respectively. In addition, proposed Rule 804(a) would require that a SB SEF intending to file a notice of withdrawal from registration as a SB SEF with the Commission file an amended Form

The Commission estimates that the annual burden for all respondents to file amendments and periodic updates to the Form SB SEF pursuant to proposed Rule 802 would be 3,003 hours⁴⁵⁴ and \$2,700.⁴⁵⁵ The Commission requests comment on the accuracy of its estimates.

The Commission preliminarily estimates that the preparation and filing of supplemental information pursuant to proposed Rule 803(a) generally would involve photocopying existing documents and therefore should take less than one-half hour per response. The Commission similarly preliminarily estimates that where a SB SEF chooses to comply with the requirements of proposed Rule 803(b), which relates to supplemental information being made available continuously on the SB SEF's website, instead of proposed Rule 803(a), which relates to filing of the actual supplemental information, the response required by proposed Rule 803(b) should take less than one-half hour as well. The Commission preliminarily estimates that each SB SEF would make approximately 15 filings on an annual basis pursuant to proposed Rules 803(a) and

SB SEF to update any inaccurate information at the time of such notice of withdrawal. The Commission preliminarily believes that the burdens associated with these requirements would be included in the burden associated with the annual update to Form SB SEF required by proposed Rule 802(f).

The Commission notes that, pursuant to proposed Rules 823(e)(1) and (2), the CCO of a SB SEF would be required to prepare annual updates to the financial reports required by Exhibits F and H. Therefore, the Commission preliminarily believes that any burden resulting from the requirement to update Exhibits F and H annually pursuant to proposed Rule 802(f) would be included in the burden associated with proposed Rule 823(e)(1) and (2) discussed in the sections of this PRA analysis relating to the duties of the SB SEF's CCO.

⁴⁵⁴ 3,003 hours = (20 (number of SB SEF respondents) x 4 (number of filings pursuant to proposed Rules 802(a) and (b)) x 25 hours (burden per filing)) + (2 (number of respondents) x 1 (number of filings pursuant to proposed Rule 802(c)) x 1 hour (burden per filing)) + (1 (number of respondents) x (1 (number of filings pursuant to proposed Rule 802(d)) x 1 hour (burden per filing)) + (20 (number of SB SEF respondents) x (1 (number of filings pursuant to proposed Rule 802(f)) x 50 hours (burden per filing))).

⁴⁵⁵ \$2,700 = (2 (number of respondents) x 1 (number of filings pursuant to proposed Rule 802(c)) x \$900 (burden per filing)) + (1 (number of respondents) x 1 (number of filings pursuant to proposed Rule 802(d)) x \$900 (burden per filing)).

(b) combined. The Commission bases these estimates on previous Commission estimates relating to supplemental material filed by national securities exchanges pursuant to Rule 6a-3.⁴⁵⁶ Therefore, the Commission estimates that the total annual reporting burden under proposed Rule 803 for all SB SEFs would be 150 hours.⁴⁵⁷ The Commission requests comment on the accuracy of this estimate.

Proposed Rule 804 would require that a SB SEF provide the Commission notice of withdrawal of registration and file an amended Form SB SEF to update any inaccurate information at the time of such notice of withdrawal. The Commission preliminarily estimates that one SB SEF per year would seek to withdraw its registration with the Commission and therefore be subject to the collection of information requirements in proposed Rule 804. The Commission preliminarily estimates that a SB SEF would incur an average burden of 1 hour to prepare and file with the Commission a notice of withdrawal of registration. The Commission preliminarily believes that the burden incurred by a SB SEF withdrawing its registration to file an amended Form SB SEF pursuant to proposed Rule 804 would be included in the estimated burden under proposed Rule 802(f) requiring annual updates to Form SB SEF. Therefore, the

⁴⁵⁶ The Commission calculated in 2010 that Rule 6a-3 would require national securities exchanges to make 25 filings per year at a burden of 0.5 hours per filing. 75 FR 32822 (June 9, 2010) (outlining the most recent Commission calculations regarding the PRA burdens for Rule 6a-3). While the requirements of Rule 6a-3 are not identical to those of proposed Rule 803, the Commission believes that there is sufficient similarity for PRA purposes that the burden would be equivalent. However, Rule 6a-3 contains a requirement for national securities exchanges to file certain monthly reports, while proposed Rule 803 contains no such requirement with respect to SB SEFs. Therefore, the Commission preliminarily estimates that a SB SEF would make 15 filings per year pursuant to proposed Rule 803, rather than 25 filings as estimated in connection with Rule 6a-3.

⁴⁵⁷ 150 hours = 20 (number of SB SEF respondents) x 15 (number of filings per respondent) x .5 hours (burden per filing).

Commission estimates that the annual burden for all respondents pursuant to proposed Rule 804 would be 1 hour.

The Commission preliminarily estimates that the total annual hourly burden for all SB SEFs combined to comply with the registration requirements under Regulation SB SEF would be 3,154 hours⁴⁵⁸ and the total one time hourly burden would be 13,901 hours.⁴⁵⁹ The Commission preliminarily estimates that the total annual cost burden for all SB SEFs to comply with the registration requirements under Regulation SB SEF would be \$2,700,⁴⁶⁰ and the total one-time cost burden for all SB SEFs would be \$10,478,900.⁴⁶¹ The Commission requests comment on the accuracy of these estimates.

2. Rule-writing Requirements for SB SEFs

The proposed rules that would require a SB SEF to establish rules, policies and procedures to meet the requirements of various proposed rules in Regulation SB SEF are summarized in Section XXII.A.2. above. Based on its experience with the rule-writing process conducted by national securities exchanges and applicants to become national securities exchanges, the Commission believes that a SB SEF would spend an average of 10 hours to draft each rule, policy or procedure required to be established under Regulation SB SEF and that the SB SEF would handle this work internally. The Commission recognizes that in some cases, the SB SEF may take longer than 10 hours to draft a particular rule, policy or procedure, but in other cases, the SB SEF may take fewer than 10 hours to draft a particular rule, policy or procedure.

⁴⁵⁸ 3,154 hours = 3,003 (estimated hourly burden to comply with proposed Rule 802) + 150 (estimated hourly burden to comply with proposed Rule 803) + 1 (estimated hourly burden to comply with proposed Rule 804).

⁴⁵⁹ See supra note 446.

⁴⁶⁰ See supra note 455.

⁴⁶¹ See supra note 447.

Therefore, the Commission preliminarily believes that the 22 proposed rules, policies and procedures that a SB SEF would be required to draft under proposed Regulation SB SEF would carry a one-time paperwork burden of 220 hours per respondent, for a maximum total of 4,400 hours.⁴⁶² The estimated 220 hours per respondent also would include the time expended for review of the draft rules, policies or procedures by the SB SEF's management. The Commission requests comment on the accuracy of this estimate.

The Commission preliminarily estimates that once a SB SEF has drafted the written rules, policies and procedures that it is required to establish pursuant to Regulation SB SEF, a SB SEF would spend approximately 10 hours per month to review its written rules, policies and procedures to ensure that they are up-to-date and remain in compliance with proposed Regulation SB SEF and to prepare any necessary new or amended rules, policies and procedures.⁴⁶³ Therefore, the Commission preliminarily estimates that the provisions of proposed Regulation SB SEF requiring that a SB SEF establish certain rules, policies and procedures would result in an ongoing annual burden of 120 hours per respondent,⁴⁶⁴ for a total estimated ongoing annual burden of 2,400 hours.⁴⁶⁵ The Commission requests comment on the accuracy of this estimate.

3. Reporting Requirements for SB SEFs

⁴⁶² 4,400 hours = 20 (number of SB SEF respondents) x 220 hours (one-time burden to draft 22 proposed rules, policies and procedures).

⁴⁶³ This burden estimate does not include the burden that would be incurred by a SB SEF in connection with submitting rule filings in connection with new rules or rule amendments to the Commission, which burden would be included in the burden for proposed Rules 805 and 806 discussed in the sections of this PRA relating to the rule filing processes for SB SEFs.

⁴⁶⁴ 120 hours = 10 hours (monthly burden) x 12 (months per year).

⁴⁶⁵ 2,400 hours = 20 (number of SB SEF respondents) x 120 hours (annual burden to update rules, policies and procedures required by proposed Regulation SB SEF).

Proposed Rule 814: Proposed Rule 814(a) would require a SB SEF to require its participants to provide information or documents to the SB SEF upon request. Proposed Rule 814(a) also would require the SB SEF to require its participants to provide information or documents to any representative of the Commission upon request.

As noted above, the Commission estimates that each SB SEF would have 275 participants.⁴⁶⁶ Based on industry sources, the Commission believes it is likely that each participant would elect to be a member of each SB SEF. The Commission therefore estimates that each of these estimated 275 participants would be a participant of each SB SEF. The Commission therefore estimates that there would be a total of 275 SB SEF participants subject to the collection of information requirements of proposed Rule 814(a). The Commission requests comment on the accuracy of this estimate.

Based on its experience in requesting information from exchanges and exchange members for various purposes, the Commission estimates that it would require an average of 25 hours per response for a SB SEF participant to compile and transmit documents and information requested pursuant to proposed Rule 814(a) and that such requests would occur a total of 4 times each year per SB SEF participant.⁴⁶⁷ Thus, the Commission estimates that the annual burden on each SB SEF participant to report documents or information pursuant to proposed Rule 814(a) would be 100 hours.⁴⁶⁸ The Commission therefore estimates that the annual aggregate burden

⁴⁶⁶ See supra note 429.

⁴⁶⁷ The estimate of 4 annual requests assumes that each SB SEF participant would receive, on average, one request for information per calendar quarter.

⁴⁶⁸ 100 hours = 4 (number of requests annually) x 25 (annual hourly burden for each participant to comply with SB SEF rules imposed pursuant to proposed Rule 814(a)).

on SB SEF participants for all SB SEFs would be 27,500 hours.⁴⁶⁹ The Commission believes that this work, should it be required, would be conducted internally. The Commission seeks comment on these proposed estimates.

Proposed Rule 814(b)(2) would require a SB SEF to provide information or documents to any representative of the Commission upon request. For PRA purposes, the Commission estimates that it would request information or documents under proposed Rule 814(b)(2) two times per year, per respondent. The amount of time that it would take for a respondent to comply with a request would vary depending on the nature and extent of the request. Based on its experience in requesting information from exchanges for a variety of purposes, the Commission estimates that it would require an average of 25 hours per response for a SB SEF to compile and transmit documents and information requested by the Commission, for an annual hourly burden of 50 hours per respondent. Thus, the Commission preliminarily estimates the aggregate annual burden on a SB SEF to comply with requests for documents or information pursuant to proposed Rule 814(b)(2) would be 1,000 hours.⁴⁷⁰ The Commission believes that this work, should it be required, would be conducted internally. The Commission solicits comment as to the accuracy of these estimates.

Proposed Rule 814(b)(3) would require a SB SEF to have the capacity to carry out such international information-sharing agreements as the Commission may require. If so directed by the Commission, a SB SEF could be required to carry out one or more international-information sharing agreements. It is difficult to estimate how many international-information sharing

⁴⁶⁹ 27,500 hours = 4 (total number of annual requests made of a SB SEF participant directly or indirectly) x 25 (hours per respondent) x 275 (number of SB SEF participants required to comply with proposed rules imposed by a SB SEF pursuant to proposed Rule 814(a)).

⁴⁷⁰ 1,000 hours = 50 (annual hourly burden to comply with proposed Rule 814(b)(2)) x 20 (number of SB SEF respondents).

agreements the Commission may direct a SB SEF to carry out or what the reporting requirements under such agreements may be.

The Commission estimates, for PRA purposes only, that SB SEFs would need to carry out such an agreement, on average, once per year. The Commission further estimates that each such agreement could require 40 hours per respondent to prepare, review and finalize. The Commission therefore preliminarily estimates that the paperwork burden for SB SEFs associated with having the capacity to carry out international information-sharing agreements as the Commission may require pursuant to proposed Rule 814(b)(3) would be 800 hours.⁴⁷¹ The Commission believes that these agreements initially would be created or reviewed internally, but also reviewed by outside counsel. The Commission estimates that the SB SEF's outside counsel would require 10 hours to review these documents for a cost of \$4,000 per respondent, and a total cost of \$80,000 for all respondents.⁴⁷² The Commission solicits comment as to the accuracy of these estimates.

In addition, the Commission preliminarily estimates that a SB SEF would be required to provide information pursuant to an international information-sharing agreement a total of twice per year and that, similar to complying with a Commission request for information pursuant to other provisions of proposed Rule 814, it would require 25 hours per response to comply with a request for information, for a total annual burden of 50 hours per year per SB SEF. The Commission believes that this work, should it be required, would be conducted internally. The Commission therefore estimates that aggregate annual paperwork burden on SB SEFs associated

⁴⁷¹ 800 hours = 40 (annual hourly burden to enter into an international information-sharing agreement pursuant to proposed Rule 814(b)(3) x 20 (number of SB SEF respondents). The Commission believes there would be no separate initial burden.

⁴⁷² These figures are based on an hourly cost of outside counsel at \$400. See Municipal Securities Disclosure Release, supra note 438.

with reporting under international information sharing agreements entered into under proposed Rule 814(b)(3) would be 1,000 hours.⁴⁷³ The Commission solicits comment as to the accuracy of these estimates.

The Commission therefore estimates the aggregate annual paperwork burden associated with proposed Rule 814 to be 27,500 hours for SB SEF participant respondents and 2,800⁴⁷⁴ hours and \$80,000 for SB SEF respondents.

Proposed Rule 816: Proposed Rule 816 would require a SB SEF to notify the Commission of any exercise of its emergency authority, and within two weeks following cessation of an emergency, submit to the Commission a report explaining the basis for declaring an emergency, how conflicts of interest were minimized, and the extent to which the SB SEF considered the effect of its emergency action on the markets for the SB swap and any security or securities underlying the SB swap. The collection of information associated with proposed Rule 816 would apply only during and following an emergency.⁴⁷⁵

The Commission notes that emergencies in the securities markets are rare, but when they do occur, they require significant time and resources to address. For PRA purposes only, the Commission estimates that a SB SEF would exercise its emergency authority once per year.

⁴⁷³ 1,000 hours = 50 (annual hourly burden to comply with reporting requirements pursuant to international information-sharing agreements x 20 (number of SB SEF respondents).

⁴⁷⁴ 2,800 hours = 1,000 (aggregate burden on SB SEF respondents to comply with proposed Rule 814(b)(2)) + 1,800 hours (aggregate burden on SB SEF respondent to comply with proposed Rule 814(b)(3)).

⁴⁷⁵ Proposed Rule 816(d)(2) provides that if a SB SEF implements any rule or rule amendment in the exercise of its emergency authority, it must file such rule or rule amendment with the Commission pursuant to proposed Rule 806 prior to the implementation of such rule or rule amendment, or, if not practicable, within 24 hours after implementation of such rule or rule amendment. The annual hourly burden to comply with proposed Rule 816(d)(2) is included in the estimated annual hourly burden for a SB SEF to comply with proposed Rule 806.

Based on its experience with national securities exchanges, the Commission estimates that the time that would be necessary for a SB SEF to prepare and transmit the notice and report regarding emergency authority pursuant to proposed Rule 816 would be 40 hours per respondent. Thus, the Commission estimates that the total annual reporting burden associated with proposed Rule 816 would be 800 hours.⁴⁷⁶ The Commission believes that this work, should it be required, would be conducted internally. The Commission solicits comment on these estimates.

Proposed Rule 818: Proposed Rule 818(e) would require a SB SEF to report to the Commission such information as the Commission may, from time to time, determine to be necessary to perform the duties of the Commission. For PRA purposes only, the Commission estimates that the Commission may request such information from a SB SEF once each year. For PRA purposes only, the Commission estimates that any request for information would be information easily accessible to the SB SEF, but could require an analysis of such information by the SB SEF. Based on the Commission's experience with information requested of other registered entities, the Commission preliminarily estimates that each request pursuant to proposed Rule 818 would require 20 hours to collect, review, draft any accompanying analysis or report, and transmit, which would result in an annual hourly burden of 20 hours per SB SEF respondent. Thus, the Commission estimates that the aggregate annual reporting burden on SB SEFs associated with proposed Rule 818(e) would be 400 hours.⁴⁷⁷ The Commission solicits comment on these estimates.

⁴⁷⁶ 800 hours = 40 (annual hourly burden to comply with proposed Rule 816) x 20 (number of SB SEF respondents).

⁴⁷⁷ 400 hours = 20 (annual hourly burden to comply with proposed Rule 818(e)) x 20 (number of SB SEF respondents). The Commission believes there would be no separate initial burden.

Proposed Rule 818(f) would require a SB SEF to provide to any representative of the Commission, upon request, copies of documents required to be kept and preserved pursuant to the recordkeeping requirements of proposed Rule 818. For PRA purposes only, the Commission preliminarily estimates that it would request information or documents under proposed Rule 818(f) twice per year and would require no more than 25 hours per response to compile and transmit, resulting in an annual hourly burden of 50 hours per SB SEF respondent.⁴⁷⁸ The Commission therefore estimates the annual aggregate paperwork burden associated with proposed Rule 818(f) would be 1,000 hours.⁴⁷⁹ The Commission solicits comment on these estimates.

The Commission therefore estimates the total annual reporting burden on SB SEFs associated with proposed Rule 818 would be 1,400 hours.⁴⁸⁰

Proposed Rule 822: Proposed Rule 822(a)(2) would require a SB SEF to submit to the Commission an annual objective review of the capability of SB SEF systems that support or are integrally related to the performance of the SB SEF's activities. If the objective review is performed by an internal department, an objective, external firm would be required to assess the internal department's objectivity, competency, and work performance. Based on its experience with its ARP program, the Commission believes that the annual burden per respondent of

⁴⁷⁸ Based on its experience in requesting information from exchanges for a variety of purposes, the Commission estimates that it would require an average of 25 hours per response for a SB SEF to compile and transmit documents and information requested by the Commission.

⁴⁷⁹ 1,000 hours = 25 (annual hourly burden to comply with proposed Rule 818(f)) x 20 (number of SB SEF respondents).

⁴⁸⁰ 1,400 hours = 400 (hourly burden to comply with proposed Rule 818(e)) + 1,000 (hourly burden to comply with proposed Rule 818(f)).

conducting an internal audit would be approximately 625 hours.⁴⁸¹ Further, the Commission's experience with the ARP program has indicated that an additional 200 hours per respondent per year would be required on average to oversee and establish the independent review of these audits.⁴⁸² Thus, the Commission estimates the aggregate annual burden on SB SEFs to comply with requirement to submit these reports would be 16,500 hours.⁴⁸³ In addition, based on its experience with the ARP program,⁴⁸⁴ the Commission estimates that the annual cost to hire an objective, external firm to be approximately \$90,000 per respondent annually. For this reason, the Commission estimates the total annual cost of hiring an objective, external firm to review internal audits as \$1,800,000 for all respondents.⁴⁸⁵ The Commission solicits comment as to the accuracy of this information.

In addition, proposed Rule 822(a)(3) would require a SB SEF to promptly notify the Commission in writing of material systems outages and submit to the Commission within five business days of when the outage occurred a written description and analysis of the outage and any remedial measures that have been implemented or are contemplated. The Commission estimates, based on its experience with the ARP program, that the burden imposed by these

⁴⁸¹ See SDR Release, *supra* note 6.

⁴⁸² *Id.*

⁴⁸³ 16,500 hours = 825 (annual hourly burden to comply proposed Rule 822(a)(2)) x 20 (number of SB SEF respondents).

⁴⁸⁴ Under the Commission's ARP inspection program of SROs and certain ATSS, the Commission staff conducts on-site inspections and attends periodic technology briefings presented by SRO and ATS staff for the Commission's ARP staff, which generally covers systems capacity and testing, review of system vulnerability, review of planned system development, and business continuity planning. Under the ARP inspection program, the Commission staff also monitors system failures and planned system changes on a daily basis.

⁴⁸⁵ \$1,800,000 = \$90,000 (annual external dollar cost per respondent to comply with proposed Rule 822(a)(2)) x 20 (number of SB SEF respondents).

requirements would be 15.4 hours on average per respondent per year, for a total estimated burden of 308 hours per year for all respondents.⁴⁸⁶ The Commission believes that this work would be conducted internally. The Commission solicits comments as to the accuracy of this estimate.

Proposed Rule 822(a)(4) would require a SB SEF to notify the Commission in writing at least thirty calendar days before implementation of any planned material systems changes. The Commission estimates that there would be an average of 60 such events per respondent per year.⁴⁸⁷ Based on the Commission's experience with the ARP program, the Commission estimates that each of these notices would require an average of 2 hours for a total burden for all respondents of 2,400 hours annually.⁴⁸⁸ The Commission believes that this work would be conducted internally. The Commission solicits comments as to the accuracy of this estimate.

The Commission therefore preliminarily estimates that the total annual hourly reporting burden associated with proposed Rule 822 would be 19,208 hours⁴⁸⁹ and \$1,800,000.⁴⁹⁰

The Commission preliminarily estimates that the total annual hourly burden for all SB

⁴⁸⁶ 308 hours = 15.4 annual hourly burden per respondent to comply proposed Rule 822(a)(3)) x 20 (number of SB SEF respondents). This annual hourly burden comports with the Commission's estimate for similar proposed requirements to be imposed on SDRs to comply with similar proposed requirements. See SDR Release, supra note 6.

⁴⁸⁷ This estimate would account for any weekly maintenance that would meet the standard of a "material systems change," as well as for any software upgrades, throughout the year, that would meet such standard.

⁴⁸⁸ 2,400 hours = 60 (notices per SB SEF) x 2 (annual hourly burden per notice) x 20 (number of SB SEF respondents). See SDR Release, supra note 6.

⁴⁸⁹ 19,208 hours = 16,500 (annual hourly burden to comply with proposed Rule 822(a)(2)) + 308 (annual hourly burden to comply with proposed Rule 822(a)(3)) + 2,400 (annual hourly burden to comply with proposed Rule 822(a)(4)).

⁴⁹⁰ See supra note 485.

SEFs combined for reporting would be 24,208 hours.⁴⁹¹ There is no one time initial hourly burden associated with the proposed reporting requirements. The Commission preliminarily estimates that the total annual cost burden for all SB SEFs combined for reporting would be \$1,880,000.⁴⁹² In addition, the Commission preliminary estimates that the total annual hourly burden on all SB SEF participants for reporting under proposed Regulation SB SEF would be 28,000 hours.

4. Recordkeeping Required Under Regulation SB SEF

The annual recordkeeping requirements that are contained in proposed Rules 818(a) and (b) are similar to the requirements that apply to SROs pursuant to Rules 17a-1(a) and (b) under the Exchange Act.⁴⁹³ The Commission currently estimates that an SRO, including a national securities exchange, would expend approximately 50 hours per year to comply with the collection of information requirement of Rule 17a-1.⁴⁹⁴ Based on the Commission's experience

⁴⁹¹ 24,208 = 2,800 (annual hourly burden to comply with proposed Rule 814) + 800 (annual hourly burden to comply with proposed Rule 816) + 1,400 (annual hourly burden to comply with proposed Rule 818) + 19,208 (annual hourly burden to comply with proposed Rule 822).

⁴⁹² \$1,880,000 = \$80,000 (annual cost burden to comply with proposed Rule 814(b)(3)) + \$1,800,000 (annual cost burden to comply with proposed Rule 822(a)(2)).

⁴⁹³ 17 CFR 240.17a-1(a) and (b). In addition, proposed Rule 811(b)(3) would require that a SB SEF make and keep records relating to all grants and denials of access to the SB SEF and proposed Rule 811(g) would require a SB SEF to make and keep records relating to all disciplinary proceedings. The records required by proposed Rules 811(b)(3) and 811(g) would be included in the business records required to be kept pursuant to proposed Rule 818. Therefore, the Commission preliminarily believes that the paperwork burden for these rules would be included in the estimated burden for proposed Rule 818. See *supra* note 417 and accompanying text.

⁴⁹⁴ Rule 17a-1 also states generally that SROs shall, upon the request of any representative of the Commission, promptly furnish copies of documents required to be kept and preserved under the rule. See 17 CFR. 240.17a-1. The Commission's estimated burden of 50 hours per respondent reflects compliance with all of the recordkeeping provisions of this rule. See 2010 Extension of Rule 17a-1 Supporting Statement, Office of

with Rule 17a-1(a) and (b), the Commission believes that 50 hours would be an appropriate estimate for the hourly burden that would apply to SB SEFs to comply with proposed Rule 818(a) and (b). The Commission notes that SB SEFs generally would be electronic platforms and that the vast preponderance of its records thus should be retained electronically in the ordinary course of its business. Therefore, the Commission preliminarily estimates that it would take a SB SEF approximately 50 hours annually to comply with proposed Rule 818(a) and (b) for an aggregate annual burden of 1,000 hours.⁴⁹⁵ This estimated amount includes, but is not limited to, the annual hourly burden to generate, collect, organize and preserve all of the documents and other records required under proposed Rule 818(a) and (b). The Commission requests comment on the accuracy of this estimate.

In addition, proposed Rule 818(c) would require a SB SEF to keep certain records with respect to trading activity on and through the SB SEF. Specifically, a SB SEF would be required to make and keep accurate, time-sequenced records of all trading interest and transactions that are received by, originated on, or executed on the SB SEF. This recordkeeping rule is similar to the audit trail requirement that applies to ATSS pursuant to Rule 302 of Regulation ATS under the Exchange Act.⁴⁹⁶ The Commission currently estimates that an ATS would expend approximately 130 hours per year to comply with the collection of information requirements of

Management and Budget, available at
http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201007-3235-003.

⁴⁹⁵ 1,000 hours = 20 (number of SB SEF respondents) x 50 hours (annual hourly burden to comply with proposed Rule 818(a) and (b)).

⁴⁹⁶ Rule 302 of Regulation ATS under the Exchange Act generally requires an ATS to keep a record of subscribers, daily summaries of trading and time sequenced records of order information in the ATS. See 17 CFR 242.302. The Commission's estimated burden of 130 hours per respondent reflects compliance with all of the recordkeeping provisions of this rule. See 2010 Extension of Rule 302 Supporting Statement, Office of Management and Budget, available at
http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201006-3235-008.

Rule 302 of Regulation ATS. Based on the Commission's experience with Rule 302 of Regulation ATS, which contains the requirement that an ATS make and keep records necessary to create a meaningful audit trail, the Commission preliminarily estimates that the annual hourly paperwork burden for a SB SEF to comply with proposed Rule 818(c) would be approximately 130 hours, which would result in an aggregate annual burden of 2,600 hours.⁴⁹⁷ The Commission requests comment on the accuracy of this estimate.

The Commission preliminarily believes that the records that a SB SEF would have to keep and preserve to comply with proposed Rule 818 would be the same records that a SB SEF would already have to keep and preserve in the ordinary course of its business. A SB SEF would be required to keep and preserve these records to, among other things, pay taxes, defend against legal actions, resolve conflicts between participants, and generally to ensure the smooth functioning of the SB SEF's business operations. Therefore, the Commission preliminarily believes that, while there would be a collection of information required by proposed Rule 818 related to recordkeeping, there would not be a paperwork burden for PRA purposes associated with the SB SEF's complying with proposed Rule 818 aside from establishing or modifying recordkeeping systems as noted below, because these records would be maintained in the ordinary course of its business.⁴⁹⁸

For purposes of the PRA, however, the Commission preliminarily estimates that a SB SEF could incur a one-time burden to set up or modify an existing recordkeeping system to

⁴⁹⁷ 2,600 hours = 20 (number of SB SEF respondents) x 130 hours (annual hourly burden to comply with proposed Rule 818(c)).

⁴⁹⁸ See 5 CFR 1320.3(b)(2). This section generally provides that the time, effort, and financial resources necessary to comply with a collection of information that would be incurred by persons in the normal course of their activities (e.g., in compiling and maintaining business records) are excluded from the definition of "burden" in the PRA if they are usual and customary.

comply with the proposed Rule 818. Based on the Commission's experience with recordkeeping costs and consistent with prior burden estimates for similar recordkeeping provisions,⁴⁹⁹ the Commission estimates that setting up or modifying a recordkeeping system would create an initial burden of 345 hours⁵⁰⁰ and \$1,800 in information technology costs per respondent to purchase recordkeeping software,⁵⁰¹ for a total initial burden of 6,900 hours⁵⁰² and \$36,000.⁵⁰³ The Commission requests comment on the accuracy of this estimate.

Additionally, the Commission preliminarily estimates that each SB SEF may have a one-time burden to upgrade its existing systems to ensure that the audit trail component of their systems complies with proposed Rule 818(c). Based on industry sources, the Commission preliminarily believes that this work would be done internally by two programmers over the course of approximately four weeks. Therefore, the Commission preliminarily estimates that it would take a total of 320 hours for a SB SEF to upgrade its existing systems for an aggregate one-time hourly burden of 6,400 hours.⁵⁰⁴

⁴⁹⁹ See Securities Exchange Act Release No. 59342 (February 2, 2009); 74 FR 6456 (February 9, 2009) (Amendments to Rules for Nationally Recognized Statistical Rating Organizations) ("NRSRO Adopting Release").

⁵⁰⁰ See NRSRO Adopting Release, *supra* note 499, 74 FR at 6472, n. 154 (estimated average one-time hourly burden of 345 hours for each nationally recognized statistical ratings organization ("NRSRO") to implement a recordkeeping system to comply with Rule 17g-2 under the Exchange Act, 17CFR 240.17g-2).

⁵⁰¹ See NRSRO Adopting Release, *id.*, 74 FR at 6472 (estimated average cost of \$1,800 for each NRSRO to purchase recordkeeping software).

⁵⁰² 6,900 hours = 345 hours (estimated hourly burden for each SB SEF to implement a recordkeeping system) x 20 (number of SB SEF respondents).

⁵⁰³ \$36,000 = \$1,800 (estimated cost to purchase recordkeeping software) x 20 (number of SB SEF respondents).

⁵⁰⁴ 6,400 hours = 320 hours (estimated one-time hourly burden for two senior programmers working 40 hours per week for four weeks at each SB SEF to upgrade systems to comply with proposed Rule 818(c)) x 20 (number of SB SEF respondents).

Therefore, the Commission preliminarily believes that the total aggregate annual hourly burden for 20 SB SEFs to comply with proposed Rule 818(a) through (c) would be approximately 3,600 hours.⁵⁰⁵ The total one time hourly burden for 20 SB SEFs to comply with proposed Rule 818 would be approximately 13,300 hours⁵⁰⁶ and \$36,000. The Commission requests comment on the accuracy of this estimate.

As discussed above, proposed Rule 813(c)(1) would require a SB SEF to establish rules requiring any participant that enters any trading interest or executes any transaction on the SB SEF to maintain books and records of any such trading interest or transaction and of any position in any security-based swap that is the result of any such trading interest or transaction. The Commission preliminarily believes that proposed Rule 813(c)(1) could impose a collection of information burden on some SB SEF participants.⁵⁰⁷ However, the Commission also preliminarily believes that the records that many SB SEF participants would have to maintain pursuant to proposed Rule 813(c)(1) would be the same records that these participants would have to maintain under other Commission recordkeeping provisions to the extent they are

⁵⁰⁵ 3,600 hours = 1,000 hours (estimated annual hourly burden to comply with proposed Rule 818(a) and (b)) + 2,600 hours (estimated annual hourly burden to comply with proposed Rule 818(c)).

⁵⁰⁶ 13,300 hours = 6,900 hours (total estimated one-time hourly burden for all SB SEF respondents combined to set-up or modify recordkeeping software to comply with proposed Rule 818) + 6,400 hours (total estimated one-time hourly burden for all SB SEF respondents combined to modify existing systems to comply with audit trail requirements of proposed Rule 818(c)).

⁵⁰⁷ The Commission also notes that proposed 809(c)(2)(i) would require non-registered ECPs to meet the recordkeeping and reporting requirements established by the SB SEF pursuant to proposed Rule 813. The collection of information associated with 809(c)(2)(i) is encompassed in the burden estimates for the collection of information associated with proposed Rule 813.

regulated entities or in the ordinary course of their business.⁵⁰⁸ Therefore, the Commission preliminarily believes that the paperwork burden for a number of SB SEF participants is either already encompassed in the collection of information for other recordkeeping obligations that they must comply with or would not be required to be calculated for purposes of this PRA analysis because such burden relates to the maintenance of records that are usually or customarily maintained.⁵⁰⁹

However, the Commission believes that proposed Rule 813(c)(1) could impose a new obligation to maintain books and records on those ECPs that would become participants of the SB SEF. For PRA purposes the Commission believes that it is appropriate to estimate that all 210 ECPs would be subject to the collection of information requirement of proposed Rule 813(c)(1).⁵¹⁰ Based on the Commission's experience with similar recordkeeping rules,⁵¹¹ the Commission preliminarily estimates that it would take each ECP that is a SB SEF participant approximately 40 hours on an annual basis to comply with the collection of information requirement of proposed Rule 813(c)(1) for a total annual burden for all ECP respondents combined of 8,400 hours.⁵¹² The Commission requests comment on the accuracy of this

⁵⁰⁸ Section 764 of the Dodd-Frank Act requires the Commission to adopt rules governing reporting and recordkeeping for SB swap dealers and major SB swap participants. See Pub. L. No. 111-203, §764. The Commission is proposing reporting and recordkeeping rules for SB swap dealers and major SB swap participants as part of a separate Commission rulemaking. See also, e.g., Rules 17a-3 (records to be made by certain exchange members, brokers and dealers) and 17a-4 (records to be preserved by certain exchange members, brokers and dealers) under the Exchange Act, 17 CFR 240.17a-3 and 17 CFR 240.17a-4.

⁵⁰⁹ See 5 CFR 1320.3(b)(2).

⁵¹⁰ See supra note 429 and accompanying text.

⁵¹¹ See, e.g., 17 CFR 240.17a-3 and 17 CFR 240.17a-4.

⁵¹² 8,400 hours = 210 (estimated number of ECPs that could be subject to the collection of information under proposed Rule 813(c)(1)) x 40 hours (estimated annual burden for each ECPs to comply with the collection of information under proposed Rule 813(c)(1)).

estimate.

For purposes of the PRA, the Commission also preliminarily estimates that ECPs that would be SB SEF participants could incur a one-time burden to set up or modify an existing recordkeeping system to comply with the proposed Rule 813(c)(1). Based on the Commission's experience with recordkeeping costs and consistent with prior burden estimates for similar recordkeeping provisions,⁵¹³ the Commission estimates that setting up or modifying a recordkeeping system would create an initial burden of 345 hours⁵¹⁴ and \$1,800 in information technology costs per ECP to purchase recordkeeping software,⁵¹⁵ for a total initial burden of 72,450 hours⁵¹⁶ and \$378,000 for all ECPs combined.⁵¹⁷ The Commission requests comment on the accuracy of this estimate.

5. Timely Publication of Trading Information Requirement for SB SEFs

Proposed Rule 817(a) would require a SB SEF to: (1) have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF; and (2) make public timely information on price, trading volume, and other trading data on SB swaps to the extent required by the

⁵¹³ See NRSRO Adopting Release supra note 499.

⁵¹⁴ See NRSRO Adopting Release, supra note 499, 74 FR at 6472, n. 154 (estimated average one-time hourly burden of 345 hours for each NRSRO to implement a recordkeeping system to comply with Rule 17g-2 under the Exchange Act).

⁵¹⁵ See NRSRO Adopting Release, supra note 499, 74 FR at 6472 (estimated average cost of \$1,800 for each NRSRO to purchase recordkeeping software).

⁵¹⁶ 72,450 hours = 345 hours (estimated hourly burden for each SB SEF participant to implement a recordkeeping system) x 210 (estimated number of ECP SB SEF participants that could seek to set up or modify a recordkeeping system to comply with proposed Rule 813(c)(1)).

⁵¹⁷ \$378,000 = \$1,800 (estimated cost to purchase recordkeeping software) x 210 (estimated number of ECP SB SEFs that could seek to purchase recordkeeping software to comply with proposed Rule 813(c)(1)).

Commission. The Commission notes that proposed Rule 817(a)(1) would incorporate Section 3D(d)(8) of the Exchange Act but would not otherwise require a SB SEF to report SB swap transactions to a registered SDR or make public timely information on price, trading volume, and other trading data on SB swaps. Rather, the Commission has proposed that other parties be responsible for reporting of SB swap transactions to a registered SDR and for the public dissemination of certain SB swap transaction information.⁵¹⁸

However, because proposed Rule 817(a) would require a SB SEF to have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF so that it could make such information public if required, the Commission preliminarily believes that each SB SEF could have a one-time hourly burden to modify its systems so that they have this functionality.⁵¹⁹ The Commission believes that for a SB SEF to ensure it has the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF, as required by Section 3D(d)(8) and as proposed to be incorporated in proposed Rule 817(a), a SB SEF would need two computer programmers, each working four weeks. This would result in a one-time hourly burden of 320 hours⁵²⁰ per SB SEF

⁵¹⁸ See Reporting and Dissemination Release supra note 6.

⁵¹⁹ The Commission believes that a SB SEF would seek to ensure that it has the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through its facilities in the ordinary course of its business. Therefore the Commission is not including the one-time burden of developing and implementing systems having the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF in its paperwork burden estimate for proposed Rule 817(a). See 5 CFR 1320.3(b)(2).

⁵²⁰ 320 hours = 2 (number of senior programmers) x 40 (hours in a standard full-time work week) x 4 (number of weeks required).

respondent, for a total annual burden on all SB SEFs of 6,400 hours.⁵²¹ The Commission solicits comment on the accuracy of these estimates.

6. Rule Filing and Product Filing Processes for SB SEFs

Under proposed Rules 805 and 806, a SB SEF would be required to submit rule filings for new rules or rule amendments, including changes to a product's terms or conditions. As noted above, the Commission estimates a total of 20 SB SEF respondents for this requirement. The proposed rules are modeled on the rule filing and product filing processes proposed by the CFTC.⁵²² Based on the Commission staff's consultation with CFTC staff,⁵²³ the Commission estimates that on average these requirements would require 2.5 hours of work per rule filing, with an estimated average of 60 responses per year per respondent. This would result in a total estimated burden of 150 hours per respondent⁵²⁴ and 3,000 hours for all the respondents annually.⁵²⁵ Based on the Commission staff's consultation with CFTC staff, the Commission believes that the SB SEF would handle the rule filing process internally. The Commission solicits comments regarding the accuracy of its estimates.

Under proposed Rules 807 and 808, a SB SEF would be required to submit filings for new products that it makes available for trading. As outlined above, the Commission estimates a total of 20 SB SEF respondents for this requirement. Based on the Commission staff's

⁵²¹ 6,400 hours = 320 (estimated one-time hourly burden per SB SEF respondent pursuant to proposed Rule 817(a)) x 20 (number of SB SEF respondents).

⁵²² See 75 FR 67282 (November 2, 2010) (CFTC proposal to amend 17 CFR 40.2-40.5).

⁵²³ See id.

⁵²⁴ 150 hours = 60 (number of responses per year per respondent) x 2.5 hours (burden per response).

⁵²⁵ 3,000 hours = 150 hours (annual burden per respondent pursuant to proposed Rules 805 and 806) x 20 (number of respondents).

consultation with CFTC staff,⁵²⁶ the Commission estimates that on average these requirements would require 2.5 hours of work per product filing, with an estimated average of 34 responses per year per respondent. The Commission estimates that this would result in a total burden of 85 hours per respondent⁵²⁷ and 1,700 hours for all the respondents annually.⁵²⁸ Based on the Commission staff's consultation with the CFTC staff, the Commission believes that the SB SEF would handle product filings internally. The Commission solicits comments regarding the accuracy of its estimates.

The Commission preliminarily estimates that the total annual hourly burden for all SB SEFs to prepare and submit rule filings under proposed Rules 805 and 806 would be 3,000 hours. The Commission preliminarily estimates that the total annual hourly burden for all SB SEFs to prepare and submit product filings under proposed Rules 807 and 808 would be 1,700 hours.

7. Requirements Relating to the SB SEF's CCO

The SB SEF's CCO would have several initial and annual paperwork burdens under proposed Rule 823(b)(6) and (7) and also under proposed Rule 823(c) through (e).

Under proposed Rule 823(b)(6) and (7), the CCO would be responsible for: (1) establishing procedures for the remediation of noncompliance issues identified by the CCO identified through any compliance office review, look-back, internal or external audit finding, self-reported error or validated complaint, and (2) establishing appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues. As noted above, the Commission estimates a total of 20 respondents for this requirement. Based

⁵²⁶ See 75 FR 67282 (November 2, 2010) (CFTC proposal to amend 17 CFR 40.2-40.5).

⁵²⁷ 85 hours = 34 (number of responses per year per respondent) x 2.5 hours (burden per response).

⁵²⁸ 1,700 hours = 85 hours (annual burden per respondent pursuant to proposed Rules 807 and 808) x 20 (number of SB SEF respondents).

on the Commission's paperwork burden estimates for compliance program rules adopted under the Investment Company Act of 1940 ("ICA") and the Investment Advisers Act of 1940,⁵²⁹ the Commission estimates that, on average, the requirements of proposed Rule 823(b)(6) and (7) would mean that each SB SEF would expend 160 hours initially⁵³⁰ to create the required two policies and procedures, for a total estimated burden for all respondents of 3,200 hours initially.⁵³¹ Also, due to the novel nature of the CCO requirements in the SB SEF industry and the new requirements under the Dodd-Frank Act, the Commission estimates that an initial one-time burden of \$40,000 in outside legal costs⁵³² would be incurred per respondent, for a total

⁵²⁹ Rule 38a-1 under the ICA (17.CFR 270.38a-1) requires each registered investment company and business development company to adopt and implement policies and procedures reasonably designed to prevent violations of the federal securities laws. See Investment Company Act Release No. IC-26299 (December 17, 2003); 68 FR 74714 (December 24, 2003) (adopting release) and see 2010 Extension of Rule 38a-1 Supporting Statement, Office of Management and Budget, available at: http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201002-3235-028 ("ICA PRA"). The ICA PRA estimates a burden of 80 hours initially for the creation of such policies and procedures.

⁵³⁰ 160 hours = 80 hours (burden per policy and procedure requirement) x 2 (number of policy and procedure requirements).

⁵³¹ 3,200 hours = 160 hours (initial burden per respondent) x 20 (number of SB SEF respondents).

⁵³² \$40,000 = \$400 (estimated hourly cost for outside counsel) x 50 hours (estimated amount of external legal work require per policy and procedure requirement) x 2 (number of policy and procedure requirements). The estimate of 50 hours of external legal work is from the Commission's estimate for external legal costs for complying with the requirements of Rule 611 of Regulation NMS for establishing polices and procedures thereunder. See Securities Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). See also 2008 Extension of Rule 611, Supporting Statement, Office of Management and Budget, available at: http://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=200802-3235-021. The Commission preliminarily estimates an hourly cost of outside counsel at \$400. See Municipal Securities Disclosure Release, *supra* note 438.

outside cost burden for all respondents of \$800,000.⁵³³ The Commission solicits comments regarding the accuracy of these estimates.

A CCO also would be required under proposed Rule 823(c) and (d) to prepare and submit an annual compliance report to the Commission and to the SB SEF's Board. Based upon the Commission's estimates for similar annual reviews and reports by CCOs of investment companies, the Commission estimates that these reports would require an average of 92 hours per respondent per year.⁵³⁴ Thus, the Commission estimates a total annual burden of 1,840 hours for all respondents.⁵³⁵ Because the report would be submitted by the CCO, the Commission does not expect that the SB SEF would incur any external costs. The Commission solicits comments on the accuracy of its estimates.

A CCO would be required under proposed Rule 823(e)(1) and (2) and Exhibits F and H to proposed Form SB SEF to submit an annual financial report that would need to satisfy a number of requirements, including the requirement that a registered public accounting firm that is qualified and independent in accordance with Rule 2-01 of Regulation S-X (17 CFR 210.2-01) audit each financial report relating to the SB SEF (unaudited for certain affiliated entities). Based on conversations with operators of current trading platforms and the Commission's

⁵³³ \$800,000 = \$40,000 (initial burden per respondent) x 20 (number of SB SEF respondents).

⁵³⁴ The ICA PRA estimated that CCOs of investment companies would expend 42 hours annually to conduct the annual review and prepare the annual compliance report under Rule 38a-1 under the ICA. See ICA PRA supra note 529. Because proposed Rule 823 would require slightly more than double the information that is required for CCO annual reports under Rule 38a-1, the Commission preliminarily estimates that the burden associated with the CCO's annual compliance report requirements of proposed Rule 823(c) and (d) would be 220% that of Rule 38a-1, which estimate would be approximately 92 hours.

⁵³⁵ 1,840 hours = 92 hours (annual burden per respondent) x 20 (number of SB SEF respondents).

experience with entities of similar size, the Commission preliminarily estimates that the reports relating to the SB SEF generally would require, on average, 500 hours per respondent to complete and cost \$500,000 for independent public accounting services per respondent. The Commission believes that the unaudited reports required for certain affiliated entities and available upon request by the Commission for other affiliated entities would not be overly time consuming to produce because, based on the Commission's experience with Form 1 filers, a respondent's accounting system should have this information available. Furthermore, because the information would not have to be audited, a respondent would only have to compile the information using a computer and commercially available software that it generally would own for pre-existing accounting purposes and then submit the information to the Commission. Based on the number of unaudited financial statements that the Commission receives from filers of Form 1 and the substance in these reports, the Commission estimates that it would take a SB SEF 40 hours to compile, review, and submit these reports. However, all of these reports would need to be provided in XBRL, as required in Rules 405(a)(1), (a)(3), (b), (c), (d) and (e) of Regulation S-T.⁵³⁶ This would create an additional burden on respondents. The Commission preliminarily estimates that, based on its experience with other data tagging initiatives, these requirements would add an additional burden of an average of 54 hours and \$23,000 in outside software and other costs per respondent per year. Thus, for purposes of complying with the financial statement requirements under proposed Rule 823(e)(1) and (2) and Exhibits F and H to proposed Form SB SEF, the Commission estimates a total annual burden of 11,880 hours⁵³⁷ and

⁵³⁶ See 17 CFR 232.405.

⁵³⁷ 11,880 hours = 20 (number of SB SEF respondents) x 594 hours (500 hours for audited SB SEF financial statements + 40 hours for unaudited financial statements of affiliated entities + 54 hours for XBRL formatting of submission).s

\$10,460,000 for respondents.⁵³⁸ The Commission solicits comments as to the accuracy of this information.

As a result, the Commission estimates that the total burdens for compliance with proposed Rule 823 would be: (1) initially, for the creation of the policies and procedures required in proposed Rule 823(b)(6) and (7), 160 hours and \$40,000, per respondent, and 3,200 hours and \$800,000, for all respondents; and (2) on an annual basis, for the annual compliance report and financial reports required under proposed Rule 823(c) through (e), 686 hours⁵³⁹ and \$523,000, per respondent, and 13,720⁵⁴⁰ hours and \$10,460,000,⁵⁴¹ for all respondents.

The Commission preliminarily estimates that the total annual hourly burden for all SB SEFs combined for the CCO requirements in proposed Rule 823 would be 13,720 hours and the total one time hourly burden would be 3,200. The Commission preliminarily estimates that the total annual cost burden for all SB SEFs to comply with the CCO requirements in proposed Rule 823 would be \$10,460,000 and the total one-time cost burden would be \$800,000.

8. Surveillance Systems Requirements for SB SEFs

As discussed above, proposed Rule 813(b) requires SB SEFs to have the capacity and resources to electronically monitor trading in SB swaps on its market by establishing an automated surveillance system, including through real-time monitoring of trading and use of automated alerts, to, among other things, detect and deter fraudulent or manipulative acts or

⁵³⁸ \$10,460,000 = 20 (number of SB SEF respondents) x \$523,000 (\$500,000 for outside accounting services for auditing SB SEF's financial statements + \$23,000 in outside software and other cost for formatting financial statement submission in XBRL format).

⁵³⁹ 686 hours = 594 hours for financial report + 92 hours for annual compliance report.

⁵⁴⁰ 13,720 hours = 686 hours (burden per respondent) x 20 (number of SB SEF respondents).

⁵⁴¹ \$10,460,000 = 20 (number of SB SEF respondents) x \$523,000 (\$500,000 for outside accounting services for auditing SB SEF's financial statements + \$23,000 in outside software and other cost for formatting financial statement submission in XBRL format).

practices, detect and deter market distortions or disruptions of trading, conduct real-time monitoring of trading to provide for comprehensive and accurate trade reconstruction, and collect and assess data to allow SB SEFs to respond to market abuses and disruptions.⁵⁴²

Based on industry sources, the Commission preliminarily estimates that establishing an automated surveillance system would require one senior programmer and three additional programmers working for a year to create and implement such a system. Assuming a 1,800 hour work year, the Commission preliminarily estimates that the average one-time initial burden per respondent of establishing an automated surveillance system compliant with these requirements, would be 7,200 hours.⁵⁴³ In addition, the Commission believes that a one-time capital expenditure of \$1,500,000 in information technology costs would be necessary to establish such a system. This estimate is based on the Commission's discussions with market participants currently operating platforms that trade OTC swaps. Based on the estimated number of 20 SB SEF respondents, the Commission estimates a total start-up cost of 144,000 hours⁵⁴⁴ and \$30,000,000 in information technology costs.⁵⁴⁵ Based on discussions with operators of current trading platforms, the Commission further estimates that to maintain these systems, a SB SEF

⁵⁴² Proposed Rule 811(i) would require a SB SEF to have the capacity to capture information that may be used in establishing whether rule violations have occurred, including through the use of automated surveillance systems as set forth in proposed Rule 813(b). Proposed Rule 813(a)(2) would require a SB SEF to monitor trading in SB swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions. The Commission preliminarily believes that the information collection burden associated with these requirements would be included in the information collection burden for proposed Rule 813(b).

⁵⁴³ 7,200 hours = 1,800 (initial hours burden per employee) x 4 (number of employees).

⁵⁴⁴ 144,000 hours = 7,200 hours (initial burden per respondent) x 20 (number of SB SEF respondents).

⁵⁴⁵ \$30,000,000 = \$1,500,000 (initial cost burden per respondent) x 20 (number of SB SEF respondents).

would have to employ two programmer/analysts. Therefore, assuming a 1,800 hour work year, the Commission preliminarily estimates the average ongoing annual costs of these systems to be 3,600 hours per respondent⁵⁴⁶ for a total of 72,000 hours for all respondents.⁵⁴⁷ In addition, the Commission estimates that these systems may incur an ongoing information technology cost of and \$500,000 per respondent, for a total ongoing annual burden of \$10,000,000⁵⁴⁸ The Commission solicits comments on the accuracy of its estimates.

9. Access by Non-Registered Eligible Contract Participants

As discussed above, proposed Rule 809(d)(1) would require a SB SEF that permits non-registered ECPs to be participants in the SB SEF to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.⁵⁴⁹ Proposed Rule 809(d)(2) would require that the risk management controls and supervisory procedures for granting access to certain ECPs as participants of the SB SEF be reasonably designed to ensure compliance with all regulatory requirements.⁵⁵⁰ The Commission notes that proposed Rule 809(d) is modeled on recently adopted Rule 15c3-5 under Exchange Act.⁵⁵¹ The PRA analysis prepared in connection with that rule has informed the Commission's estimates of the paperwork burdens that would

⁵⁴⁶ 3,600 hours = 1,800 (annual hours burden per employee) x 2 (number of employees).

⁵⁴⁷ 72,000 hours = 3,600 hours (annual burden per respondent) x 20 (number of SB SEF respondents).

⁵⁴⁸ \$10,000,000 = \$500,000 (annual cost burden per respondent) x 20 (number of SB SEF respondents).

⁵⁴⁹ See proposed Rule 809(d)(1).

⁵⁵⁰ See proposed Rule 809(d)(2).

⁵⁵¹ See 17 CFR.240.15c3-5. Though the Commission is relying on the PRA estimates it prepared in connection with Rule 15c3-5 to inform its PRA estimates for this proposed rule, the Commission notes that some of the specific requirements, controls and procedures in Rule 15c3-5 are not contained in the proposed Rule 809(d) for SB SEFs.

apply to SB SEFS under the proposed Rule 809(d).⁵⁵² Although the Commission reviewed the burden estimates it prepared in connection with Rule 15c3-5 to inform its burden estimates of the proposed Rule 809(d), the Commission recognizes that a number of entities that seek to become SB SEFs may not currently be regulated entities.

The Commission preliminarily believes that proposed Rule 809(d)(1) and (2) would impose a one-time collection of information burden on SB SEFs to establish or modify risk management systems, if they permit access by non-registered ECPs. The Commission preliminarily believes that the majority of entities that would seek to become SB SEFs would already have some risk management systems and supervisory procedures and controls to protect the integrity of their business and to comply with other requirements already specified, analyzed and accounted for herein (e.g., requirements relating to surveillance systems, recordkeeping, reporting, and the CCO). However, some entities that seek to become SB SEFs could have to change their systems and procedures and other entities that currently do not have such systems and procedures could have to establish new systems and procedures to comply with the requirement of proposed Rule 809(d).

The Commission preliminarily believes that each SB SEF would have a one-time burden to establish or modify its technology and systems to add the controls necessary to comply with the requirement of the proposed Rule 809(d). The Commission estimates that each SB SEF would spend an average of 225 hours to develop or modify their systems to bring them into compliance with the proposed rule for a total one-time burden for all SB SEFs combined of

⁵⁵² See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010).

4,500 hours.⁵⁵³ Based on industry sources, the Commission preliminarily believes that the development or modification of the required technology and systems would be performed internally.

The Commission also preliminarily believes that proposed Rules 809(d)(1) and (2) would impose an annual paperwork burden on each SB SEF to maintain its risk management system. The Commission preliminarily estimates that the ongoing annual burden for a SB SEF to maintain its risk management system would be 172.5 hours on average for a total annual burden for all SB SEFs combined of 3,450 hours.⁵⁵⁴ The Commission believes that the ongoing burden of complying with the proposed rule's collection of information burden would include, among other things, updating systems to address any issues detected, updating risk management controls to reflect changes in the SB SEF's business model, and documenting and preserving its written description of risk management controls. Based on industry sources, the Commission preliminarily believes that the maintenance of a SB SEF's risk management systems would be performed internally by one or more programmers.

The Commission preliminarily believes that proposed Rule 809(d) would impose a one-time legal and compliance burden on each SB SEF to comply with the requirement to establish, document, and maintain risk management controls and supervisory procedures. Based on the Commission's experience with broker-dealers and ATSS, the Commission preliminarily estimates that the average initial one-time legal and compliance burden would be approximately 52.5 hours per SB SEF for a total one-time legal and compliance burden for all SB SEFs

⁵⁵³ 4,500 hours = 225 (estimated average one-time burden to set up or modify systems to comply with collection of information under proposed Rule 809(d)) x 20 (number of SB SEF respondents).

⁵⁵⁴ 3,450 hours = 225 hours (estimated average annual burden to establish or maintain risk management systems to comply with collection of information under proposed Rule 809(d)) x 20 (number of SB SEF respondents).

combined of 1,050 hours.⁵⁵⁵ The Commission preliminarily estimates that one internal compliance attorney and one internal compliance manager would spend on average 7.5 hours each to evaluate appropriate access controls and procedures. The Commission also preliminarily estimates that one internal compliance attorney and one compliance manager would each require approximately 15 hours, and the CCO would require approximately 7.5 hours, to set up or modify compliance policies and procedures to comply with the proposed rule, which includes establishing written policies and procedures for reviewing the overall effectiveness of risk management controls and supervisory procedures.

The Commission also preliminarily believes that proposed Rule 809(d) would impose an annual paperwork burden on SB SEFs to review and document their written risk management controls and supervisory procedures. Based on the Commission's experience with broker-dealers and ATSS, the Commission believes that a SB SEF's ongoing annual burden would be approximately 75 hours on average for a total annual burden for all SB SEFs combined of 1,500 hours.⁵⁵⁶ This estimate includes an average of 30 hours per year for each of an internal compliance attorney and compliance manager, and 15 hours per year for the CCO, to review, document and updated these policies and procedures.

Therefore, the Commission preliminarily estimates that the total one-time burden for all SB SEFs to comply with the collection of information requirements of proposed Rule 809(d)

⁵⁵⁵ 1,050 hours = 52.5 hours (estimated average one-time burden to establish, document, and maintain risk management controls and supervisory procedures to comply with collection of information under proposed Rule 809(d)) x 20 (number of SB SEF respondents).

⁵⁵⁶ 1,500 hours = 75 hours (estimated average annual burden to establish, document, and maintain risk management controls and supervisory procedures to comply with collection of information under proposed Rules 809(d)(1) and (2)) x 20 (estimated number of SB SEF respondents).

would be 5,550 hours⁵⁵⁷ and the total annual burden to comply with the proposed Rule would be 4,950 hours.⁵⁵⁸

10. Composite Indicative Quote and Executable Bids and Offers

Proposed Rule 811(e) would require a SB SEF that operates an RFQ platform to create and disseminate through the SB SEF a composite indicative quote, made available to all participants, for SB swaps traded on or through the SB SEF and the Commission's proposed interpretation of SB SEF would require each SB SEF, at the minimum, to provide any participant with the ability to make and display executable bids or offers accessible to all participants on the SB SEF, if the participant wishes to do so. The Commission preliminarily believes that most if not all of the respondents that operate RFQ platforms already have systems that collect and disseminate a composite indicative quote for other securities traded on or through the respondents' platforms. The Commission also preliminarily believes that SB SEFs currently have the capability to offer the executable bids and offers function to its participants. Thus, the Commission preliminarily believes that the composite indicative quote and the executable bids and offers requirements would result in little or no collection of information burden for such entities. The Commission recognizes, however, that some SB SEFs may have a one-time burden to establish or update their systems to collect and disseminate composite indicative quote information and to offer the executable bids and offers function and an ongoing annual burden to determine that such composite indicative quote mechanisms and executable bids and offers function are operating properly. The Commission does not know how many SB SEFs would have to establish or update their systems to collect and disseminate composite indicative quote

⁵⁵⁷ See supra notes 553 and 555 and accompanying text for calculations of total one-time burden to comply with collection of information under proposed Rules 809(d).

⁵⁵⁸ See supra notes 554 and 556 and accompanying text for calculations of total annual burden to comply with collection of information under proposed Rules 809(d).

information or to provide the executable bids and offer function. Therefore, for PRA purposes the Commission estimates that all of the estimated 20 SB SEF respondents would incur the paperwork burdens associated with these requirements.

The Commission preliminarily believes that this work would be performed internally by one senior programmer and one programmer. The Commission preliminarily believes that one senior programmer and one programmer would spend approximately 40 hours each to establish or update the SB SEF's systems to include the composite indicative quote and executable bids and offers functions. The total one-time burden, on average, for a SB SEF to establish or update its system to include these functions would be 80 hours for a total one-time burden for all SB SEFs combined of 1,600 hours.⁵⁵⁹ Further, the Commission preliminarily believes that one programmer would spend approximately 50 hours annually, on average, monitoring and updating the system to determine that the composite indicative quote and the executable bids and offers functions would be operating appropriately. The total annual burden to all SB SEFs combined for monitoring and updating these mechanisms would be 1,000 hours.⁵⁶⁰

11. Total Paperwork Burden under Regulation SB SEF

Based on the foregoing, the Commission preliminarily believes that the total one-time hourly burden for all SB SEFs and SB SEF participants combined pursuant to the requirements under Regulation SB SEF is equal to 264,801 hours⁵⁶¹ and \$41,692,900.⁵⁶²

⁵⁵⁹ 1,600 hours = 80 hours (estimated one-time collection of information burden to establish or update systems to comply with proposed Rule 811(e) and the Commission's proposed interpretation of the definition of SB SEF as it relates to executable bids and offers functions) x 20 (estimated number of SB SEF respondents).

⁵⁶⁰ 1,000 hours = 50 hours (estimated annual collection of information burden to comply with proposed Rules 811(e)) x 20 (estimated number of SB SEF respondents).

⁵⁶¹ 263,201 hours = 13,901 hours (registration) + 4,400 hours (rule-writing) + 13,300 (SB SEF recordkeeping) + 72,450 (SB SEF participant recordkeeping) + 6,400 (timely

The Commission preliminarily believes that annual ongoing burden for all SB SEFs and SB SEF participants combined pursuant to the requirements under Regulation SB SEF are equal to 165,632 hours⁵⁶³ and \$22,342,700.⁵⁶⁴

E. Collection of Information is Mandatory

The collections of information pursuant to Regulation SB SEF would be mandatory for all registered SB SEFs and SB SEF participants, as applicable.

F. Responses to Collection of Information Will Not Be Confidential

Other than information for which a SB SEF or a SB SEF participant requests confidential treatment, or as may otherwise be kept confidential by the Commission, and which may be withheld from the public in accordance with the provisions of the Freedom of Information Act ("FOIA"), 5 U.S.C. 522, the collection of information pursuant to the proposed rules would not be confidential and would be publicly available.

G. Retention Period of Recordkeeping Requirements

Although recordkeeping and retention requirements have not yet been established for SB SEFs under the Exchange Act provisions added by the Dodd-Frank Act, the Commission is authorized to adopt such rules under proposed Regulation SB SEF as part of this proposed

publication of trading information) + 3,200 (CCO requirements) + 144,000 (surveillance systems) + 5,550 (access by ECPs) + 1,600 (composite indicative quote).

⁵⁶² \$41,692,900 = \$10,478,900 (registration) + \$36,000 (SB SEF recordkeeping) + \$378,000 (SB SEF participant recordkeeping) + \$800,000 (CCO requirements) + \$30,000,000 (surveillance systems).

⁵⁶³ 164,632 hours = 3,154 (registration) + 2,400 hours (rule-writing) + 24,208 hours (SB SEF reporting) + 27,500 hours (SB SEF participant reporting) + 3,600 hours (SB SEF recordkeeping) + 8,400 hours (SB SEF participant recordkeeping) + 4,700 hours (rule and product filings) + 13,720 hours (CCO requirements) + 72,000 hours (surveillance systems) + 4,950 (access by ECPs) + 1,000 (composite indicative quote).

⁵⁶⁴ \$22,342,700 = \$2,700 (registration) + \$1,880,000 (SB SEF reporting) + \$10,460,000 (CCO requirements) + \$10,000,000 (surveillance systems).

rulemaking.⁵⁶⁵ Proposed Rule 818 under Regulation SB SEF would require a SB SEF to maintain records of all documents made or received by it in the conduct of its business for a period of not less than five years, the first two years in an easily accessible place.

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. Determine whether there are ways to 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

⁵⁶⁵ As discussed above, new Section 3D of the Exchange Act sets forth 14 Core Principles that a SB SEF would need to satisfy, including one relating to recordkeeping and reporting, and provides the Commission with rulemaking authority with respect to implementation of these Core Principles. See Pub. L. No. 111-203, § 763(c) (adding Section 3D of the Exchange Act).

File No. S7-06-11. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-06-11, 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.

XXVIII. Consideration of Costs and Benefits

A. Overview

To increase the transparency and oversight of the OTC derivatives market, Title VII of the Dodd-Frank Act requires the Commission to undertake a number of rulemakings to implement the regulatory framework for SB swaps that is set forth in the legislation, including the registration and regulation of SB SEFs.⁵⁶⁶ Pursuant to Section 763(c) of the Dodd-Frank Act, the Commission is required to adopt rules providing for: (1) the registration and regulation of SB SEFs; and (2) the compliance by SB SEFs with the Core Principles set forth thereunder.⁵⁶⁷ To satisfy this statutory mandate, the Commission is proposing Regulation SB SEF, which would contain several rules setting forth the requirements for a platform or system to register with the Commission, and to maintain that registration, as a SB SEF, and Form SB SEF, which

⁵⁶⁶ See Pub. L. No. 111-203 Preamble.

⁵⁶⁷ The Core Principles applicable to SB SEFs are captioned: (1) Compliance with Core Principles; (2) Compliance with Rules; (3) Security-Based Swaps Not Readily Susceptible to Manipulation; (4) Monitoring of Trading and Trade Processing; (5) Ability to Obtain Information; (6) Financial Integrity of Transactions; (7) Emergency Authority; (8) Timely Publication of Trading Information; (9) Recordkeeping and Reporting; (10) Antitrust Considerations; (11) Conflicts of Interest; (12) Financial Resources; (13) System Safeguards; and (14) Designation of Chief Compliance Officer.

would contain the application form and the materials that an applicant would have to provide as part of the registration process. In addition, proposed Regulation SB SEF would contain a series of rules that are designed to implement the 14 Core Principles with which a SB SEF is statutorily required to comply. The proposed registration form and rules contained in Regulation SB SEF are designed to promote the goals of the Dodd-Frank Act of having SB swaps trade on a regulated market. In conjunction with other rulemakings proposed by the Commission under the Dodd-Frank Act, including rule proposals relating to SB swap trade reporting,⁵⁶⁸ SB swap data repositories,⁵⁶⁹ the mitigation of conflicts of interest relating to SB SEFs, SBS exchanges and SB swap clearing agencies,⁵⁷⁰ and SB swap anti-fraud and anti-manipulation prohibitions,⁵⁷¹ the proposed registration form and rules governing SB SEFs are intended to lead to a more robust, transparent, and competitive environment for the market for SB swaps.

Currently, SB swaps trade in the OTC market, rather than on regulated markets. The existing market for SB swaps is opaque, with little, if any, pre-trade or post-trade transparency. A key goal of the Dodd-Frank Act is to bring more transparency to the OTC derivatives markets and to bring the trading of SB swaps onto regulated markets.⁵⁷² The Commission, in drafting rules to implement the SB SEF provisions of the Dodd-Frank Act, is proposing to put in place a regulatory structure that will foster a transparent, fair, and competitive market for the trading of SB swaps. Considering the early stage of regulatory development and the existing structure of

⁵⁶⁸ See Reporting and Dissemination Release, *supra* note 6.

⁵⁶⁹ See SDR Release, *supra* note 6.

⁵⁷⁰ See Regulation MC Proposing Release, *supra* note 82.

⁵⁷¹ See Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps, Exchange Act Rel. No. 63236, proposed on Nov. 3, 2010.

⁵⁷² See Pub. L. No. 111-203 Preamble. See also Section 3C(h) of the Exchange Act, Pub. L. No. 111-203, requiring that, subject to certain exceptions, any SB swap subject to mandatory clearing must be traded on a SB SEF or an exchange.

the SB swaps market, however, the Commission is mindful that the proposed rules could have unforeseen consequences, either beneficial or undesirable, with respect to the shape that this market will take. In the Commission's view, it is important that the regulatory structure provides incentives for the trading of SB swaps on regulated markets that are designed to foster greater transparency and competition and are subject to Commission oversight, while at the same time allowing for the continued efficient innovation and evolution of the SB swaps market.

In this regard, rather than proposing a rule that establishes a prescribed format for the system or platform that constitutes a SB SEF, the Commission is proposing to provide baseline principles, consistent with the requirements of the Exchange Act, that any potential SB SEF would need to meet as a condition to registration as a SB SEF. Such an approach would allow flexibility to those trading venues that plan to register as SB SEFs and would permit the continued development of organized markets for the trading of SB swaps. This more flexible approach also would allow the Commission to monitor the market for SB swaps and propose adjustments, as necessary, as this market evolves.

The Commission believes that the proposed registration form and rules under Regulation SB SEF would create a comprehensive structure for the registration and regulation of SB SEFs, but would also impose costs on market participants. The Commission is sensitive to the costs and benefits that would result from proposed Regulation SB SEF and has identified certain costs and benefits of these proposals, as described more fully below. The Commission requests comment on the costs and benefits associated with the proposed registration form and rules contained in proposed Regulation SB SEF, and its cost-benefit analysis thereof, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comment on the accuracy of any of the benefits and costs it has identified

below and also welcomes comments on the accuracy of any of its cost estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

Because the structure of the SB swaps market and the behavior of its market participants is likely to change after the effective date of the Dodd-Frank Act and implementation of the Commission's rules promulgated thereunder, the impact of – and the costs and benefits that may result from – proposed Regulation SB SEF may change over time. As commenters review proposed Regulation SB SEF, they are urged to consider generally the role that regulation may play in fostering or limiting the development of the market for SB swaps.

B. Benefits

SB SEFs are expected to play a critical role in enhancing the pre-trade transparency and oversight of the market for SB swaps. SB SEFs should help further the statutory objective of financial stability and greater transparency for SB swaps⁵⁷³ by providing a venue for counterparties to execute trades in SB swaps and also by serving as a conduit for information regarding trading interest in SB swaps. In addition, because the proposed rules would impose certain regulatory responsibilities on SB SEFs, such as monitoring trading, assuring the ability to obtain information, and establishing and enforcing rules and procedures to ensure the financial integrity of SB swaps entered on or through the SB SEF, SB SEFs would be charged with an important role in helping to oversee trading in the market for SB swaps on an ongoing basis and allowing regulators to quickly assess information regarding the potential for systemic risk across trading venues.

⁵⁷³ See Pub. L. No. 111-203 Preamble.

Broadly, the Commission anticipates that Regulation SB SEF may bring several overarching benefits to the SB swap market. These include the following:

Improved Transparency. The proposed rules on the registration and regulation of SB SEFs could have significant benefits to the market for SB swaps. The trading of SB swaps on regulated markets, *i.e.*, SB SEFs, should bring more transparency to the currently opaque market for SB swaps. In addition, the Commission's proposed interpretation of the definition of a SB SEF, combined with the proposed rules relating to pre-trade transparency, should increase overall transparency in the market for SB swaps. Increased pre-trade price transparency should help alleviate informational asymmetries that may exist today in the SB swaps markets and allow an increased number of market participants to be able to see the trading interest of other market participants prior to trading, which should lead to increased price competition among market participants.⁵⁷⁴ The Commission preliminarily believes that the proposed requirements with respect to pre-trade price transparency should lead to more efficient pricing in the SB swaps market,⁵⁷⁵ but is mindful that, under certain circumstances, pre-trade price transparency could also discourage the provision of liquidity by some market participants.⁵⁷⁶

The Commission preliminarily believes that proposed Rule 811(e), which would require a SB SEF that operates an RFQ platform to create and disseminate through the SB SEF a

⁵⁷⁴ See, e.g., Ananth Madhavan, Market Microstructure: A Practitioner's Guide, Fin. Analysts J., Vol. 58, at 38 (2002) (nondisclosure of pre-trade price information benefits dealers by reducing price competition).

⁵⁷⁵ See, e.g., Ekkehart Boehmer, et al., Lifting the Veil: An Analysis of Pre-trade Transparency at the NYSE, J. of Fin., Vol. LX (2005) (greater pre-trade price transparency leads to more efficient pricing).

⁵⁷⁶ See, e.g., Ananth Madhavan, et al., Should Securities Markets Be Transparent? J. of Fin. Markets, Vol. 8 (2005) (finding that an increase in pre-trade price transparency leads to lower liquidity and higher execution costs, because limit-order traders are reluctant to submit orders given that their orders essentially represent free options to other traders).

composite indicative quote, made available to all participants, for SB swaps traded on or through the SB SEF, would provide a certain level of pre-trade transparency for an RFQ platform. Displaying the composite indicative quote would include displaying both composite indicative bids and composite indicative offers for SB swaps traded on or through the SB SEF. As a result of this proposal, an average indicative pricing interest would be available to all of the SB SEF's participants. The Commission also believes that including RFQ responses in the composite indicative quote would be an appropriate method to inform SB SEF participants of changes in the average level of pricing interest due to responses.⁵⁷⁷ At the same time, the dissemination of a composite indicative quote would provide a greater level of anonymity for the execution of trades on an RFQ platform compared with the dissemination of an individual participant's indications of interest or responses to an RFQ.

In addition, the Commission preliminary believes that proposed Rule 817(c), which prohibits a SB SEF from making any information regarding a SB swap transaction publicly available prior to the time that a SDR would be permitted to disseminate the trade information, could positively impact the market for block trades. Under proposed Rule 817(c), a SB SEF could not publicly disseminate complete transaction reports for block trades (i.e., including the transaction ID and the full notional size) prior to the time SDRs would be permitted to do so. The Commission believes that proposed Rule 817(c) would provide parties to block trades some flexibility in timing their transactions. Based on discussions with market participants, the Commission believes that parties to block trades favor a consistent approach to the timing of the public reporting of such trades. Therefore, the Commission preliminary believes that parties to block trades, especially dealers, would be able to have more flexibility in effecting a block trade

⁵⁷⁷ See supra Section VIII.C.1.

and any associated hedging transactions, because trade information about the block could not be made publicly available by the SB SEF prior to the time that it is permitted to be disseminated by a SDR.⁵⁷⁸ Furthermore, if the market participants choose to utilize this functionality, the display of executable bids or offers should also improve pre-trade price transparency.

Improved Oversight. The proposed rules would require SB SEFs to maintain an audit trail and surveillance systems to monitor trading. Regulation SB SEF also would require comprehensive reporting and recordkeeping by SB SEFs. These requirements would put in place a structure that would provide the SB SEF with information to better enable it to oversee trading on its market by its participants, including detecting and deterring fraudulent and manipulative acts. Regulation SB SEF would also provide the Commission with greater access to information on the trading of SB swaps to support its responsibilities to oversee the SB swaps market. Further, Regulation SB SEF would enable the Commission to share that information with other federal financial regulators in instances of broad market turmoil.

This framework could in turn lead to increased confidence in a well-regulated market among SB swaps market participants. To the extent market participants consider a well-regulated market as significant to their investment decisions, trust, which is a component of investor confidence, is improved and market participants may be more willing to participate in the SB swaps market. An increase in participation in the SB swaps market can potentially benefit the SB swaps market as a whole. Further, to the extent that market participants utilize SB swaps to better manage their risk with respect to a position in underlying securities or assets, the extent they are willing to participate in the SB swaps market may impact their willingness to participate in the underlying asset's market. Thus, the Commission preliminarily believes that

⁵⁷⁸ See Reporting and Dissemination Release, supra note 6, and proposed Rule 904(d) of Regulation SBSR. See also proposed Rule 817(c) of Regulation SB SEF.

the proposal could benefit the securities markets overall by encouraging a more efficient, and potentially higher, level of capital investment.

Improved Access and Competition. Currently, the market for SB swaps is dominated by a small group of dealers.⁵⁷⁹ The Dodd-Frank Act's mandate to bring SB swaps that are subject to the mandatory clearing requirement onto regulated markets, unless the SB swap is not made available to trade,⁵⁸⁰ and proposed Regulation SB SEF, which is intended to help implement the statutory directive, should help foster greater competition in the trading of SB swaps by increasing access to SB swap trading venues. The proposed rules would provide a framework to allow a number of trading platforms or systems to register as SB SEFs and thus more effectively compete for business in SB swaps. Proposed Rule 809(b) would require a SB SEF's rules to permit all eligible persons that meet the requirements for becoming a participant as set forth in the SB SEF's rules to become participants in the SB SEF.⁵⁸¹ Proposed Rule 809(b) would also give a SB SEF the option to not permit any non-registered ECP to become participants in the SB SEF. As such, proposed Rule 809(b) provides SB SEFs with flexibility in choosing whether or not to provide access to non-registered ECPs. Proposed Rule 809(d) would require that, if a SB SEF chooses to permit non-registered ECPs to become participants, it would be responsible for establishing risk management controls and supervisory procedures reasonably designed to manage financial, regulatory, and other risks associated with the non-registered ECP's access.

⁵⁷⁹ See supra note 81.

⁵⁸⁰ See Section 3C(h) of the Exchange Act.

⁵⁸¹ Proposed Rule 809(a) would required SB SEFs to only permit a person to become a participant in the security-based swap execution facility if such person is registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker (as defined in section 3(a)(4) of the Act, 15 U.S.C. 78c(a)(4)), or if such person is an eligible contract participant (as defined in section 3(a)(65) of the Act, 15 U.S.C. 78c(a)(65)).

These proposed requirements should reduce risks associated with access to SB SEFs by non-registered ECPs (e.g., if they enter into trades that exceed appropriate credit or capital limits or submit erroneous orders). In addition, the Commission preliminarily believes that a SB SEF is best positioned to implement the proposed controls and procedures.

Proposed Rule 811(b)(1) would require every SB SEF to establish fair, objective and not unreasonably discriminatory standards for granting impartial access to trading on the SB SEF. In addition, proposed Rule 811(b)(3)-(4) would require every SB SEF to make and keep records of all denials, or limitations, of access to the SB SEF, and to report such information to the Commission. These proposed requirements would further the requirement in the Exchange Act that SB SEFs provide market participants with impartial access.⁵⁸² Taken together, these proposed rules should foster greater direct access to SB SEFs by dealers, major SB swap participants, brokers and ECPs. This impartial access should, in turn, promote greater participation by liquidity providers and competition on each SB SEF. Increased participation could lead to reduced information asymmetries among market participants, while increased competition could lead to more efficient and better pricing in the SB swaps market. Further, a more competitive environment should lead to lower trading costs, which may lead to increased participation in the SB swaps market. Impartial access requirements also would help guard against situations where certain participants in a SB SEF (who also might be owners of the SB SEF) might seek to limit the number of other participants in the SB SEF in order to limit competition and increase their own profits. Thus, the impartial access should, in turn, promote greater participation by liquidity providers and competition on each SB SEF.

⁵⁸² See Section 3D(d)(2)(B)(i) of the Exchange Act.

As proposed, SB SEFs would remain free to establish standards for impartial access consistent with the requirement that they be fair and objective and do not unfairly discriminate, and that they do not apply the standards in an unfair or unreasonably discriminatory manner. Therefore, SB SEFs could choose the most cost-effective methods to ensure that all their participants and would-be participants are evaluated on a fair and impartial basis.

To address the problem of restricting the scope of SB swaps that trade on SB SEFs, the Commission is proposing to require that each SB SEF have a swap review committee that would determine which SB swaps would trade on the SB SEF, as well as the SB swaps that should no longer trade on the SB SEF.⁵⁸³ Proposed Rule 811(c)(2) would require that the composition of the swap review committee must provide for the fair representation of participants of the SB SEF as well as other market participants such that each class of participant and other market participants would be given the right to participate in such swap review committee and that no single class of participant or category of market participant would predominate. Having a swap review committee that provides for the fair representation of participants and other market participants should help assure that the process of determining those SB swaps that should trade on the SB SEF would be fair and that various classes of participants in the SB SEF, as well as other market participants, would have a voice in those decisions.

Consequently, the Commission believes that the proposed rules requiring impartial access to trading on the SB SEF and providing for fair representation on the swap review committee to

⁵⁸³ See proposed Rule 811(c). See also Core Principle 3 and proposed Rule 812, which permit a SB SEF to trade only SB swaps that are not readily susceptible to manipulation. Prior to trading any SB swap, proposed Rule 812 would require the swap review committee to determine whether, after taking into account all of the terms and conditions of the SB swap and the markets for the SB swap and any underlying security or securities, that such SB swap is not readily susceptible to manipulation. Proposed Rule 812 also would require the swap review committee to periodically review that determination.

determine which SB swaps should be traded on SB SEFs should help mitigate the inappropriate exercise of market power by any given market participant or group of market participants. In addition, the Commission believes that, in a competitive market, new SB SEFs could be created to attract market participants that are unable to meet the objective requirements of more exclusive SB SEFs or to trade the SB swaps other SB SEFs decide not to trade.

The Commission also believes that its proposed interpretation of which facilities fall within the term SB SEF, providing, at the minimum, any participant with the ability to make and display executable bids or offers accessible to all participants on the SB SEF, if the market participant wishes to do so, would also improve access to the SB SEF by participants because it provides participants an additional method with which to execute transactions on the SB SEF.

Improved Commission and SB SEF Oversight. The Commission believes that one of the goals of the Dodd-Frank Act is to increase the regulatory oversight over the currently unregulated OTC derivative markets.⁵⁸⁴ Proposed Regulation SB SEF would provide the means for the Commission to gain better insight into and oversight of the market for SB swaps. The proposed rules would provide the Commission the ability to, among other things, review the rules of SB SEFs, obtain data and records from SB SEFs, and inspect and examine SB SEFs, all of which would support the Commission's oversight function over the SB swaps market, as directed by Congress in the Dodd-Frank Act.

Specifically, proposed Rule 818(a) would require each SB SEF to keep and preserve all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records that would be made or received by it in the conduct of its business. In addition, proposed Rule 818(c) would require SB SEFs to keep audit trail records relating to all

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See Pub. L. No. 111-203 Preamble.

orders, requests for quotations, responses, quotations, other trading interest, and transactions that are received by, originated on, or executed on, the SB SEF. The records required to be kept, preserved and maintained by a SB SEF under proposed Rule 818 would help the Commission to determine whether an SB SEF is operating in compliance with the Exchange Act and the rules and regulations thereunder. The audit trail information required to be maintained under proposed Rule 818(c) would facilitate the ability of the SB SEF and the Commission to carry out their respective obligations under the Exchange Act, by providing a record of the complete history of all trading interest entered and transactions executed on the SB SEF. This audit trail could be used to help detect abusive or manipulative trading activity, prepare reconstructions of activity on the SB SEF or in the SB swaps market, and generally to understand the causes of unusual market activity.

Furthermore, proposed Rule 811(h) would require the SB SEF to make and keep records specifically of all disciplinary proceedings and appeals, which would allow the Commission to review the disciplinary process at a SB SEF, providing the Commission an additional tool to carry out its oversight responsibilities. The proposed registration requirements and related proposed Form SB SEF, and the CCO's annual compliance report, which are further discussed below, should also aid the Commission in its oversight responsibilities. As a whole, proposed Regulation SB SEF should facilitate the Commission's work in preparing the semi-annual and annual public reports of SB swap data required by Section 763 of the Dodd-Frank Act, because the Commission would be able to obtain information about the SB swap market through its oversight of SB SEFs.⁵⁸⁵

⁵⁸⁵ See Section 763(i) of the Dodd-Frank Act requiring the Commission to provide SB swap data to the public.

Improved Automation. In order to comply with the requirements of proposed Regulation SB SEF relating to recordkeeping and surveillance, SB SEFs would need to invest in and develop automated technology systems to store, monitor and communicate a variety of trading data, including orders, requests for quotations, responses and quotations, among others. The Commission preliminary believes that the proposed rules should bring about increased automation in the SB swaps markets. This increased automation could help market participants more efficiently track their trading and risk exposures in SB swaps. In addition, the automation and systems development associated with the regulation of SB SEFs, as required by proposed Regulation SB SEF, could provide SB swaps market participants with new platforms and tools to execute and process transactions in SB swaps at a lower expense per transaction. Such increased efficiency would enable participants of the SB SEF to handle increased volumes of SB swaps with greater efficiency.

In addition to the broad benefits that the Commission anticipates that Regulation SB SEF may bring to the SB swaps market, the Commission preliminarily believes that its individual proposed rules may bring particular benefits to the SB swap market. These include the following:

Interpretation of SB SEF Definition. The Commission believes that its proposed interpretation of the scope of the definition of SB SEF⁵⁸⁶ should provide sufficient flexibility for market participants in creating and operating a variety of SB SEFs to trade SB swaps. The Commission preliminary believes that a system or a platform which allows a participant the ability to send an RFQ to all participants, as well as the choice to send an RFQ to fewer than all participants, would provide flexibility to the market, because participants would be able to trade

⁵⁸⁶ See supra Section III.B for a detailed discussion of the proposed interpretation of the definition of SB SEF.

SB swaps by accepting bids and offers from multiple participants, while still preserving the ability of each participant to decide how broadly or narrowly to disseminate his or her RFQ.

The Commission believes that this proposed interpretation would likely encourage a greater number of SB swaps to trade on SB SEFs because, as mentioned above, it would give requestors the flexibility to determine how best to broadcast their interests.

The Commission believes that, rather than proposing a rule that establishes a prescribed format for a system or platform that constitutes a SB SEF, the better approach is to provide baseline principles, as outlined in the proposed interpretation consistent with the requirements of the Exchange Act, that any potential SB SEF would need to meet as a condition to registration as a SB SEF. Such an approach should provide flexibility to those trading venues that plan to register as SB SEFs and would permit the continued development of organized markets for the trading of SB swaps.

Exemptions from Definition of Exchange and Certain Regulatory Requirements

Applicable to a Broker. The proposed rules would include exemptions for SB SEFs from the definition of “exchange” and from most regulations governing brokers. Using its exemptive authority under Section 36 of the Exchange Act, the Commission is proposing: (1) to amend Rule 3a1-1 under the Exchange Act to exempt any SB SEF from the definition of “exchange,” if such SB SEF provides a marketplace solely for the trading of security-based swaps (and no other security) and complies with the provisions of proposed Regulation SB SEF;⁵⁸⁷ and (2) new Rule 15a-12 to allow a person that meets the definition of a SB SEF and broker, to satisfy the broker registration requirements by registering as a SB SEF. The Commission believes that Congress specifically provided a comprehensive regulatory framework for SB SEFs in the Dodd-Frank Act

⁵⁸⁷ See proposed Rule 3a1-1(a)(4).

and, therefore, SB SEFs should not also be required to be regulated as national securities exchanges or as brokers. Without these proposed exemptions, SB SEFs would be required to register with the Commission not only as SB SEFs, but also as exchanges and brokers. Given the regulatory framework for SB SEFs required by the Exchange Act and proposed Regulation SB SEF, the Commission preliminarily believes that requiring a SB SEF to register in such multiple capacities would not be efficient. The Commission believes that reducing or eliminating such inefficiency will confer an overall benefit to the SB swaps market by reducing the costs of complying with unnecessary rules or regulations.

Registration. The registration of SB SEFs is a requirement under the Dodd-Frank Act.⁵⁸⁸ Proposed Rule 810(a) incorporates the requirement under the Dodd-Frank Act that a SB SEF, in order to be registered and maintain registration, comply with the Core Principles in Section 3D(d) of the Exchange Act and any requirement that the Commission may impose by rule or regulation. The proposed registration process is intended to implement this requirement and assist the Commission in overseeing and regulating the SB swaps market. The information to be provided on proposed Form SB SEF is designed to enable the Commission to assess whether an applicant has the capacity and the means to perform the duties of a SB SEF and to comply with the Core Principles and other requirements imposed on registered SB SEFs.

In addition, the amendments, supplemental information and notices that the Commission proposes to require registered SB SEFs to file pursuant to proposed Rules 802, 803 and 804 are designed to further the ability of the Commission to efficiently monitor SB SEFs' compliance with the provisions of the Exchange Act and to oversee the marketplace for SB swaps and, specifically, the trading of SB swaps on SB SEFs.

⁵⁸⁸ See Section 3D(a)(1) of the Exchange Act.

Rule and Product Filings. Proposed Rules 805 and 806 set forth two alternative filing processes for a new rule or rule amendment of a registered SB SEF, and proposed Rules 807 and 808 set forth two alternative filing processes for SB SEFs to submit filings for new products that it trades. The proposed rules are intended to assist the Commission in overseeing and regulating the trading of SB swaps and to help ensure that SB SEFs operate in compliance with the Exchange Act. The self-certification processes of Rules 806 and 807 require SB SEFs to include a certification that the proposed new rule or rule amendment or SB swap, as the case may be, complies with the Exchange Act and Commission rules and regulations thereunder.⁵⁸⁹

The information to be provided by the SB SEF under proposed Rules 805 and 806 would further the ability of the Commission to assess whether a SB SEF has the capacity to perform the duties of a SB SEF and to comply with the duties, Core Principles, and other requirements imposed on registered SB SEFs, and to ensure that a registered SB SEF continues to comply with the requirements imposed on registered SB SEFs under the Exchange Act. In addition, proposed Rule 805(a)(4), which would require a SB SEF to explain the anticipated benefits and potential anticompetitive effects on market participants of a proposed new rule or rule amendment should help foster a competitive SB swaps market because it would require SB SEFs to disclose the positive as well as negative aspects of the SB SEF's proposed rules.

The information to be provided by the SB SEF under proposed Rules 807 and 808 would further the ability of the Commission to obtain information regarding SB swaps that a SB SEF intends to trade on its market. In addition, because these processes are comparable to the parallel processes of the CFTC, they would promote efficiency for SB SEFs that are also registered as SEFs.

⁵⁸⁹ See proposed Rules 806(a)(5)(iii) and 807(a)(4)(iii).

Chief Compliance Officer. The submission of the CCO's annual compliance report and the annual financial report to the Commission as would be required by proposed Rule 823 would help the Commission monitor the compliance activities and financial state of SB SEFs. These reports would also assist the Commission in carrying out its oversight of the SB SEFs and the SB swaps market by providing the Commission the information necessary to review instances, for example, of non-compliance and denials of access.

Conflicts of Interest. Proposed Rule 820 sets forth certain governance arrangements that would be required of SB SEFs. Proposed Rule 820(a) would require the rules of a SB SEF to assure a fair representation of its participants in the selection of its directors and administration of its affairs. No less than 20% of the total number of directors of the SB SEF would be required to be selected by the SB SEF participants. Further, the Commission proposes that SB SEF participant owners be restricted in their ability to participate in the "fair representation" process. In addition, proposed Rule 820(b) would require that at least one director on the Board be representative of investors ("investor director") who are (1) not SB swap dealers or major SB swap participants and (2) not associated with a participant. Finally, proposed Rule 820(c) would require the rules of a SB SEF to establish a fair process for SB SEF participants to nominate an alternative candidate or candidates to the Board by petition.

The requirements of proposed Rule 820 are important to help ensure that SB SEF participants and investors have a voice in the administration and governance of the SB SEF, without jeopardizing the overall independence of the Board.⁵⁹⁰ The proposed governance requirements should also help to mitigate any conflicts of interest that may arise between SB

⁵⁹⁰ Proposed Rule 702(d) under Regulation MC would require the Board of a SB SEF to have at least a majority of independent directors. See Regulation MC Proposing Release, supra note 82.

SEF participants who also could be owners of the SB SEF, by reducing the possibility that a small group of market participants would have the ability to unfairly disadvantage other market participants through the SB SEF governance process. In order to further mitigate conflicts of interest and achieve fairness in the governance process of a SB SEF, the proposal would also provide for the ability of SB SEF participants to have alternative candidates by requiring the SB SEF to establish a fair process for SB SEFs to nominate an alternative candidate or candidates by petition. Finally, the Commission believes that requiring representation on the SB SEF Board by investors who are not SB swap dealers or major SB swap participants, or associated with SB SEF participants, would provide an important perspective to the governance and administration of a SB SEF. Investor directors could provide unique and different perspectives from dealers and other participants of the SB SEF, which should enhance the ability of the Board to address issues in an impartial fashion and consequently support the integrity of a SB SEF's governance.

C. Costs

Although the Commission believes that proposed Regulation SB SEF would result in significant benefits to the market for SB swaps, the Commission recognizes that the proposed registration form and rules would also entail significant costs. Some costs are difficult to precisely quantify and are discussed below.

The Commission is mindful that any rules it may adopt with respect to SB SEFs under the Dodd-Frank Act may impact the incentives of market participants with respect to where and how they trade SB swaps. The Commission is cognizant that its proposed interpretation of the definition of SB SEF, coupled with the level of pre-trade transparency that would be required for trading on a SB SEF, will impact the development of the SB swaps market. Further, if the rules proposed by the Commission are, or are perceived to be, too costly for trading venues to comply

with, fewer entities than expected may seek to register as SB SEFs, thus impacting competition. In addition, if the proposed rules for trading on a SB SEF are perceived as too burdensome by market participants, some trading of SB swaps may move to foreign markets whose regulations are perceived to be less restrictive, thus frustrating the goals of the Dodd-Frank Act. At the same time, if the proposed rules relating to SB SEFs are too lenient, they may have little or no impact on the market structure and surveillance of the SB swaps markets, which could result in the loss of many of the benefits discussed above and fail to achieve the goals of the Dodd-Frank Act of greater transparency. In addition, because the trading mechanisms in the OTC market will continue to be largely unregulated, OTC-traded SB swaps may be perceived by some market participants to be less expensive to trade than SB SEF-traded swaps, *i.e.*, in the sense that they are subject to less regulation.

In addition, SB swaps traded on SB SEFs may be perceived to be subject to increased costs, monetary and otherwise. For example, some industry participants have expressed their belief that any proposed requirement of pre-trade transparency would force market participants to reveal valuable economic information regarding their trading interest more broadly than they may believe would be economically prudent and could discourage participation in the SB swaps market. An additional impact of pre-trade transparency are perceived costs associated with front running, if customers or dealers are required to show their trading interest before a trade is executed. These potential costs of pre-trade transparency may change market participants' trading strategies, which could result in them working more orders or finding ways to attempt to hide their interest.⁵⁹¹ If market participants view the Commission's proposal as too burdensome with respect to pre-trade transparency, dealers may be less willing to supply liquidity for SB

⁵⁹¹ See, *e.g.*, Ananth Madhavan, Market Microstructure: A Survey, J. of Fin. Markets, Vol. 3 (2000).

swaps that trade on SB SEFs or exchanges, thus impacting liquidity and competition. On the other hand, if the requirement with respect to pre-trade transparency is too loose, the result could be that there would be no substantive change from the status quo, including no benefits of alleviating informational asymmetries, increasing price competition and supplying better executions beyond the changes in response to the other requirements of Dodd-Frank. However, the Commission believes that this concern depends on the degree of pre-trade transparency required and the characteristics of the trading market. The proposed rules are intended to provide for greater pre-trade transparency than currently exists without requiring pre-trade transparency in a manner that would cause participants to avoid providing liquidity on SB SEFs.

The requirements of the proposed rules would impose the same minimum level of pre-trade transparency and order interaction on block trades as on non-block trades. This can potentially have an impact on the liquidity available on those types of platforms that would provide for block trading. Today, many block trades are transacted through voice brokerage, without pre-trade transparency and order interaction. Block trading enables, among other things, entities with large exposures to certain business risks to hedge those risks. For example, investors considering making investments in, or lenders considering making loans to, certain corporate borrowers may seek to purchase credit default swap ("CDS") protection to hedge some portion of the credit risk the investor does not want to retain. The availability of such credit risk protection in large block transaction size may therefore influence investment or lending decisions which in turn may influence the cost of borrowing for corporations whose investors rely on block size CDS.

Generally, economic studies have shown that block trades benefit from different market structures than non-block trades.⁵⁹² These studies suggest that pre-trade transparency can be particularly costly for block trades as prices are likely to move adversely if the existence of a large unexecuted order becomes known. Other traders may front run the block trade order or simply infer information about future price movements from its presence, thus potentially making it more costly for the block-initiating participant to find a counterparty willing to trade at an acceptable price. In addition, if a block trade interacts with other trading interest on a SB SEF, there might not be enough liquidity on the SB SEF to execute the entire block trade, leaving a portion of the block trade unexecuted, or requiring the block to be broken into smaller order sizes, which also could lead to increased transaction costs and a decreased willingness of market participants to participate in block trades.

The Commission recognizes these potential costs and believes that the proposal mitigates these costs, because it would allow SB SEFs flexibility in setting their market structure and trading rules concerning block trades. This should allow SB SEFs to create certain trading structures, e.g., multi-dealer RFQ platforms, that cater to block trades and others that cater to non-blocks. Moreover, under the proposed interpretation of the definition of SB SEF, for a transaction on an RFQ platform, the person exercising investment discretion for the transaction, whether it is the participant itself or the participant's customer, could choose to send the RFQ to less than all participants. Under this proposed interpretation, market participants would have the choice to determine how broad or how narrow to disseminate their intent to trade blocks. The Commission further notes that, if overall trading costs decline, then the costs of breaking up a

⁵⁹² See, e.g., Bessembinder Paper, supra note 159.

block into smaller parcels and spreading out those parcels by market participants seeking to execute a block transaction may not actually increase.⁵⁹³

According to industry sources consulted by Commission staff,⁵⁹⁴ the monetary cost of forming a SB SEF is estimated to range from approximately \$15 million to \$20 million per SB SEF for the first year of operation, if an entity were to establish a SB SEF without the benefit of modifying an already existing trading system. The industry sources consulted by Commission staff estimate that, for the first year of operation, the cost of software and product development would range from approximately \$6.5 million to \$10.5 million per SB SEF. The technological costs would be expected to decline considerably during the second and subsequent years of operation, and are estimated to be in the range of \$3 million to \$4 million per year per SB SEF. For entities that currently own and/or operate platforms for the trading of OTC derivatives, the cost of forming a SB SEF would be more incremental, given that these entities already have viable technology that could be modified to comply with the requirements that the Commission may impose for SB SEFs. According to industry sources, the incremental costs of enhancing a trading platform to be compatible with any SB SEF requirements established by the Commission would range from as low as \$50,000 to as much as \$3 million per SB SEF, depending on the enhancements needed to establish a platform compatible with any Commission rules governing

⁵⁹³ See, e.g., Amber Anand, et al., Market Crashes and Institutional Trading, Working Paper, Social Science Research Network (2010).

⁵⁹⁴ In discussing estimated costs with Commission staff, these industry sources were generally familiar with the requirements of the Dodd-Frank Act and the Core Principles and related requirements specified therein, but were not aware of the specifics of the rules being proposed. Thus, they were able to provide the broad general estimates of projected costs, which are described here. More specific estimates as to the costs associated with specific rules are detailed further below.

SB SEFs. The annual ongoing cost of maintaining the technology and any improvements is estimated to be in the range of \$2 million to \$4 million.⁵⁹⁵

In addition, the regulatory requirement of complying with the statutory Core Principles would increase the regulatory obligations of registered SB SEFs with respect to operating as a SB SEF and with respect to overseeing the participants that trade on their facilities. Industry sources estimate that the cost to an SB SEF of complying with the rules relating to surveillance and oversight they expected the Commission to propose would be in the range of \$1 million to \$3 million annually, with initial costs likely to be at the higher end of such range, since a SB SEF would need to create the technology necessary to monitor and surveil its market participants, as well as to create a rule book in compliance with the Core Principles and related rules. The ongoing annual compliance costs are estimated by industry sources to be approximately \$1 million, which would include the salary of a CCO and at least two junior compliance personnel, expected to be attorneys.

The Commission requests comments on the accuracy of these estimates. Specifically, the Commission requests comment on how the Commission can most accurately estimate the cost and benefits of the proposed rules and interpretations. Are there any important benefits and costs not currently discussed? How would the costs and benefits differ between operators of current platforms or systems trading SB swaps? What are the potential costs and benefits of the pre-trade transparency requirement, block trade requirement, order interaction requirement and other market structure requirements included in the proposal?

⁵⁹⁵ Although there currently are trading systems that trade SB swaps on an OTC basis, the Commission preliminarily believes that no such systems are currently in operation that would comply, without modifications, with the requirements of proposed Regulation SB SEF.

We detail below cost estimates for specific parts of the proposed rules. Many of these cost estimates are based on the PRA estimates of costs and burdens from Section XXVII, as well as other costs associated with the proposed rules.

Registration. The Commission preliminary estimates that the aggregate initial costs to all potential SB SEF registrants to file Form SB SEF, including all exhibits thereto, would be approximately \$13,505,940,⁵⁹⁶ or approximately \$675,297⁵⁹⁷ per SB SEF.

The Commission estimates the initial costs (aside from the costs associated with Exhibits F, H and P, which are separately discussed below) associated with proposed Form SB SEF would be \$32,000 per SB SEF, or \$640,000 for all potential SB SEFs.⁵⁹⁸ This would include the time required to compile the information required by proposed Form SB SEF, prepare the proposed Form SB SEF itself, and file it with the Commission. In addition, Exhibits F and H to proposed Form SB SEF would require an applicant to submit financial reports that would need to satisfy a number of requirements, including the requirement that a certified public account audit each financial report relating to the SB SEF and a requirement that unaudited financial information be provided for certain affiliated entities of the SB SEF.⁵⁹⁹ The Commission preliminarily believes that it is unlikely that during the initial implementation period a potential

⁵⁹⁶ See infra note 597.

⁵⁹⁷ \$13,505,940 / 20 potential SB SEF registrants = \$675,297.

⁵⁹⁸ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden imposed by proposed Form SB SEF (other than Exhibits F, H and P of Form SB SEF) for SB SEF registration would be 100 hours per SB SEF. See supra Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the one-time estimated dollar cost to register as a SB SEF would be \$32,000 (100 hours x \$320), or \$640,000 (\$32,000 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁵⁹⁹ See supra Section XXVII.D.1.

registrant would have audited financial statements for the SB SEF in the ordinary course of business prior to applying for registration on Form SB SEF. Therefore, in order to register as a SB SEF with the Commission on Form SB SEF and comply with Exhibits F and H thereto, potential registrants would incur an initial cost to generate such financial statements. Based on conversations with operators of current trading platforms and the Commission's experience with entities of similar size, the Commission preliminarily estimates that each potential SB SEF registrant would incur, on average, a cost of \$99,000 to complete the financial statements,⁶⁰⁰ and a cost of \$500,000 for independent public accounting services. In the aggregate, these costs are estimated to be \$1,980,000⁶⁰¹ and \$10,000,000,⁶⁰² respectively.⁶⁰³

The Commission also estimates that it would cost approximately \$7,920 per respondent to compile, review, and submit the financial reports for certain affiliated entities as required pursuant to Exhibit H to proposed Form SB SEF, or \$158,400 in the aggregate.⁶⁰⁴ All of the

⁶⁰⁰ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden would be 500 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$198 for a senior accountant to meet these requirements, the one-time estimated dollar cost to register as a SB SEF would be \$99,000 (500 hours x \$198), or \$1,980,000 (\$99,000 x 20 SB SEFs) in the aggregate. The hourly rate for the senior accountant is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶⁰¹ \$1,980,000 = \$99,000 x 20 SB SEFs.

⁶⁰² \$10,000,000 = \$500,000 x 20 SB SEFs.

⁶⁰³ See *also* Section XXVII.D.1.

⁶⁰⁴ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden to comply with the financial statement requirements of Exhibit H to proposed Form SB SEF would be 40 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$198 for a senior accountant to meet these requirements, the one-time estimated dollar cost per SB SEF would be \$7,920 (40 hours x \$198), or \$158,400 (\$7,920 x 20 SB SEFs) in the aggregate. The hourly rate for the senior accountant is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

financial statements required by Exhibits F and H to proposed Form SB SEF would need to be provided in XBRL, as required in Rules 405(a)(1), (a)(3), (b), (c), (d) and (e) of Regulation S-T.⁶⁰⁵ This would create an additional cost for potential SB SEF respondents. The Commission preliminarily estimates, based on its experience with other data tagging initiatives, that these requirements would add an additional cost on average of approximately \$12,096⁶⁰⁶ and \$23,000 in outside software and other costs per respondent, or \$241,920⁶⁰⁷ and \$460,000⁶⁰⁸ in the aggregate, respectively. Thus, for complying with the financial statement requirements under Exhibits F and H to proposed Form SB SEF, the Commission estimates a total initial cost of approximately \$642,016 per respondent⁶⁰⁹ and \$12,840,320 in the aggregate for all respondents.⁶¹⁰

Exhibit P to proposed Form SB SEF would require SB SEFs controlled by other persons and non-resident SB SEFs to provide opinions of counsel as required by Rules 801(e) and (f), respectively. Therefore, in order to register as a SB SEF with the Commission on Form SB SEF, potential registrants that are controlled by other persons or that are non-resident persons would

⁶⁰⁵ See 17 CFR 232.405.

⁶⁰⁶ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden would be 54 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$224 for a programmer analyst to meet these requirements, the initial estimated dollar cost would be \$12,096 (54 hours x \$224), or \$241,920 (\$12,096 x 20 SB SEFs) in the aggregate. The hourly rate for the programmer analyst is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶⁰⁷ \$241,920 = \$12,096 x 20 SB SEFs.

⁶⁰⁸ \$460,000 = \$23,000 x 20 SB SEFs.

⁶⁰⁹ \$99,000 + \$500,000 + \$7,920 + \$12,096 + \$23,000 = \$642,016.

⁶¹⁰ \$12,840,320 = \$642,016 x 20 SB SEFs.

incur an initial cost to generate such opinions of counsel. As discussed above, the Commission preliminarily estimates that the average initial paperwork cost for each SB SEF controlled by another person and each non-resident SB SEF to provide the opinion of counsel required by Exhibit P would be one hour and \$900 per SB SEF. As discussed above, the Commission preliminarily estimates that all 20 estimated applicants seeking to register as SB SEFs would be controlled by other persons and that one applicant seeking to register as a SB SEF will be a non-resident person. Therefore, in the aggregate, the costs to comply with Exhibit P are estimated to be \$24,400 for all SB SEFs controlled by other persons⁶¹¹ and \$1,220 for all non-resident SB SEFs.⁶¹²

Therefore, the Commission preliminarily estimates that the total one-time aggregate cost for all respondents to file the initial Form SB SEF, including all exhibits thereto, would be approximately \$13,505,940.⁶¹³

⁶¹¹ The Commission estimates that a SB SEF that is controlled by another person will assign these responsibilities to a compliance attorney. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the one-time estimated dollar cost for a SB SEF controlled by another person to comply with Exhibit P would be \$1,220 ((1 hour x \$320) + \$900), or \$24,400 (\$1,220 x 20 SB SEFs controlled by other persons) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶¹² The Commission estimates that a non-resident SB SEF will assign these responsibilities to a compliance attorney. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the one-time estimated dollar cost for a non-resident SB SEF to comply with Exhibit P would be \$1,220 ((1 hour x \$320) + \$900). This would also be the aggregate initial cost as the Commission has estimated that only one non-resident person would seek to register as a SB SEF. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶¹³ \$13,505,940 = \$640,000 (costs other than Exhibits F, H and P to Form SB SEF) + \$12,840,320 (costs relating to Exhibits F and H to Form SB SEF) + \$24,400 (costs

After the initial year in which a SB SEF would be registered, the Commission estimates that each registered SB SEF would submit 4 amendments to Form SB SEF on average and one annual update, at an annual cost of \$48,000 per SB SEF, or \$960,000 in the aggregate.⁶¹⁴ In addition, the Commission estimates that two SB SEFs controlled by another person would each submit one amendment to Exhibit P to Form SB SEF per year, at an annual aggregate cost of \$2,440.⁶¹⁵ The Commission also estimates that one non-resident SB SEF would submit one amendment to Exhibit P to Form SB SEF per year, at an annual cost of \$1,220.⁶¹⁶

relating to Exhibit P to Form SB SEF for SB SEFs controlled by other persons) + \$1,220 (costs relating to Exhibit P to Form SB SEF for all non-resident SB SEFs).

⁶¹⁴ The Commission preliminarily estimates, for purposes of its PRA, that the average annual burden to prepare and file rule amendments and the annual update to Form SB SEF would be 150 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$48,000 (150 hours x \$320), or \$960,000 (\$48,000 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶¹⁵ The Commission estimates that a SB SEF that is controlled by another person will assign these responsibilities to a compliance attorney. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost for a SB SEF controlled by another person to amend Exhibit P would be \$1,220 ((1 hour x \$320) + \$900), or \$2,440 in the aggregate (\$1,220 x 2 (estimated number of SB SEFs controlled by other persons required to amend Exhibit P per year) x 1 amendment). The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶¹⁶ The Commission estimates that a non-resident SB SEF will assign these responsibilities to a compliance attorney. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost for a non-resident SB SEF to amend Exhibit P would be \$1,220 ((1 hour x \$320) + \$900). This would also be the aggregate annual cost as the Commission has estimated that only one non-resident person would seek to register as a SB SEF, and that such non-resident SB SEF will only file one amendment to Exhibit P per year. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified

In addition, proposed Rule 804 would impose costs on SB SEFs seeking to withdraw registration. The Commission estimates that one SB SEF would seek to withdraw its registration per year. Therefore, the Commission estimates that the aggregate annual estimated dollar cost for SB SEFs seeking to withdraw registration would be \$320.⁶¹⁷

Finally, proposed Rule 803 would impose costs on SB SEFs to prepare and file supplemental information with the Commission. The Commission estimates that the average annual cost for a SB SEF to prepare and file such supplemental information would be \$2,400 for each SB SEF, or \$48,000 in the aggregate.⁶¹⁸

Thus, the Commission estimates that the total annual aggregate cost of making all required filings related to Form SB SEF would be approximately \$1,011,980.⁶¹⁹

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

⁶¹⁷ The Commission preliminarily estimates, for purposes of its PRA, that the average burden for a SB SEF to withdraw its registration would be 1 hour. See supra Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the estimated dollar cost to withdraw the registration of a SB SEF would be \$320 (1 hour x \$320). This would also be the aggregate annual cost as the Commission has estimated that only one SB SEF would seek to withdraw its registration as a SB SEF per year. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶¹⁸ The Commission preliminarily estimates, for purposes of its PRA, that the average annual burden to prepare and file supplemental information would be 7.5 hours per SB SEF. See supra Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the estimated annual dollar cost would be \$2,400 (7.5 hours x \$320), or \$48,000 (\$2,400 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶¹⁹ \$1,011,980 = \$960,000 + \$2,440 + \$1,220 + \$320 + \$48,000.

The Commission solicits comments on the costs associated with the registration related rules and new Form SB SEF and exhibits. The Commission specifically requests comment on initial costs associated with completing the registration form and ongoing annual costs of completing the required periodic and annual amendments. Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from proposed Regulation SB SEF's registration requirements?
- What are the costs currently borne by entities covered by the proposed registration requirements that may have been included in the Commission's analysis?
- Are there additional costs involved in complying with the registration requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having comprehensive and accurate registration of SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed registration requirements that have not been identified?

Rules Generally. The Commission estimates that the initial cost for SB SEFs to comply with the rule writing requirements of Regulation SB SEF, including to establish and submit the rules to the Commission, would be \$73,600 for each SB SEF, for an aggregate initial cost of

\$1,472,000.⁶²⁰ The estimated cost would include the time expended for drafting the rules, and for review of the draft rules, policies or procedures by the SB SEF's senior management.

The Commission notes that a SB SEF may choose to refine the rules, policies or procedures that it would establish in connection with the requirements of Regulation SB SEF. Once a SB SEF has drafted the written rules, policies and procedures it is required to establish pursuant to Regulation SB SEF, the Commission estimates that it would cost a SB SEF approximately \$38,400 annually to update its rules, for an aggregate estimated ongoing annual cost for all SB SEFs of approximately \$768,000.⁶²¹

The Commission requests comment on the costs and benefits of the proposed rule writing requirements 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. The Commission requests comment on the costs and benefits of the proposed registration requirements discussed above, as well as any costs and benefits not already described that could

⁶²⁰ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden to comply with the rule-writing requirements of Regulation SB SEF would be 230 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the initial estimated dollar cost would be \$73,600 (230 hours x \$320), or \$1,472,000 (\$73,600 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶²¹ The Commission preliminarily estimates, for purposes of its PRA, that the average annual burden to comply with the rule-writing requirements of Regulation SB SEF would be 120 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$38,400 (120 hours x \$320), or \$768,000 (\$38,400 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed rule writing requirements of Regulation SB SEF?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed rule writing requirements?
- Are there additional costs involved in complying with the rule writing requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having a comprehensive and accurate rule writing requirement for SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed rule writing requirements that have not been identified?

Reporting. The Commission estimates that the annual cost for SB SEFs to comply with the reporting requirements of Regulation SB SEF would be \$387,200 per SB SEF, for an aggregate annual cost of \$7,744,000.⁶²² Further, the Commission estimates the total cost of hiring outside legal counsel to review an international information sharing agreement to be

⁶²² The Commission preliminarily estimates, for purposes of its PRA, that the average annual costs comply with the reporting requirements of Regulation SB SEF would be 1,210 hours per SB SEF. See supra Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$387,200 (1,210 hours x \$320), or \$7,744,000 (\$387,200 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

\$4,000 per SB SEF, for an aggregate cost of approximately \$80,000⁶²³ for all SB SEFs. In addition, the Commission estimates the total annual cost of hiring an objective, external firm to review internal audits to be \$90,000 per SB SEF, for an aggregate cost of approximately \$1,800,000⁶²⁴ for all SB SEFs. Thus, the estimated aggregate total annual costs associated with reporting requirements for all SB SEFs would be approximately \$9,624,000.⁶²⁵

The Commission estimates that the annual cost for SB SEF participants to comply with the reporting requirements of Regulation SB SEF would be \$32,000 per SB SEF participant, for an aggregate annual cost of \$8,800,000.⁶²⁶

The Commission requests comment on the costs and benefits of the proposed reporting requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from proposed reporting requirements?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed reporting requirements?

⁶²³ \$80,000 = \$4,000 x 20 SB SEFs.

⁶²⁴ \$1,800,000 = \$90,000 x 20 SB SEFs.

⁶²⁵ \$9,624,000 = \$7,744,000 + \$80,000 + \$1,800,000.

⁶²⁶ The Commission preliminarily estimates, for purposes of its PRA, that the average annual costs to comply with the reporting requirements of Regulation SB SEF would be 100 hours per SB SEF participant, with an estimated 275 SB SEF participants in total for a total of 27,500 hours. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$32,000 (100 hours x \$320), or \$8,800,000 (\$32,000 x 275 SB SEF participants) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

- Are there additional costs involved in complying with the reporting requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having comprehensive and accurate reporting requirements for SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed reporting requirements that have not been identified?

Recordkeeping. The Commission estimates that the annual cost for SB SEFs to comply with the recordkeeping requirements of proposed Rule 818(a)-(b) would be similar to the annual cost for national securities exchanges to comply with comparable rules. The Commission estimates that the annual cost would be \$16,000 per SB SEF, for an aggregate annual cost of \$320,000.⁶²⁷ This figure includes, but is not limited to, the annual hourly burden to generate, collect, organize and preserve all of the documents and other records required under proposed Rule 818(a) and (b).

In addition, proposed Rule 818(c) would require a SB SEF to keep certain records with respect to trading activity on and through the SB SEF. Specifically, a SB SEF must make and keep accurate, time-sequenced records of all inquiries, responses, orders, quotations, other trading interest and transactions that are received by, originated on, or executed on the SB SEF.

⁶²⁷ The Commission preliminarily estimates, for purposes of its PRA, that the average annual burden to comply with the recordkeeping requirements of proposed Rule 818(a)-(b) would be 50 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$16,000 (50 hours x \$320), or \$320,000 (\$16,000 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

The Commission estimates that the annual cost to comply with this requirement would be \$41,600 per SB SEF, for an aggregate annual cost of \$832,000.⁶²⁸

The Commission preliminarily estimates that a SB SEF could incur a one-time cost to set up or modify an existing recordkeeping system to comply with proposed Rule 818. Based on the Commission's experience with recordkeeping costs, and consistent with prior cost estimates for similar recordkeeping provisions,⁶²⁹ the Commission estimates that setting up or modifying a recordkeeping system would cost \$106,680 per SB SEF, for an aggregate total of \$2,133,600.⁶³⁰

Additionally, the Commission preliminarily estimates that each SB SEF may have a one-time burden to upgrade its existing systems to ensure that the audit trail component of its systems complies with proposed Rule 818(c). Based on industry sources, the Commission preliminarily believes that this work would be done internally by two programmers over the course of

⁶²⁸ The Commission preliminarily estimates, for purposes of its PRA, that the average annual burden to comply with the recordkeeping requirements of proposed Rule 818(c) would be 130 hours per SB SEF. See supra Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$41,600 (130 hours x \$320), or \$832,000 (\$41,600 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶²⁹ See Securities Exchange Act Release No. 59342 (February 2, 2009); 74 FR 6456 (February 9, 2009) (Amendments to Rules for Nationally Recognized Statistical Rating Organizations) ("NRSRO Adopting Release").

⁶³⁰ The Commission estimates it would take 345 hours for a senior programmer to set up or modify a recordkeeping system for a cost of \$104,880 per SB SEF (345 hours x \$304), or \$2,097,600 (\$104,880 x 20 SB SEFs). In addition, the Commission estimates a cost of \$1,800 per SB SEF in information technology expenses to purchase recordkeeping software for a total initial cost of \$36,000 for all SB SEFs. The total costs would be \$106,680 (\$104,880 + \$1,800) per SB SEF or a total of \$2,133,600 (\$106,680 x 20 SB SEFs) for all SB SEFs. The hourly rate for the senior programmer is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

approximately four weeks. The Commission preliminarily estimates that it would cost a total of \$97,280 per SB SEF, or \$1,945,600 in the aggregate for all SB SEFs.⁶³¹

As discussed above, proposed Rule 809(d) would require a SB SEF that permits non-registered ECPs to be participants in the SB SEF to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. Based on conversations with industry sources, the Commission preliminarily believes that the majority of entities that would seek to become SB SEFs already would have risk management systems and supervisory procedures and controls to protect the integrity of their business and to comply with other requirements already specified and accounted for herein. The Commission also believes that only a small number of entities would have to establish completely new systems and procedures to comply with the requirement of proposed Rule 809(d).

The Commission estimates that each SB SEF would spend an average of \$68,400 to modify its risk management systems to bring them into compliance with the proposed Rule for a total one-time cost of \$1,368,000 for all SB SEFs combined,⁶³² and a total annual ongoing

⁶³¹ The Commission estimates that it would take 160 hours for two senior programmers to set up or modify a recordkeeping system for a cost of \$97,280 per SB SEF (160 hours x 2 programmers x \$304), or \$1,945,600 (\$97,280 x 20 SB SEFs) for all SB SEFs. The hourly rate for the senior programmer is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶³² The Commission preliminarily estimates, for purposes of its PRA, that the average one-time cost to comply with proposed Rule 809(d) would require one senior programmer working 225 hours. See supra Section XXVII. Assuming an hourly cost of \$304 for a senior programmer the one-time cost would be \$68,400 (225 hours x \$304), or \$1,368,000 (\$68,400 x 20) in the aggregate. The hourly rate for the senior programmer is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

burden of \$1,048,800 on all SB SEFs to maintain their systems.⁶³³ The Commission preliminarily believes that proposed Rule 809(d) also would impose a one-time legal and compliance cost of \$330,300 on all SB SEFs to comply with the requirement to establish, document, and maintain compliance policies and supervisory procedures,⁶³⁴ and an annual cost of \$482,700 on all SB SEFs to review their written compliance policies and supervisory procedures.⁶³⁵

⁶³³ The Commission preliminarily estimates, for purposes of its PRA, that the ongoing cost to comply with proposed Rule 809(d) would require one senior programmer working 172.5 hours annually. See *supra* Section XXVII. Assuming an hourly cost of \$304 for a senior programmer, the cost would be \$52,440 (172.5 hours x \$304), or \$1,048,800 (\$52,440 x 20 SB SEFs) in the aggregate. The hourly rate for the senior programmer is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶³⁴ The Commission preliminarily estimates, for purposes of its PRA, that the average one-time cost to comply with proposed Rule 809(d) would require one compliance attorney and one compliance manager to spend 7.5 hours each to evaluate appropriate access thresholds. The Commission also preliminarily estimates that one compliance attorney and one compliance manager would each require approximately 15 hours, and the CCO would require approximately 7.5 hours, to set up or modify compliance policies and procedures to comply with the proposed rule. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney, \$423 for the CCO, and \$273 for a compliance manager the cost for each SB SEF would be \$16,515 = 7,200 (22.5 hours x \$320) + \$3,172.5 (7.5 hours x \$423) + \$6,142.5 (22.5 hours x \$273), for a total of \$330,300 for all SB SEFs (\$16,515 x 20). The hourly rate for the compliance attorney, compliance manager and CCO are from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶³⁵ The Commission preliminarily estimates, for purposes of its PRA, that the ongoing cost to comply with proposed Rule 809(d) would require an average of 30 hours per year for each of an compliance attorney and compliance manager, and 15 hours per year for the CCO, to review and document their written compliance policies and supervisory procedures. Assuming an hourly cost of \$320 for a compliance attorney, \$423 for the CCO, and \$273 for a compliance manager, the cost for each SB SEF would be 24,135 = \$9,600 (30 hours x \$320) + \$6,345 (15 hours x \$423) + \$8,190 (30 hours x \$273), for a total of \$482,700 for all SB SEFs (\$24,135 x 20 SB SEFs). The hourly rate for the compliance attorney, compliance manager and CCO are from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified by the Commission's

Therefore, the Commission preliminarily estimates that the total one-time burden for all SB SEFs to comply with the collection of information requirements of proposed Rule 809(d) would be \$1,698,300,⁶³⁶ and the total annual burden for all SB SEFs to comply with the proposed Rule would be \$1,531,500.⁶³⁷

The Commission requests comment on the costs and benefits of the proposed record keeping requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed recordkeeping requirements?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed recordkeeping requirements?
- Are there additional costs involved in complying with the recordkeeping requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having comprehensive and accurate recordkeeping requirements for SB SEFs, which would provide access to such information to the Commission and other regulators?

staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

⁶³⁶ \$1,698,300 = \$1,368,000 + \$330,300. See supra notes 632 and 634 (discussing the average one-time costs to comply with Rule 809(d)).

⁶³⁷ \$1,531,500 = \$1,048,800 + \$482,700. See supra notes 633 and 635 (discussing the ongoing costs to comply with Rule 809(d)).

- Are the Commission's estimates concerning what it would cost to implement and maintain technology systems to comply with the recordkeeping requirements accurate? If not, what would the costs, in both time and dollar figures, be? Please provide data.
- Would there be additional benefits from the proposed recordkeeping requirements that have not been identified?

Publication of Trading Information. For the requirement in proposed Rule 817(a) that a SB SEF have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all SB swaps executed on or through the SB SEF, the Commission preliminarily estimates that a SB SEF would incur a one-time cost of \$92,416 per SB SEF, or \$1,848,320 in the aggregate.⁶³⁸

The Commission requests comment on the costs and benefits of the requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed publication of trading information requirements?

⁶³⁸ The Commission preliminarily estimates, for purposes of its PRA, that the average one-time cost to comply with proposed Rule 817(a) would require two senior programmers working 160 hours, for a total of 320 hours. See supra Section XXVII. Assuming an hourly cost of \$304 for a senior programmer, the one-time cost would be \$92,416 (320 hours x \$304), or \$1,848,320 (\$92,416 x 20 SB SEFs) in the aggregate. The hourly rate for the senior programmer and programmer analyst are from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed publication of trading information requirements?
- Are there additional costs involved in complying with the publication of trading information requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having these requirements for SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed publication of trading information requirements that have not been identified?

Composite Indicative Quote and Executable Bids and Offers. For the two requirements: (1) the requirement in proposed Rule 811(e) that a SB SEF operating a RFQ platform create and disseminate through the SB SEF a composite indicative quote, made available to all participants, for SB swaps traded on or through the SB SEF; and (2) the requirement imposed by the Commission's proposed interpretation of the definition of SB SEF that each SB SEF, at a minimum, provide any participant with the ability to make and display executable bids or offers accessible to all participants on the SB SEF, if the participant wishes to do so, the Commission preliminarily estimates that a SB SEF would incur a one-time cost of \$21,120 per SB SEF, or \$422,400 in the aggregate.⁶³⁹ Further, the Commission preliminarily estimates that each SB

⁶³⁹ The Commission preliminarily estimates, for purposes of its PRA, that the average one-time cost to comply with the above requirements would require one senior programmer and one programmer analyst working 40 hours each. See *supra* Section XXVII. Assuming an hourly cost of \$304 for a senior programmer and \$224 for a programmer analyst, the one-time cost would be \$21,120 ((40 hours x \$304) + (40 hours x \$224)), or \$422,400 (\$21,120 x 20 SB SEFs) in the aggregate. The hourly rate for the senior programmer and programmer analyst are from SIFMA's Management & Professional

SEF would incur a recurring annual cost of \$11,200 to monitor and update its systems to determine if its composite indicative quote and executable bid and offer functionalities operate appropriately.⁶⁴⁰

The Commission requests comment on the costs and benefits of collecting and disseminating a composite indicative quote and of allowing participants to disseminate executable bids and offers 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed requirements to collect and disseminate a composite indicative quote and executable bids and offers?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed dissemination of a composite indicative quote?
- Are there additional costs involved in complying with the requirements to collect and disseminate a composite indicative quote and providing the ability for participants to

Earnings in the Securities Industry 2010, 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.

⁶⁴⁰ The Commission preliminarily estimates, for purposes of its PRA, that the average annual cost to comply with the above requirements would require one programmer analyst working 50 hours. See supra Section XXVII. Assuming an hourly cost of \$224 for a programmer analyst the one-time cost would be \$11,200 (50 hours x \$224), or \$224,000 (\$11,200 x 20 SB SEFs) in the aggregate. The hourly rate for the senior programmer and programmer analyst are from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

disseminate executable bids and offer that have not been identified? What are the types, and amounts, of the costs?

- Can commenters assess the benefits of collecting and disseminating a composite indicative quote for SB SEFs and of SB SEFs providing participants the ability to disseminate executable bids and offers?

Rule and Product Filings. The Commission estimates that the annual cost for SB SEFs to comply with the proposed rule and product filing requirements of proposed Rules 805 through 808 would be \$75,200 per SB SEF, for an aggregate annual cost of \$1,504,000.⁶⁴¹ These estimated costs entail preparing, reviewing and submitting the filings to the Commission. Based on the Commission staff's consultation with CFTC staff, the Commission believes that SB SEFs would handle the rule and product filing processes internally.

The Commission requests comment on the costs and benefits of the proposed rule and product filing requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed rule and product filing requirements?

⁶⁴¹ Based on the Commission staff's consultation with CFTC staff, the Commission preliminarily estimates for purposes of its PRA that the average annual burden to comply with the rule filing requirements of Rules 805 and 806 would be 150 hours, and the average annual burden to comply with the product filing requirements of Rules 807 and 808 would be 85 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$75,200 (235 hours x \$320), or \$1,504,000 (\$75,200 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed rule and product filing requirements?
- Are there additional costs involved in complying with the rule and product filing requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having comprehensive and accurate rules and product filing requirements for SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed rule and product filing requirements that have not been identified?

Chief Compliance Officer. The Commission estimates that the initial cost for SB SEFs to comply with the CCO requirements of proposed Rule 823(b)(6) and (7), which relate to the handling of noncompliance issues, would be \$91,200 per SB SEF, for an aggregate annual cost of \$1,824,000.⁶⁴² A CCO also would be required under proposed Rule 823(c) and (d) to prepare and submit an annual compliance report to the Commission and to the SB SEF's Board. The Commission estimates that the annual cost for SB SEFs to comply with this requirement is

⁶⁴² The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden to comply with the CCO requirements of proposed Rule 823(b)(6) and (7) would be 160 hours. Also, due to the novel nature of the CCO requirements in the SB SEF industry and the new requirements under the Dodd-Frank Act, the Commission estimates that there would be an initial one-time burden of \$40,000 per SB SEF in outside legal costs. See supra Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$51,200 (160 hours x \$320) plus \$40,000, for a total of \$91,200, or \$1,824,000 (\$91,200 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

\$29,440 per SB SEF, for an aggregate annual cost of \$588,800.⁶⁴³ Proposed Rule 823(e)(1) and (2) and Exhibits F and H to proposed Form SB SEF also require the CCO to submit an annual financial report. Based on conversations with operators of current trading platforms and the Commission's experience with entities of similar size, the Commission preliminarily estimates that each SB SEF would incur, on average, a cost of \$99,500 to complete the reports,⁶⁴⁴ and a cost of \$500,000 for independent public accounting services. In the aggregate, these costs are estimated to be \$1,980,000 and \$10,000,000, respectively.⁶⁴⁵ The Commission also estimates that it would cost approximately \$7,920 per respondent to compile, review, and submit the financial reports for certain affiliated entities or \$158,400 in the aggregate.⁶⁴⁶ However, all of

⁶⁴³ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden to comply with the CCO requirements of proposed Rule 823(c) and (d) would be 92 hours. See *supra* Section XXVII. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the annual estimated dollar cost would be \$29,440 (92 hours x \$320) or \$588,800 (\$29,440 x 20 SB SEFs) in the aggregate. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶⁴⁴ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden would be 500 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$198 for a senior accountant to meet these requirements, the one-time estimated dollar cost to register a SB SEF would be \$99,000 (500 hours x \$198), or \$1,980,000 (\$99,000 x 20 SB SEFs) in the aggregate. The hourly rate for the senior accountant is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶⁴⁵ *Id.* See also Section XXVII.D.1.

⁶⁴⁶ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden would be 40 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$198 for a senior accountant to meet these requirements, the one-time estimated dollar cost per SB SEF would be \$7,920 (40 hours x \$198), or \$158,400 (\$7,920 x 20 SB SEFs) in the aggregate. The hourly rate for the senior accountant is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

these reports would need to be provided in XBRL, as required by Rules 405(a)(1), (a)(3), (b), (c), (d) and (e) of Regulation S-T.⁶⁴⁷ This would create an additional cost for SB SEFs. The Commission preliminarily estimates, based on its experience with other data tagging initiatives, that these requirements would add an additional cost on average of approximately \$12,096⁶⁴⁸ and \$23,000 in outside software and other costs per respondent, or \$241,920 and \$460,000 in the aggregate, respectively. Thus, the Commission estimates a total initial cost of approximately \$762,656 per respondent⁶⁴⁹ and \$15,253,120 in the aggregate for all respondents.⁶⁵⁰

The Commission requests comment on the costs and benefits of the proposed CCO requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed CCO requirements?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the cost of the proposed CCO requirements?
- Are there additional costs involved in complying with the CCO requirements that have not been identified? If so, what are the types, and amounts, of such costs?

⁶⁴⁷ See 17 CFR 232.405.

⁶⁴⁸ The Commission preliminarily estimates, for purposes of its PRA, that the average initial burden would be 54 hours per SB SEF. See *supra* Section XXVII. Assuming an hourly cost of \$224 for a programmer analyst to meet these requirements, the initial estimated dollar cost would be \$12,096 (54 hours x \$224), or \$241,920 (\$12,096 x 20 SB SEFs) in the aggregate. The hourly rate for the programmer analyst is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶⁴⁹ $\$762,656 = \$91,200 + \$29,440 + \$99,000 + \$500,000 + \$7,920 + \$12,096 + \$23,000.$

⁶⁵⁰ $\$15,253,120 = 20 \text{ (number of SB SEFs)} \times \$762,656.$

- Can commenters assess the benefits of having comprehensive and accurate CCO requirements for SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed CCO requirements that have not been identified?

Conflicts of Interest. As described above, proposed Rule 820 sets forth certain governance arrangements that would be required of SB SEFs. A SB SEF may need to revise the composition of its Board, if the Board currently is not composed of at least 20% SB SEF participants. A SB SEF could comply with the 20% participant director requirement by decreasing the size of its Board and allowing some non-participant directors to resign, maintaining the current size of its Board and replacing some non-participant directors with participant directors, or by increasing the size of its Board and electing additional participant directors. In any event, unless a SB SEF currently complies with proposed Rule 820, it would incur the cost of adding new directors or replacing existing directors. A SB SEF may also need to design or modify its governance processes to preclude any participant, either alone or together with its related persons, that beneficially owns an interest in the SB SEF from dominating or exercising disproportionate influence in the selection of participant directors, if such participant could thereby dominate or exercise disproportionate influence in the selection or appointment of the entire Board. The Commission estimates a cost per SB SEF of \$4,800, or \$96,000 in the aggregate for all SB SEFs to revise the relevant governing documents.⁶⁵¹

⁶⁵¹ The Commission preliminarily estimates, for purposes of its PRA, that it would take a compliance attorney approximately 15 hours to revise the relevant governing documents. Assuming an hourly cost of \$320 for a compliance attorney to meet these requirements, the one-time estimated dollar cost would be \$4,800 (15 hours X \$320) or \$96,000 (\$4,800 X 20 SB SEFs) in the aggregate. The hourly rate for the senior programmer and

A SB SEF may also need to revise the composition of its Board to include at least one director that is representative of investors who are not SB swap dealers or major SB swap participants, and are not associated with a participant. In this regard, SB SEFs could face difficulties in locating qualified individuals to serve as investor directors, particularly because SB swaps trading is complex and some potential candidates may decline to serve as a director if they believe that they lack sufficient expertise. There could also be costs in educating investor directors to become familiar with the manner in which SB swaps are traded and the overall market for SB swaps, as well as the new regulatory structure that would govern them, which could slow Board or committee processes at least initially.

The Commission preliminarily believes that the cost of securing an investor director to serve on the Board of the SB SEF 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 investor 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 outside directors. The Commission preliminarily estimates that those SB SEFs that must rely on a recruitment specialist could incur a cost of approximately \$68,000 per director,⁶⁵² or \$1,360,000 in the aggregate, if all SB SEFs utilized a recruitment firm.⁶⁵³

programmer analyst are from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

⁶⁵² The Commission is basing this estimate on a recent study noting that the retainer fee for outside directors is on average \$67,624 (rounded to \$68,000). See http://www.hewittassociates.com/_MetaBasicCMAAssetCache_/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

The Commission requests comment on the costs and benefits of the proposed conflicts requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed conflicts requirements?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed conflicts requirements?
- Are there additional costs involved in complying with the governance requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having governance requirements for SB SEFs?
- Would there be additional benefits from the proposed conflicts requirements that have not been identified?

Surveillance. The Commission preliminarily estimates that establishing an automated surveillance system in compliance with proposed Rules 811 and 813 would require an initial cost of \$3,256,800 per SB SEF, or \$65,136,000 in the aggregate. The initial cost per SB SEF includes \$1,756,800 in initial programming costs per SB SEF⁶⁵⁴ as well as a one-time capital

conduct a national search for a director that meets the requirements of proposed Rule 820(c)(2).

⁶⁵³ \$1,360,000 = 20 (number of SB SEFs) x \$68,000.

⁶⁵⁴ The Commission preliminarily estimates, for purposes of its PRA, that establishing an automated surveillance system would require one senior programmer and three additional programmers working for 1,800 hours each to create and implement such a system. See supra Section XXVII. Assuming an hourly cost of \$304 for a senior programmer and \$224 for a programmer analyst to meet these requirements, the initial estimated dollar cost would be \$1,756,800 = (1,800 hours x \$304) + ((1,800 hours x \$224) x 3), or \$35,136,000 (\$1,756,800 x 20 SB SEFs) in the aggregate. The hourly rate for the senior programmer and programmer analyst are from SIFMA's Management & Professional

expenditure per SB SEF of \$1.5 million in information technology costs that would be necessary to establish such a system. This capital expenditure estimate is based on the Commission's discussions with market participants currently operating platforms that trade OTC swaps.

The Commission preliminarily estimates that the ongoing annual costs associated with the automated surveillance system required by proposed Rules 811 and 813 would be \$1,306,400 per SB SEF, or \$26,128,000 in the aggregate. The annual cost per SB SEF includes \$806,400 in annual programming costs per SB SEF⁶⁵⁵ as well as an ongoing annual information technology cost of \$500,000 per SB SEF.

The Commission requests comment on the costs and benefits of the proposed surveillance system requirements 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. In addition, the Commission requests comment on the following:

- How can the Commission most accurately estimate the costs and benefits arising from the proposed surveillance system requirements?
- What are the costs currently borne by entities that may have been included in the Commission's analysis of the costs of the proposed surveillance system requirements?

Earnings in the Securities Industry 2010, 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.

⁶⁵⁵ The Commission preliminarily estimates, for purposes of its PRA, that the average annual burden to comply with the automated surveillance system requirements of proposed Rules 811 and 813 would require two programmer analysts working for 1,800 hours per SB SEF. See supra Section XXVII. Assuming an hourly cost of \$224 for a programmer analyst to meet these requirements, the initial estimated dollar cost would be \$806,400 (1,800 hours x \$224 x 2), or \$16,128,000 (\$806,400 x 20 SB SEFs) in the aggregate. The hourly rate for the programmer analyst is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, 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.

- Are there additional costs involved in complying with the surveillance system requirements that have not been identified? If so, what are the types, and amounts, of such costs?
- Can commenters assess the benefits of having comprehensive and accurate surveillance system requirements for SB SEFs, which would provide access to such information to the Commission and other regulators?
- Would there be additional benefits from the proposed surveillance system requirements that have not been identified?

D. General Request for Comments on Regulation SB SEF

- The Commission requests comment on any other aspect of the costs and benefits associated with Regulation SB SEF.
- Would the obligations imposed on reporting parties by proposed Regulation SB SEF be a significant enough barrier to entry to cause some firms not to enter the SB swaps market? If so, how many firms might decline to enter the market? How can the cost of their not entering the market be tabulated? How should the Commission weigh such costs, if any, against the anticipated benefits from increased transparency to the SB swaps market from the proposal, as discussed above?
- How many entities would be affected by proposed Regulation SB SEF?

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

Section 3(f) of the Exchange Act⁶⁵⁶ 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

⁶⁵⁶ 15 U.S.C. 78c(f).

the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act⁶⁵⁷ requires the Commission, when adopting rules under the Exchange Act, to consider the impact of any such rules 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.⁶⁵⁸

The Commission preliminary believes that the regulation of SB SEFs, as required by the Dodd-Frank Act and proposed to be implemented under Regulation SB SEF, would promote efficiency, competition, and capital formation.

Promotion of Efficiency. The Commission preliminary believes that the regulation of SB SEFs, as required by the Dodd-Frank Act and proposed to be implemented under Regulation SB SEF, would promote efficiency by encouraging innovation, automation, and reduction of informational asymmetries.

The proposed rules are designed to be flexible and to foster innovation in the SB swaps market, particularly with respect to the trading of SB swaps by a diverse group of market participants. The Commission formulated the proposed rules, along with the proposed interpretation of the definition of SB SEF in a manner that would allow entities that seek to become SB SEFs to structure diverse platforms for the trading of SB swaps, subject to certain baseline requirements. These proposed baseline requirements are meant to permit access by a wide group of market participants to a range of SB swaps in keeping with the mandate of the Dodd-Frank Act. Thus, the Commission believes that the trading of SB swaps could evolve to

⁶⁵⁷ 15 U.S.C. 78w(a)(2).

⁶⁵⁸ Id.

its most efficient structure while also meeting the statutory and regulatory requirements relating to such activity.

The Commission preliminarily believes that the proposed requirements with respect to pre-trade price transparency could lead to more efficient pricing in the SB swaps market. The proposed rules are designed to result in an increase in pre-trade price transparency for SB swaps, which should aid market participants in evaluating current market prices for SB swaps, thereby furthering more efficient price discovery. Price transparency, coupled with the potential increase in the number of market participants with access to trading in SB swaps, could further decrease the spread in quoted prices, and thus could lead to higher efficiency in the trading of these securities.

Some industry participants, however, have expressed concerns to the Commission that pre-trade price transparency could force market participants to reveal more information about trading interest than they believe would be economically desirable. To the extent that market participants consider that pre-trade price transparency requirements are too burdensome and choose not to participate in the market, thereby foregoing any potential economic benefits that may have resulted from purchasing a particular SB swap, market efficiency could be harmed for less liquid instruments and for large blocks of SB swaps.

The Commission preliminarily believes that automation and systems development that would be associated with the regulation of SB SEFs, as required by proposed Regulation SB SEF, would provide market participants with new platforms and tools to execute and process transactions in SB swaps, which could result in lower trading costs and thus could lead to more efficient trading of SB swaps.

The Commission also believes that the proposed exemptions for SB SEFs from regulation as national securities exchanges or as brokers would eliminate what would be largely an additive oversight of SB SEFs and therefore would promote efficiency, because SB SEFs would not have to expend resources to comply with these regulatory obligations from which they would be exempt.

Promotion of Competition. The Commission preliminary believes that the regulation of SB SEFs, as required by the Dodd-Frank Act and proposed to be implemented under Regulation SB SEF, could promote competition. The proposed rules that would require SB SEFs to establish fair, objective and not unreasonably discriminatory standards for granting impartial access to trading on the SB SEF would foster greater access to SB SEFs by SB swap dealers, major SB swap participants, brokers, and ECPs. The resulting increase in the number of participants who could access venues for the trading of SB swaps would allow a range of market participants to compete for business on the SB SEF through price competition or other dimensions of service. The proposed pre-trade transparency requirements, including the proposed requirement to create and disseminate a composite indicative quote, could further promote price competition by making available information about trading interest before execution of the trade, thereby allowing participants to improve upon current quotes.

The Dodd-Frank Act's mandate to bring SB swaps that are subject to the mandatory clearing requirement and that are made available to trade onto regulated markets as well as the proposed interpretation of the definition of SB SEF, and proposed Regulation SB SEF that are intended to further implement the statutory directive, should help foster greater competition in the trading of SB swaps. The trading of SB swaps on regulated markets, and the Commission's

proposals to institute rules for such trading, should allow diverse trading platforms or systems to register as SB SEFs and to compete for business in the SB swap market.

The Commission proposes to initially permit temporary registration of SB SEFs while it considers each applicant's full registration application, as long as the applicant meets certain requirements for temporary registration. This proposed temporary registration should help alleviate burdens associated with starting up a SB SEF and promote competition by reducing barriers to entry, because entry into the SB swap market would not be delayed by procedural matters, such as the timing of Commission review of the applicant's full registration submission. In addition, the Commission would have the opportunity to observe the SB SEF in operation before it grants permanent registration to the SB SEF, thereby helping to ensure that the SB SEF promotes desirable competition.

Promotion of Capital Formation. The Commission preliminary believes that the regulation of SB SEFs, as required by the Dodd-Frank Act and as proposed to be implemented under Regulation SB SEF, would promote capital formation because the proposed interpretation of the definition of SB SEF, along with the elements of proposed Rule 811 that relate to pre-trade price transparency, are intended to provide a flexible approach as to the parameters of what can be traded on a SB SEF. As a result, entities that currently provide a platform or system for OTC derivatives trading should be able to leverage off of their current trading platforms when developing a SB SEF-compatible trading platform. These entities would have various options available to them when developing their systems or platforms to comply with the Commission's proposed rulemaking. This flexible feature of the proposals should help promote capital formation because resources would be invested in a more efficient manner to improve upon or expand the features of those that plan to register as a SB SEF.

In addition, proposed Regulation SB SEF would provide the Commission with information relating to trading, recordkeeping, and surveillance of SB SEFs, as well as access to the books and records of SB SEFs. A well-regulated SB swap market, where the Commission has access to information about SB swap transactions, would increase the Commission's ability to assess risks in the SB swap market. In addition, the proposals would provide for various safeguards to help promote market integrity, including proposed Rule 809 relating to access to the SB SEF and proposed Rule 822 relating to systems safeguards. Proposed Regulation SB SEF also is intended to support the statutorily-mandated regulatory obligations of SB SEFs through proposed Rule 823 relating to the duties of the CCO, among other proposed rules. Any resulting increase in market integrity would likely increase market participants' confidence in the soundness and fairness of the SB swap market. Such increased confidence likely would stimulate financial investment in SB swaps by corporate entities and others that may find that more transparent venues for the trading of SB swaps would allow them to purchase SB swaps to offset business risks and to meet hedging objectives. Further, to the extent that market participants utilize SB swaps to better manage portfolio risks with respect to positions in underlying securities, the extent that they are willing to participate in the SB swap market may impact their willingness to participate in the underlying asset's market. Therefore, the Commission preliminarily believes that the proposed rules would help encourage capital formation.

Burden on Competition. Based on discussions with industry participants, the Commission preliminary believes that the start-up costs to become a SB SEF for those entities that currently own and/or operate a platform for the trading of OTC swaps would be moderate. According to these industry participants, any needed modifications to their systems or operations

as a result of the Commission's proposals generally would entail the expenditure of resources chiefly on regulatory and compliance matters and on enhancing electronic systems to support both the operational and regulatory aspects of a SB SEF. A trading platform that currently trades OTC swaps would need to make some adjustments to its systems and structure to trade SB swaps in compliance with proposed Regulation SB SEF. The Commission preliminary believes that the development and registration of, and introduction of trading in SB swaps by, a SB SEF would result in some barriers to entry that otherwise would not exist. This is particularly the case because, prior to the enactment of the Dodd-Frank Act, there were no statutory provisions mandating the trading of certain SB swaps on regulated markets.

The Commission requests comment on all aspects of this analysis and, in particular, on whether proposed Regulation SB SEF and the proposed interpretation of the definition of SB SEF would place a burden on competition, as well as the effect of the proposals on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

XXX. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA," the Commission must advise the OMB as to whether proposed Regulation SB SEF constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) a significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of proposed Regulation SB SEF on the economy on an annual basis, on the costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

XXXI. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")⁶⁵⁹ requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)⁶⁶⁰ of the Administrative Procedure Act,⁶⁶¹ as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."⁶⁶² Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not have a significant economic impact on a substantial number of small entities.⁶⁶³

A. Security-Based Swap Execution Facilities

The proposed rules and form under Regulation SB SEF would apply to all entities that seek to register with the Commission as a SB SEF and thus to operate as a SB SEF in

⁶⁵⁹ 5 U.S.C. 601 et seq.

⁶⁶⁰ 5 U.S.C. 603(a).

⁶⁶¹ 5 U.S.C. 551 et seq.

⁶⁶² Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

⁶⁶³ See 5 U.S.C. 605(b).

compliance with Regulation SB SEF. In the Dodd-Frank Act, Congress defined for the first time the scope of a SB SEF and mandated the registration of these new entities. Based on its understanding of the market and conversations with industry sources, the Commission preliminarily believes that approximately 20 SB SEFs could be subject to the requirements of proposed Regulation SB SEF.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1i) when used with reference to an “issuer” or a “person,” other than an investment company, an “issuer” or “person” that, on the last day of its most recent fiscal year, had total assets of \$5 million or less,⁶⁶⁴ or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,⁶⁶⁵ or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.⁶⁶⁶ Under the standards adopted by the Small Business Administration (“SBA”), entities in financial investments and related activities⁶⁶⁷ are considered small entities if they have \$7 million or less in annual receipts.

⁶⁶⁴ See 17 CFR 240.0-10(a).

⁶⁶⁵ See 17 CFR 240.17a-5(d).

⁶⁶⁶ See 17 CFR 240.0-10(c).

⁶⁶⁷ These entities would include firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities. See SBA’s Table of Small Business Size Standards, Subsector 523.

Based on the Commission's existing information about the SB swap market and the entities likely to register as SB SEFs, the Commission preliminarily believes that the entities likely to register as SB SEFs would not be considered small entities. The Commission preliminarily believes that most, if not all, of the SB SEFs would be large business entities or subsidiaries of large business entities, and that all SB SEFs would have assets in excess of \$5 million and annual receipts in excess of \$7,000,000. Therefore, the Commission preliminarily believes that none of the potential SB SEFs would be considered small entities.

B. SB SEF Participants

The proposed rules under Regulation SB SEF also would impose requirements on participants of SB SEFs, *i.e.*, SB swap dealers, major SB swap participants, brokers and non-registered ECPs. Among other requirements relating to participants, SB SEFs would be required to establish and enforce rules that require its participants to maintain books and records of any trading interest, transaction, or position in any SB swap pertinent to their activity on the SB SEF and to provide prompt access to those books and records to the SB SEF and to the Commission. Based on conversations with industry sources, the Commission preliminarily believes that there could be a total of 275 persons that could become SB SEF participants and thus would thus be subject to the requirements of the proposed rules.⁶⁶⁸

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of \$5 million or less,⁶⁶⁹ or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its

⁶⁶⁸ See supra Section XXVII.C.

⁶⁶⁹ See 17 CFR 240.0-10(a).

audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,⁶⁷⁰ or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.⁶⁷¹ Under the standards adopted by the SBA, small entities in the finance and insurance industry include the following: (1) for entities in credit intermediation and related activities,⁶⁷² entities with \$175 million or less in assets or, (2) for non-depository credit intermediation and certain other activities,⁶⁷³ \$7 million or less in annual receipts; (3) for entities in financial investments and related activities,⁶⁷⁴ entities with \$7 million or less in annual receipts; (4) for insurance carriers and entities in related activities,⁶⁷⁵ entities with \$7 million or less in annual receipts; and (5) for funds, trusts, and other financial vehicles,⁶⁷⁶ entities with \$7 million or less in annual receipts.

⁶⁷⁰ See 17 CFR 240.17a-5(d).

⁶⁷¹ See 17 CFR 240.0-10(c).

⁶⁷² This includes commercial banks, savings institutions, credit unions, firms involved in other depository credit intermediation, credit card issuing, sales financing, consumer lending, real estate credit, and international trade financing. See SBA's Table of Small Business Size Standards, Subsector 522.

⁶⁷³ This includes firms involved in secondary market financing, all other non-depository credit intermediation, mortgage and nonmortgage loan brokers, financial transactions processing, reserve, and clearing house activities, and other activities related to credit intermediation. See SBA's Table of Small Business Size Standards, Subsector 522.

⁶⁷⁴ This includes firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities. See SBA's Table of Small Business Size Standards, Subsector 523.

⁶⁷⁵ This includes direct life insurance carriers, direct health and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance (except life, health and medical) carriers, reinsurance carriers, insurance agencies and brokerages, claims adjusting, third party administration of insurance and

Based on feedback from industry participants about the SB swap market, the Commission preliminarily believes that the entities that will be participants of SB SEFs, whether SB swap dealers, major SB swap participants, registered brokers or non-registered ECPs, would exceed the thresholds defining “small entities” set out above. Thus, the Commission believes it is unlikely that proposed Regulation SB SEF, as it would affect SB SEF participants, would have a significant economic impact on any small entity.

C. Certification

For the foregoing reasons, the Commission certifies that the proposed rules and form under Regulation SB SEF would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission requests comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

XXXII. Statutory Authority and Text of Proposed Amendments

Pursuant to the Exchange Act, 15 U.S.C. 78a et seq., and particularly, Sections 3, 6, 15, 19, 23(a), 30(b), 30(c) and 36 (15 U.S.C. 78c, 78f, 78o, 78s, 78w(a), 78dd(b), 78dd(c) and 78mm), thereof, and Section 763 of the Dodd-Frank Act (15 U.S.C. 78c-4), the Commission is proposing to adopt § 240.15a-12, Regulation SB SEF and Form SB SEF under the Exchange Act and to amend § 240.3a1-1 under the Exchange Act.

List of Subjects in 17 CFR Parts 240, 242 and 249

Securities, brokers, reporting and recordkeeping requirements.

pension funds, and all other insurance related activities. See SBA’s Table of Small Business Size Standards, Subsector 524.

⁶⁷⁶ This includes pension funds, health and welfare funds, other insurance funds, open-end investment funds, trusts, estates, and agency accounts, real estate investment trusts and other financial vehicles. See SBA’s Table of Small Business Size Standards, Subsector 525.

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

1. The general authority citation for Part 240 is revised and the following citation is added 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, 78n-1, 78o, 78o-4, 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; 18 U.S.C. 1350 and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

§ 240.15a-12 also issued under 15 U.S.C. 78c-4.

* * * * *

2. § 240.3a1-1 is amended by adding paragraph (a)(4) and revising paragraph (b) introductory text to read as follows:

§ 240.3a1-1 Exemption from the definition of “Exchange” under Section 3(a)(1) of the Act.

(a) * * *

(4) Is a security-based swap execution facility, as that term is defined in section 3(a)(77) of the Act (15 U.S.C. 78c(a)(77)), that:

(i) Is in compliance with Regulation SB SEF (17 CFR 242.800 through 242.823); and

(ii) Does not serve as a marketplace for transactions in securities other than security-based swaps.

(b) Notwithstanding paragraph (a)(1), (2), or (3) of this section, an organization,

association, or group of persons shall not be exempt under this section from the definition of “exchange,” if:

* * * * *

3. Add § 240.15a-12 to read as follows:

§ 240.15a-12 Conditional exemption from the regulation of brokers registered as security-based swap execution facilities.

(a) A security-based swap execution facility (as that term is defined in section 3(a)(77) of the Act (15 U.S.C. 78c(a)(77))) may register as a broker under section 15(a)(1) and (b) of the Act (15 U.S.C. 78o(a)(1) and (b)) by registering as a security-based swap execution facility, if such security-based swap execution facility does not engage in any activity other than facilitating the trading of security-based swaps on or through the security-based swap execution facility in a manner consistent with Regulation SB SEF (17 CFR 242.800 through 242.823).

(b) Except for the provisions of the Act specified in paragraph (c) of this section, a broker registered under paragraph (a) of this section that does not engage in any activity other than facilitating the trading of security-based swaps on or through the security-based swap execution facility in a manner consistent with the Regulation SB SEF (17 CFR 242.800 through 242.823) shall be exempt from the requirements of the Act and the rules and regulations thereunder that, by their terms, require, prohibit, restrict, limit, condition, or affect activities of a broker unless those requirements of the Act or any rule, regulation, or order thereunder specifies that it applies to a security-based swap execution facility.

(c) The following provisions of the Act shall apply to a broker that is a security-based swap execution facility:

(1) Section 15(b)(4) of the Act (15 U.S.C. 78o(b)(4));

(2) Section 15(b)(6) of the Act (15 U.S.C. 78o(b)(6)); and

(3) Section 17(b) of the Act (15 U.S.C. 78q(b)).

(d) A broker registered under paragraph (a) of this section that does not engage in any activity other than facilitating the trading of security-based swaps on or through the security-based swap execution facility in a manner consistent with Regulation SB SEF (17 CFR 242.800 through 242.823) shall be exempt from the Securities Investor Protection Act.

PART 242— REGULATIONS M, SHO, ATS, AC, NMS, AND SB SEF AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

4. The authority citation for part 242 is amended by adding the following citations in numerical order to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

* * * * *

Sections 242.800 through 242.823 are also issued under sec. 943, Pub. L. No. 111-203, Section 763.

* * * * *

5. The heading for part 242 is revised to read as set forth above.

6. Add §§ 242.800 through 242.823 to read as follows:

* * * * *

242.800	Definitions
242.801	Application for registration as a security-based swap execution facility
242.802	Amendments to application

- 242.803 Supplemental material to be filed by security-based swap execution facilities
- 242.804 Withdrawal from or revocation of registration for security-based swap execution facilities
- 242.805 Voluntary submission of rules for Commission review and approval
- 242.806 Self-certification of rules
- 242.807 Trading security-based swaps pursuant to certification
- 242.808 Trading security-based swaps pursuant to Commission review and approval
- 242.809 Access to security-based swap execution facilities
- 242.810 Compliance with core principles
- 242.811 Compliance with rules
- 242.812 Security-based swaps not readily susceptible to manipulation
- 242.813 Monitoring of trading and trade processing
- 242.814 Ability to obtain information
- 242.815 Financial integrity of transactions
- 242.816 Emergency authority
- 242.817 Timely publication of trading information
- 242.818 Recordkeeping and reporting
- 242.819 Antitrust considerations
- 242.820 Conflicts of interest
- 242.821 Financial resources
- 242.822 System safeguards

242.823 Designation of Chief Compliance Officer of security-based swap
execution facility

* * * * *

§ 242.800 Definitions.

Terms used in this Regulation SB SEF (17 CFR 242.800 through 242.823) that appear in section 3 of the Act (15 U.S.C. 78c) have the same meaning as in section 3 of the Act (15 U.S.C. 78c) and the rules or regulations thereunder. In addition, the following definitions shall apply:

The term affiliate means any person that, directly or indirectly, controls, is controlled by, or is under common control with, the person.

The terms beneficial ownership, beneficially owns, or any derivative thereof have the same meaning, with respect to any security or other ownership interest, as set forth in § 240.13d-3 of this chapter, as if (and whether or not) such security or other ownership interest were a voting equity security registered under section 12 of the Act (15 U.S.C. 78l); provided that to the extent any person is a member of a group within the meaning of section 13(d)(3) under the Act (15 U.S.C. 78m(d)(3)) and § 240.13d-5(b) of this chapter, 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.

The term block trade has the same meaning as § 242.900 (published at 75 FR 75208, Dec. 2, 2010), provided however that until the Commission sets the criteria and formula for determining what constitutes a block trade under § 242.907(b), a security-based swap execution facility may set its own criteria and formula for determining what constitutes a block trade as long as such criteria and formula comply with the Core Principles relating to security-based swap execution facilities in section 3D of the Act (15 U.S.C. 78c-4) and the rules and regulations

thereunder.

The term Board means the Board of Directors or Board of Governors of the security-based swap execution facility or any equivalent body.

The term competent, objective personnel means a recognized information technology firm or a qualified internal department knowledgeable of information technology systems.

The term control, controlled by, or any derivative thereof, for purposes of §§ 242.800 through 823, 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. For purposes of §§ 242.800 through 823, 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.

The term director means any member of the Board.

The term EDGAR Filer Manual has the same meaning as set forth in § 232.11 of this chapter.

The term emergency has the same meaning as set forth in section 12(k)(7) of the Act (15 U.S.C. 781(k)(7)).

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.

The term independent director means:

(1) A director who has no material relationship with:

(i) The security-based swap execution facility or any affiliate of the security-based swap execution facility; or

(ii) A participant or any affiliate of a participant.

(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 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 any affiliate thereof;

(ii) (A) The director is a participant 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 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 any affiliate thereof or from a participant 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 any affiliate thereof or of a participant 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 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 any 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 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 any affiliate thereof, or was a partner or employee of the outside auditor of the security-based swap execution facility or any affiliate thereof who worked on the audit of the security-based swap execution facility 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 of the security-based swap execution facility, 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 any affiliate thereof or a participant 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.

The term material change means a change that a Chief Compliance Officer would reasonably need to know in order to oversee compliance of the security-based swap execution facility.

The term material compliance matter means any compliance matter that the Board would reasonably need to know to oversee the compliance of the security-based swap execution facility and includes, without limitation:

(1) A violation of the federal securities laws by the security-based swap execution facility, its officers, directors, employees, or agents;

(2) A violation of the policies and procedures of the security-based swap execution facility by the security-based swap execution facility, its officers, directors, employees, or agents; or

(3) A weakness in the design or implementation of the security-based swap execution facility's policies and procedures.

The term material systems change means a change to automated systems that:

(1) Significantly affects existing capacity or security;

(2) In itself, raises significant capacity or security issues, even if it does not affect other existing systems;

(3) Relies upon substantially new or different technology;

(4) Is designed to provide a new service or function; or

(5) Otherwise significantly affects the operations of the security-based swap execution facility.

The term material systems outage means an unauthorized intrusion into any system or an event at a security-based swap execution facility that causes a problem in systems or procedures that results in:

(1) A failure to maintain accurate, time-sequenced records of all orders, quotations, and transactions that are received by, or originated on, the security-based swap execution facility;

(2) A disruption of normal operations, including switchover to back-up equipment with no possibility of near-term recovery of primary hardware;

(3) A loss of use of any system;

(4) A loss of transactions;

(5) Excessive back-ups or delays in executing trades;

(6) A loss of ability to disseminate vital information;

(7) A communication of an outage situation to other external entities;

(8) A report or referral of an event to the Board or senior management of the security-based swap execution facility;

(9) A serious threat to systems operations even though systems operations were not disrupted;

(10) A queuing of data between system components or queuing of messages to or from participants of such duration that a participant's normal activity with the security-based swap execution facility is affected; or

(11) A failure to maintain the integrity of systems that results in the entry of erroneous or inaccurate inquiries, responses, orders, quotations, other trading interest, transactions, or other information in the security-based swap execution facility or the securities markets as a whole.

The term non-resident person means:

(1) In the case of an individual, one who resides in or has his principal place of business in any place not in the United States;

(2) In the case of a corporation, one incorporated in or having its principal place of business in any place not in the United States; and

(3) In the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not in the United States.

The term objective review means an internal or external review, performed by competent, objective personnel following established audit procedures and standards, and containing a risk assessment conducted pursuant to a review schedule.

The term participant when used with respect to a security-based swap execution facility means a person that is permitted to directly effect transactions on the security-based swap execution facility.

The term person associated with a participant means any partner, officer, director, or branch manager of such 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 participant, or any employee of such participant.

The term related person when used with respect to a participant means:

(1) Any affiliate of a participant;

(2) Any person associated with a participant;

(3) Any immediate family member of a participant, or any immediate family member of the spouse of such participant, who, in each case, has the same home as the person 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 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 participant or who is a director or officer of the security-based swap execution facility or any of its parents or subsidiaries.

The term review schedule means a schedule in which each element contained in § 242.822(a)(1) would be assessed at specific, regular intervals.

The term tagged means having an identifier that highlights specific information submitted to the Commission that is in the format required by the EDGAR Filer Manual, as described in Section 301 of Regulation S-T (17 CFR 232.301).

§ 242.801 Application for registration as a security-based swap execution facility.

(a) An application for registration as a security-based swap execution facility shall be filed electronically in a tagged data format with the Commission on Form SB SEF (referenced in § 249.1700 of this chapter), in accordance with the instructions contained therein. The application must include information sufficient to demonstrate compliance with the Act and rules and regulations thereunder. Form SB SEF consists of instructions, an Execution Page, and a list of Exhibits that the Commission requires in order to be able to determine whether an applicant is able to comply with the Act and rules and regulations thereunder. An application on Form SB SEF will not be considered to be complete unless the applicant has submitted, at a minimum, the Execution Page and Exhibits as required in Form SB SEF, and any other material that the Commission may require, upon request, in order to be able to determine whether an applicant is able to comply with the Act and rules and regulations thereunder. If the application is not complete, the Commission shall notify the applicant that the application will not be deemed to have been submitted for purposes of the Commission's review.

(b)(1) In connection with an application for registration furnished to the Commission under paragraph (a) of this section on or before July 31, 2014, within 360 days of the date of the filing of such application (or within such longer period as to which the applicant consents), the Commission shall:

(i) By order grant registration; or

(ii) Institute proceedings to determine whether registration should be denied. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing and shall be concluded within 450 days after the date on which the application for registration is furnished to the Commission under paragraph (a) of this section. At the conclusion of such proceedings, the Commission, by order, shall grant or deny such registration. The Commission may extend the time for conclusion of such proceedings for up to 90 days, if it finds good cause for such extension and publishes its reasons for so finding, or for such longer period as to which the applicant consents.

(2) In connection with an application for registration furnished to the Commission under paragraph (a) of this section after July 31, 2014, within 180 days of the date of the filing of such application (or within such longer period as to which the applicant consents), the Commission shall:

(i) By order grant registration; or

(ii) Institute proceedings to determine whether registration should be denied. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing and shall be concluded within 270 days after the date on which the application for registration is furnished to the Commission under paragraph (a) of this section. At the conclusion of such proceedings, the Commission, by order, shall grant or deny such registration.

The Commission may extend the time for conclusion of such proceedings for up to 90 days, if it finds good cause for such extension and publishes its reasons for so finding, or for such longer period as to which the applicant consents.

(3) The Commission shall grant the registration of a security-based swap execution facility if the Commission finds that the requirements of the Act and the rules and regulations thereunder with respect to the applicant are satisfied. The Commission shall deny the registration of a security-based swap execution facility if it does not make such finding.

(c) For any application for registration as a security-based swap execution facility filed pursuant to paragraph (a) of this section on Form SB SEF (referenced in § 249.1700 of this chapter) on or before July 31, 2014, for which the applicant indicates that it would like to be considered for temporary registration pursuant to this paragraph (c), the Commission may grant temporary registration of the security-based swap execution facility that shall expire on the earlier of:

(1) The date that the Commission grants or denies registration of the security-based swap execution facility; or

(2) The date that the Commission rescinds the temporary registration of the security-based swap execution facility.

(d) A security-based swap execution facility shall designate and authorize on Form SB SEF (referenced in § 249.1700 of this chapter) an agent in the United States, other than a Commission member, official, or employee, who shall accept any notice or service of process, pleadings, or other documents in any suit, action or proceedings brought against the security-based swap execution facility to enforce the federal securities laws or the rules or regulations thereunder.

(e) Any person applying for registration pursuant to paragraph (a) of this section that is controlled by any other person shall certify on its Form SB SEF (referenced in § 249.1700 of this chapter) and provide an opinion of counsel that any such person that controls such security-based swap execution facility will consent to and can, as a matter of law:

(1) Provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the security-based swap execution facility; and

(2) Submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the security-based swap execution facility.

(f) Any non-resident person applying for registration pursuant to paragraph (a) of this section shall certify on its Form SB SEF (referenced in § 249.1700 of this chapter) and provide an opinion of counsel that the security-based swap execution facility can, as a matter of law:

(1) Provide the Commission with prompt access to the books and records of such security-based swap execution facility; and

(2) Submit to onsite inspection and examination by representatives of the Commission.

(g) An application for registration or any amendment thereto that is filed pursuant to Regulation SB SEF (referenced in § 249.1700 of this chapter) shall be considered a “report” filed with the Commission for purposes of sections 18(a) and 32(a) of the Act (15 U.S.C. 78r(a) and 78ff(a)) and the rules and regulations thereunder.

§ 242.802 Amendments to application.

(a) After the discovery that any information filed on Form SB SEF (referenced in § 249.1700 of this chapter), any statement therein, or any Exhibit or amendment thereto, was inaccurate when filed, the security-based swap execution facility shall file with the Commission

an amendment correcting such inaccuracy promptly, but in no event later than 5 business days after such discovery.

(b)(1) The security-based swap execution facility shall file electronically with the Commission an amendment to Form SB SEF (referenced in § 249.1700 of this chapter), on Form SB SEF, within 5 business days after any action is taken that renders inaccurate, or that causes to be incomplete, any of the following:

(i) Information filed on the Execution Page of Form SB SEF (referenced in § 249.1700 of this chapter), or amendment thereto; or

(ii) Information filed as part of Exhibits C, E, G or N, or any amendments thereto.

(2) An amendment required under this paragraph (b) shall set forth the nature and effective date of the action taken and shall provide any new information and correct any information rendered inaccurate.

(c) Any security-based swap execution facility that is controlled by any other person shall file electronically with the Commission an amendment to Exhibit P to Form SB SEF (referenced in § 249.1700 of this chapter) on Form SB SEF, within 5 business days after any changes in the legal or regulatory framework of any person that controls the security-based swap execution facility that would impact the ability of or the manner in which any such person consents to or provides the Commission prompt access to its books and records, to the extent such books and records are related to the activities of the security-based swap execution facility, or impacts the Commission's ability to inspect and examine any such person with respect to the activities of the security-based swap execution facility. The amendment shall include a revised opinion of counsel pursuant to Exhibit P describing how, as a matter of law, any person that controls the security-based swap execution facility will continue to meet its obligations to consent to and

provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the security-based swap execution facility, and to consent to and be subject to onsite inspection and examination by representatives of the Commission with respect to the activities of the security-based swap execution facility under such new legal or regulatory framework.

(d) A non-resident security-based swap execution facility shall file electronically with the Commission an amendment to Exhibit P to Form SB SEF, on Form SB SEF (referenced in § 249.1700 of this chapter), within 5 business days after any changes in legal or regulatory framework that would impact the security-based swap execution facility's ability to or the manner in which it provides the Commission prompt access to its books and records or impacts the Commission's ability to inspect and examine the security-based swap execution facility. The amendment shall include a revised opinion of counsel pursuant to Exhibit P describing how, as a matter of law, the entity will continue to meet its obligations to provide the Commission with prompt access to its books and records and to be subject to onsite inspection and examination by representatives of the Commission under such new legal or regulatory framework.

(e) Whenever the number of changes to be reported in an amendment, or the number of amendments filed, are so great that the purpose of clarity will be promoted by the filing of a complete new statement and exhibits, a security-based swap execution facility may, at its election, or shall, upon request of any representative of the Commission, file as an amendment a complete new statement together with all exhibits which are prescribed to be filed in connection with Form SB SEF (referenced in § 249.1700 of this chapter).

(f) Within 60 days of the end of its fiscal year, a security-based swap execution facility shall file an amendment to its Form SB SEF (referenced in § 249.1700 of this chapter), which

shall update the Form SB SEF in its entirety. Each exhibit to the amended Form SB SEF shall be up to date as of the end of the latest fiscal year of the security-based swap execution facility.

§ 242.803 Supplemental material to be filed by security-based swap execution facilities.

(a) A registered security-based swap execution facility, or a security-based swap execution facility exempted from such registration pursuant to section 3D(e) of the Act (15 U.S.C. 78c-4(e)), shall file electronically with the Commission any material relating to the trading of security-based swaps (including notices, circulars, bulletins, lists, and periodicals) issued or made generally available to participants. Such material shall be filed with the Commission upon issuing or making such material available to the participants.

(b) If the information required to be filed under paragraph (a) of this section is available continuously on an Internet website controlled by a security-based swap execution facility, in lieu of filing such information with the Commission, such security-based swap execution facility may:

- (1) Indicate the location of the Internet website where such information may be found;
- and
- (2) Certify that the information available at such location is accurate as of its date.

§ 242.804 Withdrawal from or revocation of registration for security-based swap execution facilities.

(a) A registered security-based swap execution facility may withdraw from registration by filing a written notice of withdrawal with the Commission. The security-based swap execution facility shall designate on its notice of withdrawal a person associated with the security-based swap execution facility to serve as the custodian of the security-based swap execution facility's books and records. Prior to filing a notice of withdrawal, a security-based

swap execution facility shall file an amended Form SB SEF (referenced in § 249.1700 of this chapter) to update any inaccurate information.

(b) A notice of withdrawal from registration filed by a security-based swap execution facility shall become effective for all matters (except as provided in this paragraph (b)) on the 60th day after the filing thereof with the Commission, within such longer period of time as to which such security-based swap execution facility consents or the Commission, by order, may determine as necessary or appropriate in the public interest or for the protection of investors, or within such shorter period of time as the Commission may determine.

(c) A notice of withdrawal that is filed pursuant to this rule shall be considered a "report" filed with the Commission for purposes of sections 18(a) and 32(a) of the Act (15 U.S.C. 78r(a) and 78ff(a)), and the rules and regulations thereunder.

(d) If the Commission finds, on the record after notice and opportunity for hearing, that any registered security-based swap execution facility has obtained its registration by making any false or misleading statements with respect to any material fact or has violated or failed to comply with any provision of the federal securities laws and the rules and regulations thereunder, the Commission, by order, may revoke the registration. Pending final determination of whether any registration shall be revoked, the Commission, by order, may suspend such registration, if such suspension appears to the Commission, after notice and opportunity for hearing, to be necessary or appropriate in the public interest or for the protection of investors.

(e) If the Commission finds that a registered security-based swap execution facility is no longer in existence or has ceased to do business in the capacity specified in its application for registration, the Commission, by order, may cancel the registration.

§ 242.805 Voluntary submission of rules for Commission review and approval.

(a) Request for approval of rules. A registered security-based swap execution facility may request that the Commission approve a new rule or rule amendment prior to implementation of the new rule or rule amendment or, if the request was initially submitted under § 242.806 or 242.807, subsequent to implementation of the new rule or rule amendment. A request for approval shall:

(1) Be filed electronically with the Commission in a format specified by the Commission;

(2) Set forth the text of the new rule or rule amendment (in the case of a rule amendment, deletions and additions must be indicated);

(3) Describe the proposed effective date of the new rule or rule amendment and any action taken or anticipated to be taken to adopt the proposed rule by the registered security-based swap execution facility or by its Board, or by any committee thereof, and cite the rules of the registered security-based swap execution facility that authorize the adoption of the proposed rule change;

(4) Explain the operation, purpose, and effect of the new rule or rule amendment, including, as applicable, a description of the anticipated benefits to market participants or others, any potential anticompetitive effects on market participants or others, and how the rule fits into the registered security-based swap execution facility's framework of regulation;

(5) Certify that the registered security-based swap execution facility has published on its website a notice of pending new rule or rule amendment with the Commission and a copy of the submission, concurrent with the filing of the submission with the Commission;

(6) Include the documentation relied on to establish the basis for compliance with the applicable provisions of the Act and Commission rules and regulations thereunder, including section 3D(d) of the Act (15 U.S.C. 78c-4(d)) and the rules and regulations thereunder;

(7) Provide additional information that may be beneficial to the Commission in analyzing the new rule or rule amendment. If a proposed rule affects, directly or indirectly, the application of any other rule of the registered security-based swap execution facility, the pertinent text of any such rule must be set forth and the anticipated effect described;

(8) Describe briefly any substantive opposing views expressed to the registered security-based swap execution facility by the Board or committee members, participants, or market participants with respect to the new rule or rule amendment that were not incorporated into the new rule or rule amendment;

(9) Identify any Commission rule or regulation that the Commission may need to amend, or sections of the Act or the rules or regulations thereunder that the Commission may need to interpret, in order to approve the new rule or rule amendment. To the extent that such an amendment or interpretation is necessary to accommodate a new rule or rule amendment, the submission should include a reasoned analysis supporting the proposed amendment or interpretation;

(10) In the case of proposed amendments to the terms and conditions of a security-based swap, include a written statement verifying that the registered security-based swap execution facility has undertaken a due diligence review of the legal conditions, including conditions relating to contractual and intellectual property rights, that may materially affect the trading of the security-based swap; and

(11) A request for confidential treatment, if appropriate, as permitted pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules and regulations thereunder, 17 CFR 200.83.

(b) Standard for review and approval. The Commission shall approve a new rule or rule amendment unless the new rule or rule amendment is inconsistent with the Act or Commission rules or regulations.

(c) Forty-five day review.

(1) All rules submitted for Commission approval under paragraph (a) of this section shall be deemed approved by the Commission 45 days after receipt by the Commission, or at the conclusion of such extended period as provided under paragraph (d) of this section, unless the registered security-based swap execution facility is notified otherwise within the applicable period, if:

(i) The submission complies with the requirements of paragraph (a) of this section; and

(ii) The registered security-based swap execution facility does not amend the new rule or rule amendment or supplement the submission, except as requested by the Commission, during the pendency of the review period. Any amendment or supplementation not requested by the Commission will be treated as the submission of a new filing under this section.

(d) Extension of time for review. The Commission may further extend the review period in paragraph (c) of this section for any approval request for:

(1) An additional 45 days, if the new rule or rule amendment raises novel or complex issues that require additional time for review, is of major economic significance, the submission is incomplete, or the requestor does not respond completely to the Commission's questions in a timely manner, in which case, the Commission shall notify the submitting registered security-based swap execution facility within the initial 45-day review period and shall briefly describe the nature of the specific issues for which additional time for review shall be required; or

(2) Any period, beyond the additional 45 days provided in paragraph (d)(1) of this section, to which the registered security-based swap execution facility agrees in writing.

(e) Notice of non-approval. Any time during its review under this section, the Commission may notify the registered security-based swap execution facility that it will not, or is unable to, approve the new rule or rule amendment. This notification will briefly specify the nature of the issues raised and the specific provision of the Act or Commission rules or regulations, including the form or content requirements of this section, with which the new rule or rule amendment is inconsistent or appears to be inconsistent with the Commission rules or regulations.

(f) Effect of non-approval. (1) Notification to a registered security-based swap execution facility under paragraph (e) of this section shall not prevent the registered security-based swap execution facility from subsequently submitting a revised version of the new rule or rule amendment for the Commission's review and approval or from submitting the new rule or rule amendment as initially proposed in a supplemented submission. The revised submission will be reviewed without prejudice.

(2) Notification to a registered security-based swap execution facility under paragraph (e) of this section of the Commission's determination not to approve the new rule or rule amendment of the registered security-based swap execution facility shall be presumptive evidence that the registered security-based swap execution facility may not truthfully certify the same, or substantially the same, proposed rule or rule amendment under § 242.806.

(g) Expedited approval.

Notwithstanding the provisions of paragraph (c) of this section, a new rule or rule amendment, including proposed changes to the terms and conditions of a security-based swap,

that is consistent with the Act and Commission rules and regulations and with standards approved or established by the Commission may be approved by the Commission at such time and under such conditions as the Commission shall specify in the written notification; provided, however, that the Commission may, at any time, alter or revoke the applicability of such a notice to any particular product or rule amendment.

§ 242.806 Self-certification of rules.

(a) Required certification. A registered security-based swap execution facility shall comply with the following conditions prior to implementing any rule that has not obtained Commission approval under § 242.805:

(1) The registered security-based swap execution facility has filed its submission electronically in a format specified by the Commission.

(2) The registered security-based swap execution facility has provided to the Commission a certification that it published on its website a notice of pending certification with the Commission and a copy of the submission, concurrent with the filing of a submission with the Commission. Information that the registered security-based swap execution facility seeks to keep confidential may be redacted from the documents published on its website but must be republished consistent with any determination made pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules and regulations thereunder, 17 CFR 200.83.

(3) The Commission has received the submission not later than the opening of business on the business day that is 10 business days prior to the registered security-based swap execution facility's proposed implementation of the rule or rule amendment; provided, however, that if a security-based swap execution facility implements any rule or rule amendment in the exercise of

its emergency authority pursuant to § 242.816, it shall file such rule or rule amendment with the Commission pursuant to this paragraph (a) prior to the implementation of such rule or rule amendment, or, if not practicable, within 24 hours after implementation of such emergency rule or rule amendment.

(4) The Commission has not stayed the submission pursuant to paragraph (c) of this section.

(5) The rule submission includes:

(i) The text of the rule (in the case of a rule amendment, deletions, and additions must be indicated);

(ii) The date of intended implementation;

(iii) A certification by the registered security-based swap execution facility that the rule complies with the Act and Commission rules and regulations thereunder;

(iv) The documentation relied on to establish the basis for compliance with the applicable provisions of the Act and Commission rules and regulations thereunder, including section 3D(d) of the Act (15 U.S.C. 78c-4(d)) and the rules and regulations thereunder;

(v) A brief explanation of any substantive opposing views expressed to the registered security-based swap execution facility by the Board or committee members, participants, or market participants that were not incorporated into the rule, or a statement that no such opposing views were expressed;

(vi) A request for confidential treatment, if appropriate, as permitted pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules and regulations thereunder, 17 CFR 200.83; and

(vii) For amendments to the terms and conditions of a security-based swap, a written statement verifying that the registered security-based swap execution facility has undertaken a due diligence review of the legal conditions, including conditions relating to contractual and intellectual property rights, that may materially affect the trading of the product.

(6) The registered security-based swap execution facility has provided, upon request of any representative of the Commission, additional evidence, information, or data that may be beneficial to the Commission in conducting a due diligence assessment of the filing and the registered security-based swap execution facility's compliance with any of the requirements of the Act or Commission rules or regulations thereunder.

(b) Review by the Commission. The Commission shall have 10 business days to review the new rule or rule amendment before the new rule or rule amendment is deemed certified and can be made effective, unless the Commission notifies the registered security-based swap execution facility during the 10-business day review period that it intends to issue a stay of the certification under paragraph (c) of this section.

(c) Stay. (1) Stay of certification of new rule or rule amendment. The Commission may stay the certification of a new rule or rule amendment submitted pursuant to paragraph (a) of this section by issuing a notification informing the registered security-based swap execution facility that the Commission is staying the certification of the new rule or rule amendment on the grounds that the new rule or rule amendment presents novel or complex issues that require additional time to analyze, the new rule or rule amendment is accompanied by an inadequate explanation, or the new rule or rule amendment is potentially inconsistent with the Act or Commission rules or regulations thereunder. The Commission will have 90 days from the date of the notification to conduct a review.

(2) Public comment. The Commission shall provide a 30-day comment period within the 90-day review period while the stay is in effect as described in paragraph (c)(1) of this section. The Commission shall publish a notice of the 30-day comment period on the Commission's website. Comments from the public shall be submitted as specified in that notice.

(3) Expiration of a stay of certification of new rule or rule amendment. A new rule or rule amendment subject to a stay pursuant to paragraph (c) of this section shall become effective, pursuant to the certification, at the expiration of the 90-day review period described in paragraph (c)(1) of this section unless the Commission withdraws the stay prior to that time or the Commission notifies the registered security-based swap execution facility during the 90-day review period that it objects to the certification on the grounds that the new rule or rule amendment is inconsistent with the Act or Commission rules or regulations thereunder.

(d) Notwithstanding paragraph (a) of this section, a registered security-based swap execution facility may place the following new rules or rule amendments into effect on the following business day without certification to the Commission if the following conditions are met:

(1) The rule is limited to corrections of typographical errors, renumbering, periodic routine updates to identifying information about approved entities, and other such non-substantive revisions of the terms and conditions of a security-based swap that have no effect on the economic characteristics of the security-based swap; and

(2) The registered security-based swap execution facility provides to the Commission at least weekly a summary notice of all rule amendments made effective pursuant to this paragraph during the preceding week. Such notice must be labeled "Weekly Notification of Rule Amendments" and need not be filed for weeks during which no such actions have been taken.

One copy of each such submission shall be furnished electronically in a format specified by the Commission.

(e) Notwithstanding paragraph (a) of this section, a registered security-based swap execution facility may place the following new rules or rule amendments into effect without certification or notice to the Commission if the following conditions are met:

(1) The rule governs:

(i) Administrative procedures. The organization and administrative procedures of a security-based swap execution facility's governing bodies, such as the Board, officers, and committees, but not any of the following: voting requirements, Board or committee composition requirements or procedures, decision making procedures, use or disclosure of material non-public information gained through the performance of official duties, or requirements relating to conflicts of interest; or

(ii) Administration. The routine, daily administration, direction and control of employees, requirements relating to gratuity and similar funds, but not any of the following: guaranty, reserves, or similar funds; declaration of holidays; and changes to facilities housing the market; and

(2) The registered security-based swap execution facility maintains documentation regarding all changes to rules and posts all such rule changes on its website.

§ 242.807 Trading security-based swaps pursuant to certification.

(a) A registered security-based swap execution facility shall comply with the submission requirements of this section prior to trading a security-based swap that has not been approved under § 242.808. A submission shall comply with the following conditions:

(1) The registered security-based swap execution facility has filed its submission electronically in a format specified by the Commission;

(2) The Commission has received the submission by the opening of business on the business day preceding the day on which the security-based swap would begin trading;

(3) The Commission has not stayed the submission pursuant to paragraph (c) of this section; and

(4) The submission includes:

(i) A copy of the terms and conditions of the security-based swap;

(ii) The intended date on which the security-based swap may begin trading;

(iii) A certification by the registered security-based swap execution facility that the security-based swap to be traded complies with the Act and Commission rules and regulations thereunder;

(iv) The documentation relied on to establish the basis for compliance with the Act and the rules and regulations thereunder, including section 3D(d) of the Act (15 U.S.C. 78c-4(d)) and the rules and regulations thereunder;

(v) A written statement verifying that the registered security-based swap execution facility has undertaken a due diligence review of the legal conditions, including legal conditions that relate to contractual and intellectual property rights, that may materially affect the trading of the security-based swap;

(vi) A certification that the registered security-based swap execution facility published on its website a notice of pending certification with the Commission and a copy of the submission, concurrent with the filing of the submission with the Commission. Information that the registered security-based swap execution facility seeks to keep confidential may be redacted

from the documents published on its website, but must be republished consistent with any determination made pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules and regulations thereunder, 17 CFR 200.83; and

(vii) A request for confidential treatment, if appropriate, as permitted pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules and regulations thereunder, 17 CFR 200.83.

(b) A registered security-based swap execution facility, upon request of any representative of the Commission, shall provide any additional evidence, information, or data that demonstrates that the security-based swap meets, initially or on a continuing basis, all of the requirements of the Act and Commission rules and regulations thereunder.

(c) Stay. (1) The Commission may stay the certification of a security-based swap pursuant to paragraph (a) of this section by issuing a notification informing the registered security-based swap execution facility that the Commission is staying the certification on the grounds that the security-based swap proposed to begin trading presents novel or complex issues that require additional time to analyze, the certification is accompanied by an inadequate explanation or the proposed security-based swap is potentially inconsistent with the Act or Commission rules or regulations thereunder. The Commission will have 90 days from the date of the notification to conduct the review.

(2) Public comment. The Commission shall provide a 30-day comment period, within the 90-day review period while the stay is in effect as described in paragraph (c)(1) of this section. The Commission shall publish a notice of the 30-day comment period on the Commission's website. Comments from the public shall be submitted as specified in that notice.

(3) Expiration of a stay. A proposed security-based swap subject to a stay pursuant to paragraph (c) of this section shall become effective, pursuant to the certification, at the expiration of the 90-day review period described in paragraph (c)(1) of this section unless the Commission withdraws the stay prior to that time or the Commission notifies the registered security-based swap execution facility during the 90-day review period that it objects to the proposed certification on the grounds that it is inconsistent with the Act or Commission rules or regulations thereunder.

§ 242.808 Trading security-based swaps pursuant to Commission review and approval.

(a) A registered security-based swap execution facility may request that the Commission approve a security-based swap prior to trading such security-based swap or, if a security-based swap was initially submitted under § 242.807, subsequent to the commencement of trading such security-based swap. A submission requesting approval shall be filed electronically with the Commission in a format specified by the Commission and include:

- (1) A copy of the terms and conditions of the security-based swap;
- (2) The documentation relied on to establish the basis for compliance with the Act and rules and regulations thereunder, including section 3D(d) of the Act (15 U.S.C. 78c-4(d)) and the rules and regulations thereunder;
- (3) A written statement verifying that the registered security-based swap execution facility has undertaken a due diligence review of the legal conditions, including legal conditions that relate to contractual and intellectual property rights, that may materially affect the trading of the security-based swap;

(4) A request for confidential treatment, if appropriate, as permitted pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules and regulations thereunder, 17 CFR 200.83;

(5) A certification that the registered security-based swap execution facility has published on its website a notice of pending request for approval with the Commission and a copy of the submission, concurrent with the filing of a submission with the Commission. Information that the registered security-based swap execution facility seeks to keep confidential may be redacted from the documents published on its website, but must be republished consistent with any determination made pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission rules or regulations thereunder, 17 CFR 200.83; and

(b) A registered security-based swap execution facility, upon request of any representative of the Commission, shall provide additional evidence, information, or data that demonstrates that the security-based swap meets, initially or on a continuing basis, all of the requirements of the Act and Commission rules or regulations thereunder.

(c) Standard for review and approval. The Commission shall approve a security-based swap unless the terms and conditions of such security-based swap are inconsistent with the Act or Commission rules or regulations thereunder.

(d) Forty-five day review. All security-based swaps submitted for Commission approval under this section shall be deemed approved by the Commission 45 days after receipt by the Commission or at the conclusion of an extended period as provided under paragraph (e) of this section, unless the registered security-based swap execution facility is notified otherwise within the applicable period, if:

(1) The submission complies with the requirements of paragraph (a) of this section; and

(2) The registered security-based swap execution facility making the submission does not amend the terms and conditions of the security-based swap or supplement its request for approval during that period, except as requested by the Commission to correct typographical errors, renumber, or make other non-substantive revisions, during that period. Any voluntary, substantive amendment by the registered security-based swap execution facility shall be treated as a new submission under this section.

(e) Extension of time. The Commission may extend the 45-day review period in paragraph (d) of this section for:

(1) An additional 45 days, if the proposed security-based swap raises novel or complex issues that require additional time for review, in which case the Commission shall notify the registered security-based swap execution facility within the initial 45-day review period and shall briefly describe the nature of the specific issues for which additional time for review is required; or

(2) Any extended review period to which the registered security-based swap execution facility agrees in writing.

(f) Notice of non-approval. The Commission at any time during its review under this section may notify the registered security-based swap execution facility that it will not, or is unable to, approve the security-based swap. This notification will briefly specify the nature of the issues raised and the specific provision of the Act or Commission rules or regulations thereunder, including the form or content requirements of paragraph (a) of this section, with which the security-based swap is inconsistent, appears to be inconsistent, or is potentially inconsistent.

(g) Effect of non-approval. (1) Notification to a registered security-based swap execution facility under paragraph (f) of this section of the Commission's determination not to approve a security-based swap shall not prejudice the registered security-based swap execution facility from subsequently submitting a revised version of the security-based swap for Commission approval or from submitting the security-based swap as initially proposed pursuant to a supplemented submission.

(2) Notification to a registered security-based swap execution facility under paragraph (f) of this section of the Commission's inability to approve the security-based swap shall be presumptive evidence that the registered security-based swap execution facility may not truthfully certify under § 242.807 that the same, or substantially the same, security-based swap complies with the Act or Commission rules and regulations thereunder.

§ 242.809 Access to security-based swap execution facilities.

(a) A security-based swap execution facility shall permit a person to become a participant in the security-based swap execution facility only if such person is registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker (as defined in section 3(a)(4) of the Act, 15 U.S.C. 78c(a)(4)), or if such person is an eligible contract participant (as defined in section 3(a)(65) of the Act, 15 U.S.C. 78c(a)(65)).

(b) A security-based swap execution facility shall permit all eligible persons that meet the requirements for becoming a participant in the security-based swap execution facility under paragraph (a) of this section and the security-based swap execution facility's rules to become participants of the security-based swap execution facility, consistent with the requirements for providing impartial access in section 3D(d)(6) of the Act (15 U.S.C. 78c-4(d)(6)) and § 242.811(b); provided, however, that a security-based swap execution facility may choose to not

permit any eligible contract participants that are not registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker (as defined in section 3(a)(4) of the Act, 15 U.S.C. 78c(a)(4)) to become participants in the security-based swap execution facility.

(c) A security-based swap execution facility shall establish rules setting forth requirements for an eligible person to become a participant in the security-based swap execution facility consistent with the security-based swap execution facility's obligations under the Act and the rules and regulations thereunder. Such rules must require a participant, at a minimum, to:

(1) Be a member of, or have an arrangement with a member of, a registered clearing agency to clear trades in the security-based swaps that are subject to mandatory clearing pursuant to section 3C(a)(1) of the Act (15 U.S.C. 78c-3(a)(1)) and entered into by the participant on the security-based swap execution facility;

(2)(i) Meet the minimum financial responsibility and recordkeeping and reporting requirements imposed by the Commission by virtue of its registration as a security-based swap dealer, major security-based swap participant, or broker; or

(ii) In the case of an eligible contract participant that is not registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker, meet the recordkeeping and reporting requirements that the security-based swap execution facility shall establish pursuant to § 242.813;

(3) Agree to comply with the rules, policies, and procedures of the security-based swap execution facility; and

(4) Consent to the disciplinary procedures of the security-based execution facility for violations of the security-based swap execution facility's rules.

(d)(1) A security-based swap execution facility that permits an eligible contract participant that is not registered as a security-based swap dealer, major security-based swap participant or broker to become a participant in the security-based swap execution facility pursuant to this section shall establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.

(2) The risk management controls and supervisory procedures for granting access to eligible contract participants that are not registered as a security-based swap dealer, major security-based swap participant, or broker as participants of the security-based swap execution facility shall be reasonably designed to ensure compliance with all regulatory requirements.

§ 242.810 Compliance with core principles.

(a) To be registered, and maintain registration, as a security-based swap execution facility, a security-based swap execution facility shall comply with:

(1) The Core Principles described in section 3D of the Act (15 U.S.C. 78c-4) and the rules and regulations thereunder; and

(2) The requirements of this rule and any other requirement that the Commission may impose by rule or regulation.

(b) A security-based swap execution facility shall establish:

(1) Rules that provide for the equitable allocation of reasonable dues, fees, and other charges among its participants and any other users of its system;

(2) Rules and systems that are not designed to permit unfair discrimination among its participants and any other persons using its system;

(3) Rules that promote just and equitable principles of trade; and

(4) Rules to provide, in general, a fair procedure for disciplining participants for violations of the rules of the security-based swap execution facility.

(c) A security-based swap execution facility shall not use for non-regulatory purposes any confidential information it collects or receives, from or on behalf of any person, in connection with the security-based swap execution facility's regulatory obligations.

§ 242.811 Compliance with rules.

(a) A security-based swap execution facility shall:

(1) Establish and enforce compliance with any rule established by such security-based swap execution facility, including:

(i) The terms and conditions of the security-based swaps traded or processed on or through the security-based swap execution facility; and

(ii) Any limitation on access to the security-based swap execution facility;

(2) Establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means:

(i) To provide market participants with impartial access to the market; and

(ii) To capture information that may be used in establishing whether rule violations have occurred; and

(3) Establish rules governing the operation of the security-based swap execution facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the security-based swap execution facility, including block trades.

(b) A security-based swap execution facility shall:

(1) Establish fair, objective, and not unreasonably discriminatory standards for granting impartial access to trading on the security-based swap execution facility, which standards shall

include a requirement that each participant of the security-based swap execution facility submit to the oversight (including the disciplinary procedures of paragraph (g) of this section) of the security-based swap execution facility, with respect to the participant's trading on the facility, as a condition of becoming a participant in such security-based swap execution facility;

(2) Not unreasonably prohibit or limit any person in respect to access to the services offered by such security-based swap execution facility by applying the standards established under paragraph (b)(1) of this section in an unfair or unreasonably discriminatory manner;

(3) Make and keep records of:

(i) All grants of access, including, for all participants, the basis for granting such access;

and

(ii) All denials or limitations of access for each applicant or participant (as applicable), and the reasons for denying or limiting access;

(4) Report the information required regarding grants, denials, and limitations of access on Form SB SEF (referenced in § 249.1700 of this chapter) and in the annual compliance report of the Chief Compliance Officer pursuant to § 242.823(c); and

(5) Establish a fair process for the review of any prohibition or limitation on access with respect to a participant or any refusal to grant access with respect to an applicant.

(c) A security-based swap execution facility shall establish and enforce compliance with rules concerning the terms and conditions of the security-based swaps traded on the security-based swap execution facility.

(1) A security-based swap execution facility shall establish a swap review committee to determine:

(i) The security-based swaps that shall trade on the security-based swap execution

facility; and

(ii) The security-based swaps that shall no longer trade on the security-based swap execution facility.

(2) The composition of the swap review committee shall provide for the fair representation of participants of the security-based swap execution facility and other market participants, such that each class of participant and other market participants shall be given the right to participate in such swap review committee and that no single class of participant or category of market participant shall predominate. The rules of the security-based swap execution facility shall stipulate the method by which such representation shall be chosen by the Board.

(3) The security-based swap execution facility shall establish criteria that the swap review committee shall consider in determining which security-based swaps shall trade on the security-based swap execution facility.

(4) The swap review committee shall periodically review, on at least a quarterly basis, each security-based swap trading on the security-based swap execution facility to determine whether the trading characteristics of each security-based swap justify a change to the trading platform for each such security-based swap. In addition to the factors set forth in paragraph (c)(3) of this section in making such a determination, the swap review committee shall consider whether:

(i) The liquidity in each security-based swap is at an appropriate level for the security-based swap's trading platform on which it trades; and

(ii) Such security-based swap would be more suited for trading on a different type of platform, including a platform that provides for increased price transparency for participants entering orders, requests for quotations, responses, quotations, or other trading interest. The first

review shall not be earlier than 120 days after the initiation of trading for a given security-based swap.

(5) The swap review committee shall report decisions on each security-based swap promptly to the Chief Compliance Officer and annually to the regulatory oversight committee.

(d) A security-based swap execution facility shall establish and enforce rules governing the procedures for trading on the security-based swap execution facility, including, but not limited to, rules concerning:

(1) Doing business on the security-based swap execution facility;

(2) The types of orders, requests for quotations, responses, quotations, or other trading interest that will be available on the security-based swap execution facility;

(3) The manner in which trading interest, including orders, requests for quotations, responses, or quotations will be handled on the security-based swap execution facility. The rules of a security-based swap execution facility shall provide for fair treatment of all trading interest;

(4) The manner in which price transparency for participants entering orders, requests for quotations, responses, quotations, or other trading interest into the system will be promoted;

(5) The manner in which trading interest, including orders, requests for quotations, responses, quotations, and transaction data will be disseminated, whether to participants of the security-based swap execution facility or otherwise, and whether for a fee or otherwise;

(6) Prohibited trading practices;

(7) The prevention of the entry of orders, requests for quotations, responses, quotations, or other trading interest that may result in a trade that is clearly erroneous with respect to the terms of the trade; the fair and non-discriminatory manner of handling any trade that is clearly erroneous; and the resolution of any disputes concerning a clearly erroneous trade;

(8) Trading halts in any security-based swap, which rules shall include procedures for halting trading in a security-based swap when trading has been halted or suspended in the underlying security or securities pursuant to the rules or an order of a regulatory authority with authority over the underlying security or securities;

(9) The manner in which block trades will be handled, if different from the handling of non-block trades; and

(10) Any other rules concerning trading on the security-based swap execution facility.

(e) A security-based swap execution facility that operates a request-for-quote platform shall create and disseminate through the security-based swap execution facility a composite indicative quote for security-based swaps traded on or through such system, which shall be made available to all participants. The composite indicative quote shall include both composite indicative bids and composite indicative offers.

(f) A security-based swap execution facility shall establish and enforce rules concerning:

(1) The reporting of trades executed on the security-based swap execution facility to a clearing agency, if the transaction is subject to clearing; and

(2) The procedures for the processing of transactions in security-based swaps that occur on or through the security-based swap execution facility, including, but not limited to, procedures to resolve any disputes concerning the execution of a trade.

(g) A security-based swap execution facility shall establish rules and procedures concerning the disciplining of participants, including, but not limited to, rules:

(1) Authorizing its staff to recommend and take disciplinary action for violations of the rules of the security-based swap execution facility;

(2) Specifying the sanctions that may be imposed upon participants for violations of the

rules of the security-based swap execution facility such that each sanction is commensurate with the corresponding violation; and

(3) Establishing fair and non-arbitrary procedures for any disciplinary process and appeal thereof.

(h) A security-based swap execution facility shall:

(1) Make and keep records of all disciplinary proceedings, sanctions imposed, and appeals thereof; and

(2) Disclose all disciplinary actions taken annually on an amendment to Form SB SEF and in the security-based swap execution facility's annual compliance report of the Chief Compliance Officer required pursuant to § 242.823(c). Such report shall include information summarizing any disciplinary action taken and the reasons for such action.

(i) A security-based swap execution facility shall establish rules and procedures to assure that information to be used to determine whether rule violations have occurred is captured and retained in a timely manner.

(j) A security-based swap execution facility shall:

(1) Have the capacity to capture information that may be used in establishing whether rule violations have occurred, including through the use of automated surveillance systems as set forth in § 242.813(b);

(2) Maintain appropriate resources to fulfill its obligations under this section; and

(3) Investigate possible rule violations.

§ 242.812 Security-based swaps not readily susceptible to manipulation.

(a) A security-based swap execution facility shall permit trading only in security-based swaps that are not readily susceptible to manipulation.

(b) Prior to permitting the trading of any security-based swap, a security-based swap execution facility's swap review committee shall have determined, after taking into account all of the terms and conditions of the security-based swap and the markets for the security-based swap and any underlying security or securities, that such security-based swap is not readily susceptible to manipulation.

(c) Periodic Review. The rules of a security-based swap execution facility shall require that, after commencement of trading of a security-based swap, the swap review committee shall periodically review the trading in the security-based swap. If the swap review committee cannot determine, after taking into account all of the terms and conditions of the security-based swap, the markets for the security-based swap and any underlying security or securities, and the trading in the security-based swap, that such security-based swap is not readily susceptible to manipulation, the security-based swap execution facility shall no longer permit the trading of such security-based swap.

§ 242.813 Monitoring of trading and trade processing.

(a) A security-based swap execution facility shall:

(1) Establish and enforce rules, terms and conditions defining, or specifications detailing:

(i) Trading procedures to be used in entering and executing orders traded on or through the facilities of the security-based swap execution facility; and

(ii) Procedures for trade processing of security-based swaps on or through the facilities of the security-based swap execution facility; and

(2) Monitor trading in security-based swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade

reconstructions.

(b) A security-based swap execution facility shall have the capacity and appropriate resources to electronically monitor trading in security-based swaps on its market by establishing an automated surveillance system, including through real-time monitoring of trading and use of automated alerts, that is designed to:

(1) Detect and deter any fraudulent or manipulative acts or practices, including insider trading or other unlawful conduct or any violation of the rules of the security-based swap execution facility that has occurred or is occurring;

(2) Detect and deter market distortions or disruptions of trading that may impact the entry and execution of trading interests or the processing of trading interests on or through the security-based swap execution facility;

(3) Conduct real-time monitoring of trading to provide for comprehensive and accurate trade reconstruction; and

(4) Collect and assess data to allow the security-based swap execution facility to respond promptly to market abuses or disruptions.

(c) A security-based swap execution facility shall establish and enforce rules that require any participant that enters any order, request for quotation, response, quotation, or other trading interest, or executes any transaction on the security-based swap execution facility, to:

(1) Maintain books and records of any such order, request for quotation, response, quotation or other trading interest, or transaction, and of any position in any security-based swap that is the result of any such order, request for quotation, response, quotation, other trading interest, or transaction; and

(2) Provide prompt access to such books and records to the security-based swap

execution facility and to the Commission.

(d) A security-based swap execution facility shall establish and maintain procedures to investigate possible rule violations, to prepare reports concerning the findings and recommendations of any such investigations, and to take corrective action, as necessary.

§ 242.814 Ability to obtain information.

(a) A security-based swap execution facility shall establish and enforce rules requiring its participants to:

(1) Furnish to the security-based swap execution facility, upon request, and in the form and manner prescribed by the security-based swap execution facility, any information necessary to permit the security-based swap execution facility to perform its responsibilities under this section, including, without limitation, surveillance, investigations, examinations and discipline of participants; such information may include, without limitation, financial information, books, accounts, records, files, memoranda, correspondence, and any other information pertaining to orders, requests for quotations, responses, quotations, or other trading interest entered and transactions executed on or through the security-based swap execution facility;

(2) Cooperate with the security-based swap execution facility and allow access by the security-based swap execution facility, at such reasonable times as the security-based swap execution facility may request, to examine the books and records of the participant or to obtain or verify information related to orders, requests for quotation, responses, quotations, or other trading interest entered and transactions executed on or through its facilities; and

(3) Cooperate with any representative of the Commission and allow access by any representative of the Commission, at such reasonable times as any representative of the Commission may request, to examine the books and records of the participant or to obtain or

verify other information related to orders, requests for quotation, responses, quotations, or other trading interest entered and transactions executed on or through its facilities.

(b) A security-based swap execution facility shall:

(1) Cooperate with any representative of the Commission and allow access by any representative of the Commission, at such reasonable times as any representative of the Commission may request, to:

(i) Examine the books and records required to be kept by the security-based swap execution facility pursuant to § 242.818; and

(ii) Obtain or verify other information related to orders, requests for quotations, responses, quotations, or other trading interest entered and transactions executed on or through its facilities;

(2) Upon request of any representative of the Commission, promptly furnish to the possession of such representative copies of any documents, in such form and manner acceptable to such representative, that the security-based swap execution facility possesses or has access to pursuant to paragraph (a) of this section;

(3) Have the capacity to carry out such international information-sharing agreements as the Commission may require; and

(4) Certify at the time of registration on Form SB SEF, and annually thereafter as part of the annual compliance report described in § 242.823, that the security-based swap execution facility has the capacity to fulfill its obligations under any international information-sharing agreements to which it is a party as of the date of such certification.

§ 242.815 Financial integrity of transactions.

(a) A security-based swap execution facility shall establish and enforce rules and

procedures for ensuring the financial integrity of security-based swaps entered on or through the facilities of such security-based swap execution facility, including the clearance and settlement of security-based swaps pursuant to section 3C(a)(1) of the Act (15 U.S.C. 78c-3(a)(1)).

(b) Notwithstanding the requirements of § 242.810(b)(2), the rules of a security-based swap execution facility relating to the trading on the security-based swap execution facility, of security-based swaps that will not be cleared at a registered clearing agency may permit a participant to take into account counterparty credit risk.

§ 242.816 Emergency authority.

(a) A security-based swap execution facility shall establish rules and procedures to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as necessary or appropriate, which rules and procedures shall include the items set forth in paragraphs (b) and (c) of this section.

(b) A security-based swap execution facility shall establish rules and procedures that specify:

(1) The person or persons authorized by the security-based swap execution facility to declare an emergency;

(2) How the security-based swap execution facility will notify the Commission of its decision to exercise its emergency authority;

(3) How the security-based swap execution facility will notify the public of its decision to exercise its emergency authority;

(4) The processes for decision-making by the security-based swap execution facility personnel with respect to the exercise of emergency authority, including alternate lines of communication and guidelines to avoid conflicts of interest in the exercise of such authority; and

(5) The processes for determining that an emergency no longer exists and notifying the Commission and the public of such decision.

(c) A security-based swap execution facility shall have rules permitting the security-based swap execution facility to immediately take any or all of the following actions during an emergency:

(1) Impose or modify trading limits, price limits, position limits, or other market restrictions, including suspending or curtailing trading on its market in any security-based swap or class of security-based swaps;

(2) Extend or shorten trading hours;

(3) Coordinate trading halts with markets trading a security or securities underlying any security-based swap;

(4) Coordinate with a registered clearing agency to liquidate or transfer positions in any open security-based swap of one of its participants; and

(5) Any action, if so directed by the Commission.

(d)(1) A security-based swap execution facility shall promptly notify the Commission of the exercise of its emergency authority, followed by submission of written documentation within two weeks following cessation of the emergency explaining the basis for declaring an emergency, how conflicts of interest were minimized, and the extent to which the security-based swap execution facility considered the effect of its emergency action on the markets for the security-based swap and any security or securities underlying the security-based swap;

(2) If a security-based swap execution facility implements any rule or rule amendment in the exercise of its emergency authority, it shall file such rule or rule amendment with the Commission pursuant to § 242.806 prior to the implementation of such rule or rule

amendment or, if not practicable, within 24 hours after implementation of such rule or rule amendment.

§ 242.817 Timely publication of trading information.

(a) A security-based swap execution facility shall:

(1) Have the capacity to electronically capture, transmit, and disseminate information on price, trading volume, and other trading data on all security-based swaps executed on or through the security-based swap execution facility; and

(2) Make public timely information on price, trading volume, and other trading data on security-based swaps to the extent and in the manner prescribed by the Commission.

(b) If any security-based swap execution facility makes available information regarding a security-based swap transaction to any party other than a counterparty to the transaction, then the security-based swap execution facility must make that information available to all participants on terms and conditions that are fair and reasonable and not unfairly discriminatory; provided however, that nothing in this paragraph shall prohibit a security-based swap execution facility from acting as the agent of a reporting party, as defined in § 242.900 (published at 75 FR 75208 (Dec. 2, 2010)), for purposes of reporting required information directly to a registered security-based swap data repository.

(c) A security-based swap execution facility shall not make any information regarding a security-based swap transaction publicly available prior to the time a security-based swap data repository is permitted to publicly disseminate such information under § 242.902 (published at 75 FR 75208 (Dec. 2, 2010)).

§ 242.818 Recordkeeping and reporting.

(a) A security-based swap execution facility shall keep and preserve at least one copy of

all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records (including the audit trail records required pursuant to the provisions of paragraph (c) of this section) as shall be made or received by it in the conduct of its business.

(b) A security-based swap execution facility shall keep and preserve all such documents and other records for a period of not less than five years, the first two years in an easily accessible place.

(c) A security-based swap execution facility shall establish and maintain accurate, time-sequenced records of all orders, requests for quotations, responses, quotations, other trading interest, and transactions that are received by, originated on, or executed on the security-based swap execution facility. These records shall include the key terms of each order, request for quotation, response, quotation, other trading interest, or transaction and shall document the complete life of each order, request for quotation, response, quotation, other trading interest, or transaction on the security-based swap execution facility, including any modification, cancellation, execution, or any other action taken with respect to such order, request for quotation, response, quotation, other trading interest, or transaction.

(d) A security-based swap execution facility shall establish, maintain, and enforce written policies and procedures to verify the accuracy of the transaction data that it collects and reports.

(e) A security-based swap execution facility shall report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission may, from time to time, determine to be necessary to perform the duties of the Commission under the Act.

(f) A security-based swap execution facility shall, upon request of any representative of the Commission, promptly furnish to the possession of such representative copies of any documents, in such form and manner acceptable to such representative, required to be kept and

preserved by it pursuant to paragraphs (a) and (b) of this section.

§ 242.819 Antitrust considerations.

Unless necessary or appropriate to achieve compliance with the Act and the rules and regulations thereunder, a security-based swap execution facility shall not:

- (a) Adopt any rule or take any action that results in any unreasonable restraint of trade; or
- (b) Impose any material anticompetitive burden on trading or clearing.

§ 242.820 Conflicts of interest.

For additional rules relating to the mitigation of conflicts of interest of security-based swap execution facilities, § 242.702 (published at 75 FR 65882, Oct. 26, 2010).

(a) The rules of a security-based swap execution facility shall assure a fair representation of its participants in the selection of its directors and administration of its affairs, but no less than 20 percent of the total number of directors of the security-based swap execution facility must be selected by the participants; provided, however, that the security-based swap execution facility shall preclude any participant, or any group or class of participants, either alone or together with its related persons, that beneficially owns, directly or indirectly, an interest in the security-based swap execution facility from dominating or exercising disproportionate influence in the selection of such directors if the participant may thereby dominate or exercise disproportionate influence in the selection or appointment of the entire Board.

(b) At least one director on the Board shall be representative of investors who are not security-based swap dealers or major security-based swap participants, and such director must not be a person associated with a participant.

(c) The rules of a security-based swap execution facility must establish a fair process for participants to nominate an alternative candidate or candidates to the Board by petition and shall

specify the percentage of the participants that is necessary to put forth such alternative candidate or candidates, which percentage shall not be unreasonable.

§ 242.821 Financial resources.

(a) A security-based swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the security-based swap execution facility, as determined by the Commission.

(b) The financial resources of a security-based swap execution facility shall be considered to be adequate if, when using reasonable estimates and assumptions and not overestimating resources or underestimating expenses, liabilities, and financial exposure, the value of the financial resources:

(1) Enables the security-based swap execution facility to meet its financial obligations to participants, notwithstanding a default by the participant creating the largest financial exposure for the security-based swap execution facility in extreme but plausible market conditions; and

(2) Exceeds the total amount that would enable the security-based swap execution facility to cover its operating costs for a one-year period, as calculated on a rolling basis.

§ 242.822 System safeguards.

(a) Requirements for security-based swap execution facilities. A security-based swap execution facility, with respect to those systems that support or are integrally related to the performance of its activities, shall:

(1) Establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security. These policies and procedures shall, at a minimum, require the security-based swap execution facility to:

(i) Establish reasonable current and future capacity estimates, including quantifying in appropriate units of measure the limits of the security-based swap execution facility's capacity to receive (or collect), process, store, or display (or disseminate for display or other use) the data elements included within each function, and identifying the factors (mechanical, electronic, or other) that account for the current limitations;

(ii) Conduct periodic, capacity stress tests of critical systems to determine such systems' ability to process transactions in an accurate, timely, and efficient manner;

(iii) Develop and implement reasonable procedures to review and keep current its system development and testing methodology;

(iv) Review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters;

(v) Establish adequate contingency and disaster recovery plans that shall include plans to resume trading of security-based swaps by the security-based swap execution facility no later than the next business day following a wide-scale disruption. In developing such plans, the security-based swap execution facility shall take into account:

(A) The extent of alternative trading venues for the security-based swaps traded by the security-based swap execution facility, including the number of security-based swaps traded on the security-based swap execution facility, the market share of the security-based swap execution facility, and the number of participants on the security-based swap execution facility; and

(B) The necessity of geographic diversity and diversity of infrastructure between the security-based swap execution facility's primary site and any back-up sites.

(2) On an annual basis, submit an objective review to the Commission within 30 calendar days of completion. Where the objective review is performed by an internal department, an

objective, external firm shall assess the internal department's objectivity, competency, and work performance with respect to the review performed by the internal department. The external firm must issue a report of the objective review, which the security-based swap execution facility must submit to the Commission on an annual basis, within 30 calendar days of completion of the review;

(3) Promptly notify the Commission in writing of material systems outages and any remedial measures that have been implemented or are contemplated. Prompt notification includes the following:

(i) Immediately notify the Commission when a material systems outage is detected;

(ii) Immediately notify the Commission when remedial measures are selected to address the material systems outage;

(iii) Immediately notify the Commission when the material systems outage is addressed;
and

(iv) Submit to the Commission within five business days of when the material systems outage occurred a more detailed written description and analysis of the outage and any remedial measures that have been implemented or are contemplated.

(4) Notify the Commission in writing at least 30 calendar days before implementation of any planned material systems changes.

(b) Electronic filing. A security-based swap execution facility shall submit a notification, review, or description and analysis that is required to be submitted to the Commission pursuant to this section in an appropriate electronic format. Any such notification, review, or description and analysis shall be submitted to the Division of Trading and Markets, Office of Market Operations, at the principal office of the Commission in Washington, DC. Any such notification,

review, or description and analysis shall be considered submitted when an electronic version is received at the Division of Trading and Markets at the principal office of the Commission in Washington, DC.

(c) Confidential treatment. A person who submits a notification, review, or description and analysis pursuant to this section for which such person seeks confidential treatment shall clearly mark each page or segregable portion of each page with the words "Confidential Treatment Requested." A notification, review, or description and analysis submitted pursuant to this section will be accorded confidential treatment to the extent permitted by law.

§ 242.823 Designation of Chief Compliance Officer of security-based swap execution facility.

(a) In general. Each security-based swap execution facility shall identify on Form SB SEF (referenced in § 249.1700 of this chapter) a person who has been designated by the Board to serve as a Chief Compliance Officer of the security-based swap execution facility. The compensation and removal of the Chief Compliance Officer shall require the approval of a majority of the Board.

(b) Duties. Each Chief Compliance Officer designated by a registered security-based swap execution facility shall:

(1) Report directly to the Board or the senior officer of the security-based swap execution facility;

(2) Review the compliance of the security-based swap execution facility with the Core Principles described in section 3D of the Act (15 U.S.C. 78c-4) and the rules and regulations thereunder;

(3) In consultation with the Board or the senior officer of the security-based swap

execution facility, resolve any conflicts of interest that may arise;

(4) Be responsible for establishing and administering each policy and procedure that is required to be established pursuant to section 3D of the Act (15 U.S.C. 78c-4) and the rules and regulations thereunder;

(5) Monitor compliance with the Act and the rules and regulations thereunder relating to its business as a security-based swap execution facility, including each rule prescribed by the Commission under section 3D of the Act (15 U.S.C. 78c-4);

(6) Establish procedures for the remediation of noncompliance issues identified by the Chief Compliance Officer through any:

(i) Compliance office review;

(ii) Look-back;

(iii) Internal or external audit finding;

(iv) Self-reported error; or

(v) Validated complaint; and

(7) Establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

(c) Annual Reports.

(1) In general. The Chief Compliance Officer shall annually prepare and sign a report that contains a description of the compliance of the registered security-based swap execution facility with respect to the Act and the rules and regulations thereunder and each policy and procedure of the security-based swap execution facility (including the code of ethics and conflicts of interest policies of the security-based swap execution facility). Each compliance report shall also contain, at a minimum, a description of:

(i) The security-based swap execution facility's enforcement of its policies and procedures;

(ii) Information on all investigations, inspections, examinations, and disciplinary cases opened, closed, and pending during the reporting period;

(iii) All grants of access (including, for all participants, the reasons for granting such access) and all denials or limitations of access (including, for each applicant, the reasons for denying or limiting access), consistent with § 242.811(b)(3);

(iv) Any material changes to the policies and procedures since the date of the preceding compliance report;

(v) Any recommendation for material changes to the policies and procedures as a result of the annual review, the rationale for such recommendation, and whether such policies and procedures were or will be modified by the security-based swap execution facility to incorporate such recommendation;

(vi) The results of the security-based swap execution facility's surveillance program, including information on the number of reports and alerts generated, and the reports and alerts that were referred for further investigation or for an enforcement proceeding;

(vii) Any complaints received regarding the security-based swap execution facility's surveillance program; and

(viii) Any material compliance matters identified since the date of the preceding compliance report.

(2) Requirements. A financial report of the security-based swap execution facility shall be filed with the Commission as described in paragraph (e) of this section and shall accompany a compliance report as described in paragraph (c)(1) of this section. The compliance report shall

include a certification that, under penalty of law, the compliance report is accurate and complete. The compliance report shall also be filed in a tagged data format in accordance with the instructions contained in the EDGAR Filer Manual, as described in § 232.301 of this chapter.

(d) The Chief Compliance Officer shall submit the annual compliance report to the Board for its review prior to the submission of the report to the Commission.

(e) Financial report. With each annual compliance report, the Chief Compliance Officer shall also prepare and submit to the Commission a financial report of the security-based swap execution facility. Each financial report filed with a compliance report shall:

(1) For the financial statements relating to the security-based swap execution facility:

(i) Be a complete set of financial statements of the security-based swap execution facility that are prepared in accordance with U.S. generally accepted accounting principles for the two most recent fiscal years of the security-based swap execution facility;

(ii) Be audited in accordance with standards of the Public Company Accounting Oversight Board by a registered public accounting firm that is qualified and independent in accordance with § 210.2-01 of this chapter;

(iii) Include a report of the registered public accounting firm that complies with paragraphs (a) through (d) of § 210.2-02 of this chapter;

(iv) Include the accounting policies and practices of the security-based swap execution facility; and

(v) If the security-based swap execution facility's financial statements contain consolidated information of the security-based swap execution facility's subsidiaries, then the security-based swap execution facility's financial statement must provide condensed financial information, in a financial statement footnote, as to the financial position, changes in financial

position, and results of operations of the security-based swap execution facility, as of the same dates and for the same periods for which audited consolidated financial statements are required. Such financial information need not be presented in greater detail than is required for condensed statements by § 210.10-01(a)(2), (3), and (4) of this chapter. Detailed footnote disclosure that would normally be included with complete financial statements may be omitted with the exception of disclosures regarding material contingencies, long-term obligations, and guarantees. Descriptions of significant provisions of the security-based swap execution facility's long-term obligations, mandatory dividend or redemption requirements of redeemable stocks, and guarantees of the security-based swap execution facility shall be provided along with a five-year schedule of maturities of debt. If the material contingencies, long-term obligations, redeemable stock requirements, and guarantees of the security-based swap execution facility have been separately disclosed in the consolidated statements, then they need not be repeated in this schedule.

(2) For the financial statements of a security-based swap execution facility's affiliated entities (any subsidiary in which the applicant has, directly or indirectly, a 25% interest and for any entity that has, directly or indirectly, a 25% interest in the applicant):

(i) Be a complete set of unconsolidated financial statements (in English) for the latest two fiscal years; and

(ii) Include such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading.

(3) All financial statements must be provided in eXtensible Business Reporting Language consistent with § 232.405 (a)(1), (a)(3), (b), (c), (d), and (e) of this chapter; and

(4) If the financial report required by § 242.823(e) is submitted to the Commission on

Form SB SEF (referenced in § 249.1700 of this chapter) pursuant to § 242.802(f) at the same time that the Chief Compliance Officer submits the annual compliance report required by § 242.823(c) and the Chief Compliance Officer represents in the annual compliance report that the financial report has been submitted on Form SB SEF pursuant to § 242.802(f), the Chief Compliance Officer need not also submit the financial report as part of the annual compliance report.

(f) Reports filed pursuant to paragraphs (c) and (e) of this section shall be filed within 60 days after the end of the fiscal year covered by such reports.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

7. The general 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.

8. Reserve Subparts O (published at 76 FR 4489, Jan. 26, 2011) and P.

9. Add Subpart R (consisting of § 249.1700) to read as follows:

Subpart R – Forms for Security-Based Swap Execution Facilities

§ 249.1700. Form SB SEF, form for application for registration as a security-based swap execution facility and for amendments to the registration form of a registered security-based swap execution facility.

[Note: Form SB SEF does not appear in the Code of Federal Regulations.]

FORM SB SEF

APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR,
REGISTRATION AS A SECURITY-BASED SWAP EXECUTION
FACILITY

FORM SB SEF INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. Form SB SEF (referenced in 17 CFR 249.1700) is the form for the application for, and amendment to application for, registration as a security-based swap execution facility ("SB SEF") pursuant to Section 3D of the Securities Exchange Act of 1934 (15 U.S.C. 78c-4) ("Exchange Act") and the rules of Regulation SB SEF thereunder.
2. **UPDATING** – An applicant or registered SB SEF must file amendments to its Form SB SEF in accordance with 17 CFR 242.802 and 804, as applicable.
3. **CONTACT EMPLOYEE** - The individual listed on the Execution Page (Page 1) of this Form SB SEF as the contact employee must be authorized to receive all contact information, communications, and mailings, and is responsible for disseminating such information within the applicant's organization.
4. **FORMAT**
 - Attach an Execution Page (Page 1) with original manual signatures.
 - Please type all information.
 - Use only the current version of this Form SB SEF or a reproduction.
5. If the information called for by any Exhibit is available in printed form, the printed material may be filed, provided it does not exceed 8 1/2 X 11 inches in size.
6. If any Exhibit required is inapplicable, a statement to that effect shall be furnished in lieu of such Exhibit.
7. A SB SEF that is filing this Form SB SEF as an application may not satisfy the requirements to provide certain information by means of an Internet web page. However, all materials must be filed with the Securities and Exchange Commission ("SEC" or "Commission") electronically, unless the Commission requests that the materials be filed in paper.

8. **WHERE TO FILE AND NUMBER OF COPIES** - Submit one original and two copies of this Form SB SEF to: SEC, Division of Trading and Markets, Office of Market Supervision, 100 F Street, N.E., Washington, DC 20549-7010.

9. **PAPERWORK REDUCTION ACT DISCLOSURE**

- This Form SB SEF requires an applicant seeking to register as a SB SEF to provide the Commission with certain information regarding the operation of the SB SEF.
- §§ 242.802 and 242.804 also require registered SB SEFs to update certain information on this Form SB SEF on a periodic basis and the entire Form SB SEF annually.
- 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. Sections 3(a)(77), 3C(h), 3D(a), 3D(d), 3D(e), 3D(f) and 23(a) of the Exchange Act authorize the Commission to collect information on this Form SB SEF from SB SEFs. See 15 U.S.C. §§78c(a)(77), 78e, 78c-4(h), 78c-4(a), 78c-4(d), 78c-4(e), 78c-4(f) and 78w(a).
- Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on the facing page of this Form SB SEF and any suggestions for reducing this burden.
- This Form SB SEF is designed to enable the Commission to determine whether a SB SEF applying for registration is in compliance with the provisions of Section 3D of the Exchange Act (15 U.S.C. 78c-4) and the rules under Regulation SB SEF thereunder.
- It is estimated that a SB SEF will spend approximately 694 hours and \$523,000 completing the initial application on Form SB SEF pursuant to 17 CFR 242.801. It is estimated that each SB SEF controlled by another person and each non-resident SB SEF will spend approximately an additional 1 hour and \$900 to complete Exhibit P to the initial application on this Form SB SEF. It is also estimated that each SB SEF will spend approximately 25 hours to prepare each periodic amendment to its Form SB SEF pursuant to 17 CFR 242.802(a) and (b) and approximately 50 hours to prepare each annual update to its Form SB SEF pursuant to 17 CFR 242.802(f). It is

estimated that each SB SEF controlled by another person and each non-resident SB SEF will spend approximately 1 hour and \$900 to prepare each amendment to its Form SB SEF pursuant to 17 CFR 242.802(c) and (d), respectively.

- It is mandatory that an applicant seeking to register as a SB SEF file this Form SB SEF with the Commission. It is also mandatory that registered SB SEFs file amendments to this Form SB SEF under 17 CFR 242.802 and 804.
- No assurance of confidentiality is given by the Commission with respect to the responses made in this Form SB SEF. The public has access to the information contained in this Form SB SEF.
- This collection of information has been reviewed by the Office of Management and Budget ("OMB") in accordance with the clearance requirements of 44 U.S.C. §3507. The applicable Privacy Act system of records is SEC-2 and the routine uses of the records are set forth at 40 FR 39255 (August 27, 1975) and 41 FR 5318 (February 5, 1976).

FORM SB SEF INSTRUCTIONS

B. EXPLANATION OF TERMS

APPLICANT - The entity or organization filing an application for registration as a security-based swap execution facility, or amending any such application, on this Form SB SEF.

AFFILIATE - Shall have the same meaning as set forth in 17 CFR 242.800.

BOARD - Shall have the same meaning as set forth in 17 CFR 242.800.

CONTROL - Shall have the same meaning as set forth in 17 CFR 242.800.

EXCHANGE ACT - The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

NON-RESIDENT PERSON - Shall have the same meaning as set forth in 17 CFR 242.800.

PARTICIPANT - Shall have the same meaning as set forth in 17 CFR 242.800.

PERSON - Shall have the same meaning as set forth in section 3(a)(9) of the Exchange Act (15 U.S.C. 78c(a)(9)).

PERSON ASSOCIATED WITH A PARTICIPANT - Shall have the same meaning as set forth in 17 CFR 242.800.

RELATED PERSON - Shall have the same meaning as set forth in 17 CFR 242.800.

SECURITY-BASED SWAP - Shall have 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.

SECURITY-BASED SWAP DEALER - Shall have 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.

SECURITY-BASED SWAP EXECUTION FACILITY - Shall have 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.

REGISTERED SECURITY-BASED SWAP EXECUTION FACILITY - Shall mean any security-based swap execution facility registered pursuant to Section 3D(a) of the Exchange Act (15 U.S.C. 78c-4(a)) and the rules of Regulation SB SEF thereunder.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR,
REGISTRATION AS A SECURITY-BASED SWAP EXECUTION FACILITY**

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of the applicant, would violate the federal securities laws and may result in disciplinary, administrative, or criminal action.

**INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL
VIOLATIONS**

APPLICATION FOR REGISTRATION AMENDMENT

If this is an APPLICATION, indicate if the applicant requests consideration for temporary registration pursuant to Rule 801(c) of Regulation SB SEF under the Exchange Act: YES NO

If this is an AMENDMENT to an application, or to an effective registration (including an annual amendment), list all items that are amended:

1. State the name of the applicant: _____

2. Provide the applicant's primary street address (Do not use a P.O. Box):

(Number and Street)

(City)

(State)

(Zip Code)

3. Provide the applicant's mailing address (if different):

(Number and Street)

(City)

(State)

(Zip Code)

4. Provide the applicant's business telephone and facsimile number:

(Telephone)

(Facsimile)

5. Provide the name, title, and telephone number of a contact employee:

(Name)

(Title)

(Telephone)

6. Provide the name and address of counsel for the applicant:

(Name)

(Number and Street)

(City)

(State)

(Zip Code)

7. Provide the date applicant's fiscal year ends: _____

8. Indicate legal status of applicant: Corporation Sole Proprietorship Partnership Limited Liability Company

Other (specify):

If other than a sole proprietor, indicate the date and place where the applicant obtained its legal status (e.g. state where incorporated, place where partnership agreement was filed or where the applicant entity was formed), and the statute under which the applicant was organized:

(Date) (MM/DD/YYYY) State/Country of formation:

(Statute under which the applicant was organized)

9. Applicant understands and consents that any notice or service of process, pleadings, or other documents in connection with any action or proceeding against the applicant may be effectuated by certified mail to the officer specified or person named below at the U.S. address given. Such officer or person cannot be a Commission member, official or employee.

(Name of Person or, if the Applicant is a Corporation, Title of Officer)

(Name of the Applicant or Applicable Entity)

(Number and Street)

(City)

(State)

(Zip Code)

(Telephone)

EXECUTION: The undersigned, being first duly sworn, deposes and says that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including exhibits, schedules, or other documents attached hereto, and other information filed herewith, all of which are made a part hereof, are current, true, and complete. It is understood that all required items and exhibits are considered integral parts of this form and that the submission of any amendment represents that all unamended items and Exhibits remain true, current, and complete as previously filed. The applicant and the undersigned certify that the applicant is currently in compliance with, and is currently operating its business in a manner consistent with, the Exchange Act and all rules and regulations thereunder. The applicant and the undersigned certify that the applicant is so organized, and has the capacity, to assure the prompt, accurate, and reliable performance of its functions as a security-based swap execution facility. The applicant and the undersigned certify that the applicant has the capacity to fulfill its obligations under all international information-sharing agreements to which it is a party. If the applicant is controlled by another person, the applicant and the undersigned certify that any person that controls the applicant has consented to and can, as a matter of law, (i) provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the security-based swap execution facility; and (ii) submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the security-based swap execution facility. If the applicant is a non-resident person, the applicant and the undersigned further represent that the applicant can, as a matter of law, (i) provide the

Commission with prompt access to the applicant's books and records and (ii) submit to an onsite inspection and examination by representatives of the Commission.

Date:

(MM/DD/YY)

(Name of applicant)

By:

(Signature)

(Printed Name and Title)

Subscribed and sworn before me this _____ day of _____, _____ by

(Month)

(Year)

(Notary

Public)

My Commission expires _____ County of _____ State of

This page must always be completed in full with original, manual signature and notarization.

Affix notary stamp or seal where applicable.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
APPLICATION FOR, AND AMENDMENTS TO APPLICATION FOR,
REGISTRATION AS A SECURITY-BASED SWAP EXECUTION FACILITY
PURSUANT TO SECTION 3D OF THE EXCHANGE ACT

DO NOT WRITE BELOW THIS LINE - FOR OFFICIAL USE ONLY

EXHIBITS

File all Exhibits with an application for registration as a security-based swap execution facility pursuant to Section 3D of the Exchange Act and Rule 801 of Regulation SB SEF thereunder, or with amendments to such applications pursuant to Rule 802 and 804 of Regulation SB SEF. For each exhibit, include the name of the applicant, the date upon which the exhibit was filed, and the date as of which the information is accurate (if different from the date of the filing). If any Exhibit required is inapplicable, a statement to that effect shall be furnished in lieu of such Exhibit.

Exhibit A A copy of the governing documents of the applicant, including but not limited to, a corporate charter, articles of incorporation or association, limited liability company agreement, or partnership agreement, with all subsequent amendments, and by-laws or corresponding rules or instruments, whatever the name, of the applicant.

Exhibit B A copy of all written rulings, settled practices having the effect of rules, stated policies, and interpretations of the Board or other committee of the applicant in respect of any provisions of the governing documents, rules, or trading practices of the applicant which are not included in Exhibit A.

Exhibit C A list of the officers and directors, or persons performing similar functions who presently hold or have held their offices or positions during the previous year, and a list of all standing committees and their members (including the nominating committee, regulatory oversight committee, and all committees that have the authority to act on behalf of the Board or the nominating committee), indicating the following for each:

1. Name;
2. Title;
3. Dates of commencement and termination of term of office or position;
4. Type of business in which each is primarily engaged (e.g., security-based swap dealer, major security-based swap participant, inter-dealer broker, end-user, etc.);
5. If a director, whether such person qualifies as an "independent director" pursuant to Rule 800 of Regulation SB SEF; and
6. If a director, whether such person is a member of any standing committees, committees that have the authority to act on behalf of the Board, or the nominating committee.

Exhibit D A chart or charts illustrating fully the internal organizational structure of the applicant. The chart or charts should indicate the internal divisions or departments; the responsibilities of each such division or department; and the reporting structure of each division or department, including its oversight by committees (or their equivalent).

Exhibit E A list of all persons that have either, direct or indirect, ownership or voting interest in the security based swap execution facility that equals or exceeds 5% and a list of all related persons of such persons; provided that a related person (1) has ownership or voting interest in the security-based swap execution facility; or (2) is a participant. For each of the persons and related persons listed in this Exhibit E, please provide the following:

1. Full legal name;
2. Title or legal status;

3. Whether such person or related person is a participant;
4. Date that title, legal status, or participation in a security-based swap execution facility was acquired or commenced;
5. Percentage of ownership interest held;
6. Type of ownership interest held, including whether the ownership interest is "beneficial ownership" as defined in Rule 800 of Regulation SB SEF or is entitled to vote;
7. Percentage of voting interest held; and
8. Type of voting interest held.

Exhibit F For the latest two fiscal years of the applicant, financial statements that shall: 1) be a complete set of financial statements of the applicant that are prepared in accordance with U.S. generally accepted accounting principles for the most recent fiscal year of the applicant; 2) be audited in accordance with standards of the Public Company Accounting Oversight Board by a registered public accounting firm that is qualified and independent in accordance with Rule 2-01 of Regulation S-X (17 CFR 210.2-01); 3) include a report of the registered public accounting firm that complies with paragraphs (a) through (d) of Rule 2-02 of Regulation S-X (17 CFR 210.2-02); 4) include the accounting policies and practices of the applicant; 4) if the applicant's financial statements contain consolidated information of a subsidiary of the applicant, then the applicant's financial statement must provide condensed financial information, in a financial statement footnote, as to the financial position, changes in financial position, and results of operations of the applicant, as of the same dates and for the same periods for which audited consolidated financial statements are required. Such financial information need not be presented in greater detail than is required for condensed statements by Rules 10-01(a)(2), (3), and (4) of Regulation S-X (17 CFR 210.10-01). Detailed footnote disclosure that would normally be included with complete financial statements may be omitted with the exception of disclosures regarding material contingencies, long-term obligations, and guarantees. Descriptions of significant provisions of the applicant's long-term obligations, mandatory dividend or redemption requirements of

redeemable stocks, and guarantees of the applicant shall be provided along with a five-year schedule of maturities of debt. If the material contingencies, long-term obligations, redeemable stock requirements, and guarantees of the applicant have been separately disclosed in the consolidated statements, then they need not be repeated in this schedule; and 5) be provided in eXtensible Business Reporting Language consistent with Rules 405 (a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T (17 CFR 232.11).

Exhibit G An executed or executable copy of any agreements or contracts entered into or to be entered into by the applicant, or a subsidiary or an affiliate of the applicant, including partnership or limited liability company, third-party regulatory service, or other agreements relating to the operation of an electronic trading system to be used to effect transactions on the security-based swap execution facility ("System"), that enable or empower the applicant to comply with Section 3D of the Exchange Act (15 U.S.C. 78c-4).

Exhibit H For each of the applicant's affiliated entities (every subsidiary in which the applicant has, directly or indirectly, a 25% interest and for every entity that has, directly or indirectly, a 25% interest in the applicant) provide a complete set of unconsolidated financial statements (in English) for the latest two fiscal years and include such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading. The financial statements shall be provided in eXtensible Business Reporting Language consistent with Rules 405 (a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T (17 CFR 232.11). In addition to the foregoing, for all other affiliates of the applicant not listed in the paragraph above, the information required by the paragraph above shall be made available upon request.

Exhibit I Describe the manner of operation of the System. This description should include the following:

1. A detailed description of the manner in which the System satisfies the definition of "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act and any

Commission rules, interpretations, or guidelines regarding such definition, including a description of how the System displays all orders, quotes, requests for quote, responses, and trades in an electronic or other form, and the timelines in which the System does so; how orders interact on the System, the ability of market participants to see and transact with orders, quotes, requests for quotes, and responses; and an explanation of the trade-matching algorithm if it is based on order priority factors other than price and time;

2. The means of access to the System, including any limitations on access;
3. Procedures governing entry and display of quotations and orders in the System;
4. Procedures governing the execution, reporting, clearance and settlement of transactions in connection with the System;
5. Proposed fees;
6. Procedures for ensuring compliance with System usage guidelines and rules;
7. The hours of operation of the System and the date on which the applicant intends to commence operation of the System;
8. A copy of the users' manual or equivalent document;
9. If the applicant proposes to hold funds or securities on a regular basis, describe the controls that will be implemented to ensure safety of those funds or securities; and
10. The name of any entity, other than the security-based swap execution facility, that will be involved in operation of the System, including the execution, trading, clearing and settling of transactions on behalf of the security-based swap execution facility, and a description of the role and responsibilities of each entity.

Exhibit J A complete set of all forms pertaining to:

1. Application for participation or use of the security-based swap execution facility.
2. Application for approval as a person associated with a participant or other user of the security-based swap execution facility.
3. Any other similar materials.

Provide a table of contents listing the forms included in this Exhibit J.

Exhibit K A complete set of all forms of financial statements, reports, or questionnaires required of participants or any other users of the security-based swap execution facility relating to financial responsibility or minimum capital requirements for such participants or any other users. Provide a table of contents listing the forms included in this Exhibit K.

Exhibit L Describe the applicant's criteria for participation in or use of the security-based swap execution facility. Provide a list of all grants of access (including, for all participants, the reasons for granting such access) and all denials or limitations of access (including, for each applicant or participant, the reasons for denying or limiting access). Describe conditions under which participants or persons associated with participants may be subject to suspension or termination with regard to access to the security-based swap execution facility. Describe any procedures that will be involved in the suspension or termination of a participant or person associated with a participant. Provide a list of all disciplinary actions taken.

Exhibit M Provide an alphabetical list of all participants or other users of the security-based swap execution facility, including the following information:

1. Name;
2. Date of acceptance as a participant or other user;
3. Principal business address and telephone number;
4. If participant or other user is an individual, the name of the entity with which such individual is associated and the relationship of such individual to the entity (e.g., partner, officer, director, employee, etc.);
5. Describe the type of activities primarily engaged in by the participant or other user (e.g., security-based swap dealer, major security-based swap participant, inter-dealer broker, other market maker, non-broker dealer, non-security-based swap dealer, commercial end-user, inactive or other functions). A person shall be "primarily engaged" in an activity or function for

purposes of this item when that activity or function is the one in which that person is engaged for the majority of their time. When more than one type of person at an entity engages in any of the types of activities or functions enumerated in this item, identify each and state the number of participants, or other users in each; and

6. The class of participation or other access.

Exhibit N Provide a brief description of the criteria used to determine what securities may be traded on the security-based swap execution facility.

Exhibit O Provide a schedule of the security-based swaps to be traded on the security-based swap execution facility, including for each a description of the security-based swap.

Exhibit P (1) If the applicant is controlled by another person, provide an opinion of counsel that any person that controls the applicant has consented to and can, as a matter of law, (i) provide the Commission with prompt access to its books and records, to the extent such books and records are related to the activities of the security-based swap execution facility; and (ii) submit to onsite inspection and examination by representatives of the Commission with respect to the activities of the security-based swap execution facility.

(2) If the applicant is a non-resident person, provide an opinion of counsel that the applicant can, as a matter of law, (i) provide the Commission with prompt access to the books and records of such applicant and (ii) submit to onsite inspection and examination by representatives of the Commission.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: Feb. 2, 2011

*Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3148 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14221

In the Matter of

JACK W. LUNA

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS, PURSUANT SECTION
203(k) OF THE INVESTMENT ADVISERS
ACT OF 1940, 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 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Jack W. Luna ("Luna" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, 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 that:

RESPONDENT

1. Luna, age 44, resides in Southlake, Texas. Luna was a registered representative with various FINRA broker-dealers from 2003 to 2009. He was employed as an advisory representative with Titan from March 2007 to August 2009.

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FACTS

2. Titan Wealth Management, LLC ("Titan") is a Texas corporation located in Plano, Texas, which was registered with the Commission as an investment adviser from July 2007 until its revocation in March 2010. Titan was registered as an investment adviser in the state of Texas from August 2004 to August 2007. During the relevant period, Titan was owned by Thomas Lester Irby II ("Irby"). See *In the Matter of Thomas Lester Irby II and Titan Wealth Management, LLC*, Admin. Proc. No. 3-13697 (March 29, 2010).

3. Irby formed Titan in 2004, and together they provided investment advice to individual clients, pension plans, and institutional clients. Prior to 2007, Titan primarily invested its clients' money in exchange traded funds and mutual funds.

4. In March 2007, Luna joined Titan as an advisory representative. Shortly thereafter, Irby introduced Luna to an investment purportedly involving steeply discounted European mid-term notes ("MTNs"). Irby told Luna that Irby pooled investor funds to purchase either an entire MTN or a partial interest in an MTN. The terms of investment varied, but Irby told Luna that the MTN investment paid short term returns ranging from 10% to 50%. Irby told Luna that Titan did not receive any compensation or commissions from the purchase or sale of the MTNs and that the investments were low risk because they involved short term notes issued by established European banks.

5. Although Luna was initially skeptical about the risks and return on the MTN investment, Luna was reassured after Irby showed Luna information on Irby's computer purportedly referencing the MTNs. Based on these representations from Irby, and without conducting any independent due diligence, Luna decided personally to invest, and recommended that several of his clients (including family members) invest, in the MTNs recommended by Titan.

6. Luna did not verify how the funds he and his clients had invested were being used. At some point, Luna became aware that money was being sent to a company controlled by Irby, but Luna did not verify that Irby was investing the funds as he represented he would (and how Luna represented to his clients). Once he and his initial clients received their principal and returns as promised, Luna recommended the MTN investment to additional clients, representing it to be low risk and comparing it to a certificate of deposit.

7. In January 2008, several of Luna's clients failed to receive their promised returns of principal and interest. Luna questioned Irby about these delays, and was given several explanations, ranging from problems with the European Banks because of the credit crisis to a story that the funds were being held up by Homeland Security. Based on these explanations by Irby, Luna informed clients that funds from the sale of the MTNs were *en route*, and continued to recommend the investment to other clients without disclosing prior delays in the return of principal and returns.

8. On August 25, 2009, the Commission filed an emergency action in federal district court against defendants Titan, Irby and Point West Partners, LLC, and relief defendants Joseph

Romanow, David Romanow, Karen Bowie, France Michaud, Pegasus Holdings Group, Inc. and John J. Kim, to halt Irby's scheme and preserve assets for the benefit of investors. *See SEC v. Titan Wealth Management, LLC, et al.*, No 4:09-CV-418 (E.D. Tx.). On September 10, 2009, the court entered an agreed preliminary injunction against Titan, PWP and Irby, and issued orders imposing an asset freeze, allowing expedited discovery, and directing the defendants and relief defendants to preserve documents and provide accountings. Luna was not a party in this lawsuit.

9. In its complaint, the Commission alleged that Titan raised over \$3 million dollars from its clients for MTN investments, but that Irby did not pool investor funds to purchase an MTN or any interest in an MTN. Instead, the Commission alleged, Titan and Irby misappropriated or misapplied millions of dollars of investor funds, including the transfer of over \$1.7 million to the named relief defendants and \$859,001 to make Ponzi payments.

10. As a result of the conduct described above, Luna caused Titan's violations of Section 206(2) of the Advisers Act.

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 Luna's Offer.

Accordingly, pursuant to Section 203(k) of the Advisers Act, it is hereby ORDERED that Respondent Luna shall cease and desist from committing or causing any violations and any future violation of Section 206(2) of the Advisers Act.

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63826 / February 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14222

In the Matter of

GUSTAV GEORGE
BUJKOVSKY,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO RULE
102(e) OF THE COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Gustav George Bujkovsky ("Respondent" or "Bujkovsky") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(3)(i)].¹

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

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

II.

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

III.

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

1. Bujkovsky, age 67, of Escondido, California, is and has been a lawyer licensed to practice law by the State Bar of California since 1971.

2. Between April and August 2009, Bujkovsky represented as clients MAK 1 Enterprises Group, LLC ("MAK 1") and its principals, Mohit A. Khanna and Sharanjit K. Khanna, who sold MAK 1's unregistered securities. Investors in the \$35 million MAK 1 scheme were promised exorbitantly high returns through guaranteed investments such as foreign currency trading. MAK 1 was a Ponzi scheme and was halted by an emergency action filed by the Commission in federal court in San Diego in August 2009. In that action, *SEC v. Mohit A. Khanna, et al.*, Case No. 09CV1784BEN (filed Aug. 17, 2009), the Commission charged MAK 1 and the Khannas with violations of the federal securities laws.

3. On November 22, 2010, a judgment was entered by consent against Bujkovsky, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Gustav George Bujkovsky, et al., Civil Action Number 10-CV-1965 BEN (JMA) in the United States District Court for the Southern District of California.

4. The Commission's Complaint alleged that Bujkovsky, despite having notice that MAK 1 was conducting an unregistered and likely fraudulent securities offering, made material misrepresentations and failed to disclose material facts to some MAK 1 investors. The Commission alleged that Bujkovsky misrepresented that MAK 1 was engaged in foreign currency trading and that his own clients invested in MAK 1 and had received the promised high returns, and that the MAK 1 investment was insured and had other downside risk protection. The complaint further alleged that after Mohit Khanna told Bujkovsky on July 9, 2009 that MAK 1 did not engage in foreign currency trading and was a fraud, Bujkovsky lulled certain investors by falsely representing that their money would be returned after problems were resolved with so-called "intermediaries" including, purportedly, European banks. The Complaint alleged that

during the period of Bujkovsky's representation, MAK 1 raised more than \$3.3 million from investors, over \$1.9 million of which was returned to earlier investors as interest payments or return of principal, and over \$1.5 million of which were sent to Bujkovsky's client trust account from MAK 1 or the Khannas. The Commission alleged that by transferring these funds through his client trust account and the account of a sham corporation he created, Bujkovsky helped the Khannas misappropriate about \$1.3 million investor funds for their own use and that Bujkovsky retained over \$459,000 of investor funds, about half of which he used for his personal expenses or paid to his wife, Betty D. Hansen.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that: Bujkovsky is suspended from appearing or practicing before the Commission as an attorney.

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. 63827 / February 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14223

In the Matter of

Advantage Life Products, Inc.,
B-Teller, Inc.
(n/k/a CA Goldfields, Inc.), and
Independent Energy Holdings, P.L.C.,

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 Advantage Life Products, Inc., B-Teller, Inc. (n/k/a CA Goldfields, Inc.), and Independent Energy Holdings, P.L.C.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Advantage Life Products, Inc. ("ADVT")¹ (CIK No. 824840) is a void Delaware corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ADVT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of \$1,997,535 for the prior nine months. As of January 25, 2011, the common stock of ADVT was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

¹The short form of each issuer's name is also its stock symbol.

2. B-Teller, Inc. (n/k/a CA Goldfields, Inc.) ("CAGI") (CIK No. 1000079) is an inactive Washington corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CAGI 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, 2005, which reported no revenues or expenses for the prior six months. As of January 25, 2011, the common stock of CAGI was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Independent Energy Holdings, P.L.C. ("INYYQ") (CIK No. 1050692) is an England and Wales corporation located in Solihull, West Midlands, United Kingdom with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). INYYQ 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 June 30, 1999. As of January 25, 2011, the American Depository Shares representing Ordinary Shares of INYYQ were not publicly quoted or traded.

B. DELINQUENT PERIODIC FILINGS

4. As described 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.

5. 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.

6. 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


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9181 / February 3, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3149 / February 3, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29574 / February 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14224

In the Matter of

**AXA ROSENBERG
GROUP
LLC, AXA ROSENBERG
INVESTMENT
MANAGEMENT LLC, and
BARR ROSENBERG
RESEARCH CENTER
LLC,**

Respondents.

**CORRECTED ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS, PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940,
AND SECTIONS 203(e), 203(f), AND 203(k)
OF THE INVESTMENT ADVISERS ACT
OF 1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND
A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), and Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against AXA Rosenberg Group LLC ("ARG"), AXA Rosenberg Investment Management LLC ("ARIM"), and Barr Rosenberg Research Center LLC ("BRRC") (collectively, "Respondents").

II.

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

III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that:

Overview

1. This case involves an institutional money manager specialized in quantitative investment strategies that concealed from investors a material error in its computer code in violation of the federal securities laws. ARG is the holding company of two SEC-registered investment advisers: BRRC, which developed the code for the quantitative investment model (the "Model"), and ARIM, the institutional money manager that used the Model to manage client portfolios. Senior management at ARG and BRRC failed to disclose the error for months after it was discovered in June 2009 and as a result ARG, BRRC and ARIM provided investors inaccurate information about the Model's performance and capabilities. This error adversely impacted 608 of 1421 client portfolios managed by ARG and caused \$216,806,864 in losses.

2. In late June 2009, a BRRC employee discovered an error in the Model's computer code that was introduced in 2007 and effectively eliminated one of the key components in the Model for managing risk. This employee later discussed his finding in a meeting with senior ARG and BRRC officials and employees. A senior ARG and BRRC official ("Senior Official") directed them to keep quiet about the error and to not inform others about it, and he directed that the error not be fixed at that time. While the error was eventually fixed for U.S. managed portfolios in September 2009 and for other portfolios in late October and early November 2009, BRRC employees followed the Senior Official's directive not to disclose the error until November 2009, when a BRRC employee felt compelled to inform ARG's CEO. Following this, ARG conducted an

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

internal investigation, which it concluded in mid-March 2010, and obtained advice of external legal counsel concerning its obligation to disclose the error. In late-March 2010, ARG disclosed the error to Commission examination staff after Commission examination staff informed ARG of an impending examination of ARIM and BRRC. ARG disclosed the error to clients on April 15, 2010.

3. Before and after discovery of the error, ARIM's clients were voicing substantial concerns about the underperformance of their portfolios. In particular, clients were expressing dissatisfaction with their portfolios' industry overexposure, an element partly controlled by the Model's ability to manage risk. Because the Senior Official and others concealed the error for several months, the Respondents failed to disclose the error when responding to the client concerns. In fact, in presentations and other communications to clients and consultants after discovery of the error, the Respondents misrepresented the Model's ability to control risk and ascribed underperformance to market volatility and factors having nothing to do with the error. In addition, from the time the error was introduced, BRRC's compliance program and procedures were not adequately tailored to the particular risks of the firm, and to the extent there were procedures, they were not adhered to.

4. By virtue of this conduct, ARG willfully² violated Sections 17(a)(2) and 17(a)(3) of the Securities Act; ARIM willfully violated Section 206(2) of the Advisers Act; and BRRC willfully violated Sections 206(2) and 206(4) and Rule 206(4)-7 thereunder of the Advisers Act.

Respondents

5. AXA Rosenberg Group LLC is a holding company formed in 1998. ARG owns and governs ARIM, BRRC, and other offshore investment advisers ("Affiliated Advisers"). ARG is not registered with the Commission in any capacity.

6. AXA Rosenberg Investment Management LLC is an institutional money manager and investment adviser registered with the Commission based in Orinda, California. It is the investment adviser for U.S. clients.

7. Barr Rosenberg Research Center LLC is an investment adviser registered with the Commission based in Orinda, California, that develops and maintains the Model.

Background

8. ARIM and BRRC pioneered the use of quantitative techniques – embodied in BRRC's Model – to implement investment strategies. The Model was comprehensive in its ability to capture and process a substantial amount of publicly available

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

information, such as financial data for particular companies, news, and industry information, and to make investment decisions largely without human interaction. The Model consisted of three components: the Alpha Model, Risk Model, and Optimizer. The Alpha Model evaluates public companies based on their earnings and valuation. The Risk Model identifies risk on two primary bases – specific stock risk and common factor risks. Common factor risks include, among other things: (i) specific industry risks, which are risks associated with certain industries (such as oil, automobiles, or airlines); (ii) country risks, which are risks associated with particular countries; and (iii) stock fundamental risks, which capture price to earnings ratios and similar metrics. The Optimizer takes the output from the Alpha and Risk Models, balances them against each other, and recommends an optimal portfolio for the client based on a benchmark chosen by the client, such as the S&P 500.

9. BRRC's clients are ARIM and the Affiliated Advisers, which use the Model as their exclusive investment decision-making tool and market the Model, relying on information provided by BRRC, as the basis of their offer of investment advisory services to prospective clients. Within BRRC, an informal but undisclosed "micro group" consisting largely of a small group of long-time and trusted BRRC employees, none of whom had any compliance-related responsibilities, was primarily responsible for the Model. The micro group was led by the Senior Official and only its members had full access to the Model and all of its underlying code.

Discovery and Concealment of the Error

10. In April 2007, BRRC put into production a new version of the Risk Model. BRRC had assigned the task of writing the computer code that would link this new Risk Model with the Optimizer primarily to two programmers. Although BRRC tested the new Risk Model, it did not conduct independent quality control over the programmers' work on the code. When these two programmers linked the Risk Model to the Optimizer, they made an error in the Optimizer's computer code. Although BRRC conducted simulations involving the new Risk Model before rolling it out, these simulations did not detect the error. As a result, BRRC did not detect the symptoms of the error and did not discover the error itself until testing another new version of the Risk Model.

11. Starting in 2009, a BRRC employee began work as part of BRRC's effort to implement a new version of the Risk Model. In June 2009, this employee noticed certain unexpected results when comparing the new Risk Model to the existing one that was rolled out in April 2007. He learned that the Optimizer was not reading the Risk Model's assessment of common factor risks correctly because an error in the code caused a failure to perform the required scaling of information received from the Risk Model. Some Risk Model components sent information to the Optimizer in decimals while other components reported information in percentages; therefore the Optimizer had to convert the decimal information to percentages in order to effectively consider all the information on an equal footing. Because proper scaling did not occur, the Optimizer did not give the intended weight to common factor risks.

12. In late June 2009, this BRRC employee informed the Senior Official and other BRRC employees of the error and presented his findings to them in a meeting. The employee emailed another senior BRRC employee following this meeting, detailing his discovery of the error and proposing that the error be fixed immediately.

13. The Senior Official and other BRRC employees met around the end of June 2009 to further discuss the error. The BRRC employee who discovered the error advocated that the error be fixed immediately. The Senior Official, however, disagreed and stated that the error should be corrected when the new Risk Model would be implemented. The Senior Official directed BRRC employees with knowledge of the error to keep quiet about the discovery of the error and to not inform others about it. The BRRC employee who discovered the error asked the Senior Official whether ARG's Global Chief Investment Officer ("CIO") should be informed, and the Senior Official instructed that he should not be told.

14. From at least the beginning of 2009, another team located in London (the "U.K. Group") that reported to ARG's Global CIO had begun to examine and test the Model, based on substantial concerns expressed by some of ARIM's and the Affiliated Advisers' clients about their portfolios' underperformance due to industry overexposure, an element partly controlled by the Model's ability to assess common factor risks. As they tested the Model, the U.K. Group discussed their research and findings with the BRRC employee who discovered the error. By August 2009, as the U.K. Group began to hone in on the error, the Senior Official's instruction to keep quiet about the error became increasingly problematic. Ultimately, in early September 2009, certain BRRC employees with knowledge of the error admitted to the U.K. Group that the error existed. By September 2009, certain of the Respondents' senior officers knew about the error, but still failed to disclose the error to ARG's Global CEO or clients.

15. On September 24, 2009, Respondents' Investment Committee met to discuss certain changes to the Risk Model, which included a proposed change to the common factor risk component. Although the proposed change was intended to fix the error, certain members of the Investment Committee were not informed that there was an error or that this change was in fact meant to correct the error. The Investment Committee authorized the change to the Risk Model.

16. The Senior Official omitted to disclose the error to ARG's Board. In mid-to-late 2009, ARG convened a series of Board meetings to discuss the Model's performance. Many of the meetings addressed client complaints about underperformance and industry overexposure. The Senior Official and others who knew about the error attended the meetings and participated in these discussions. In early October 2009, the Board had a discussion about the Model and its performance. At one point, a director asked a question relating to the Model's underperformance. The Senior Official replied that "mistakes if there were any will not be made in the future" and that he was "not aware of significant" mistakes in the Model.

17. In late November 2009, a BRRC employee informed ARG's Global CEO that there was an error in the code of the Model that effectively eliminated common

factor risks and that the error had already been corrected. ARG initiated an internal investigation in late December 2009 and obtained advice of external legal counsel concerning Respondents' obligations to disclose the error. ARG's internal investigation concluded in mid-March 2010.

18. ARG disclosed the error to the Commission staff after the Commission examination staff informed ARIM and BRRC that they would begin an examination of the firms on March 23, 2010. ARG convened a series of Board meetings beginning on March 26. On March 31, 2010, Commission examination staff arrived at ARIM's and BRRC's offices to begin their exam. At the end of that day, ARG informed the Commission staff of the error. On April 15, 2010, ARG informed clients of the error.

Misrepresentations and Omissions

19. After discovery of the error in June 2009, the Respondents made material misrepresentations and omissions concerning the error to ARIM's clients, including (i) omitting to disclose the error and its impact on client performance, (ii) attributing the Model's underperformance to market volatility rather than the error, and (iii) misrepresenting the Model's ability to control risks. For example, in July 2009, the Respondents misrepresented to a client that the Model's underperformance was attributable to market volatility rather than, in part, to the error, and in August 2009, the Respondents misrepresented to a mutual fund sub-advisory client that the Risk Model's common factor risks were functioning when in fact they had been disabled due to the error.

20. The Respondents also made misrepresentations and omissions about the scope and application of their compliance policies and procedures, particularly as to BRRC, both before and after the discovery of the error. For example, the Respondents misrepresented to clients that internal controls processes and procedures covered BRRC when in fact certain of these controls, such as the internal audit program, were not implemented. Moreover, although the Respondents represented that the Investment Committee reviewed and approved changes to the Model, the Investment Committee rarely convened.

Policies and Procedures

21. Policies and procedures referenced in Respondents' Compliance Manual required that the error be disclosed and escalated to senior ARG management, including ARG's Global CEO, Global CIO, and General Counsel.

22. ARG's Code of Ethics, which applied to ARIM and BRRC, provides:

The Firm [defined in the Code of Ethics to include, among other entities, ARIM, BRRC, and the Affiliated Advisers] is committed to conducting its business according to a high standard of honesty and fairness. This commitment to observing a high ethical standard is designed not only to ensure compliance with applicable laws and regulations in the jurisdictions

where AXA Rosenberg Group operates, but also to earn and keep the trust of its clients, shareholders, personnel, and business partners.

It is the policy of the Firm to conduct its business in accordance with best international practice, and always strictly within the laws of the countries in which it operates, in a manner that manages conflicts of interest appropriately and seeks to avoid even any appearance of conflict of interest. These practices are essential for maintaining the reputation, the client confidence, and the regulatory licenses upon which the business of the Firm depends. Employees are expected to observe a high standard of business and personal ethics and to exercise proper judgment in conducting the Firm's business.

23. The "AXA Rosenberg Group LLC Incident and Issue Escalation Policy" (the "Escalation Policy"), which was also applicable to ARIM and BRRRC, was designed "to establish operating procedures and guidelines for the timely escalation of incidents and issues which raise potential and/or actual significant risks to the operations or reputation of the firm" in order "to avoid, minimize, or otherwise mitigate any negative financial, regulatory, legal or reputational impact of such incidents and issues on the firm." This policy required that any breakdown of "Risk Management and Internal Controls" or "failure in compliance procedures (including violations of regulatory requirements, breaches of client mandates/investment guidelines, or any other compliance requirement)" that resulted in an actual loss of \$25,000 or potential loss of \$100,000 be reported to ARG's Global CEO, Global CIO, or General Counsel. Also, any "regulatory or legislative breach or similar incident that has, or could potentially, result in a formal investigation or disciplinary sanctions by local regulators, government and industry bodies and could therefore result in fines or a rise in regulatory scrutiny" or any matter which "potentially could have an adverse impact on the public reputation of AXA Rosenberg" must also be reported to these senior managers.

24. In not disclosing and escalating the error to senior management, the Senior Official and other BRRRC employees did not comply with these policies and procedures.

Violations

ARG's Violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act

25. As a result of the conduct described above, ARG violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. Section 17(a)(2) of the Securities Act specifically prohibits any untrue statements of material fact or material omissions in the offer or sale of securities. Section 17(a)(3) of the Securities Act prohibits engaging in a course of business which operates as a fraud or deceit in the offer or sale of securities.³

³ Establishing violations of Sections 17(a)(2) and 17(a)(3) does not require a showing of scienter; negligence is sufficient. Aaron v. SEC, 446 U.S. 680 (1980); SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997).

26. ARG violated Sections 17(a)(2) and 17(a)(3) of the Securities Act by making material misrepresentations and omissions about the Model. Specifically, ARG misrepresented and omitted to disclose to investors the existence of a material error in the Model and the Model's ability to account for risk. ARG misrepresented that common factor risks were accounted for in the Model when in fact, due to the undisclosed error, common factor risks were disabled. These facts would have been important to clients because they indicated that a key component of the Risk Model was not working and would have, in part, explained underperformance in certain accounts and other concerns those clients had been voicing for some time.

27. ARG also misrepresented the compliance and control procedures in effect at BRRC. ARG misrepresented to investors that all internal controls processes and procedures that applied to BRRC were implemented. A reasonable investor would consider these facts important when deciding to engage ARIM as an adviser because BRRC maintained the Model that directed all securities transactions at ARIM, and an investor clearly would have had concerns about the Model knowing that certain controls and checks were not in place to monitor BRRC.

ARIM and BRRC's Violations of Section 206(2) of the Advisers Act

28. As a result of the conduct described above, ARIM and BRRC willfully violated Section 206(2) of the Advisers Act. This section prohibits any investment adviser from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. Pursuant to Section 206(2), investment advisers have a fiduciary duty that requires them to act in the best interests of their clients and to make full and fair disclosure of all material facts.

29. By concealing and delaying to fix the error, BRRC and ARIM breached their fiduciary duty to their clients. During the relevant period, clients were expressing concerns about their overexposure to certain industries and underperformance, both of which were in part attributable to the error. Although the Senior Official and others were aware of these concerns, they did not disclose the error. This failure to disclose extended to certain client presentations, in which ARIM and BRRC personnel misrepresented that the underperformance was attributable to factors other than the error and inaccurately stated that the Risk Model's common factor risks were functioning when in fact they had been disabled due to the error. In addition, the Senior Official's failure to fix the error allowed it to remain uncorrected for several additional months. Because BRRC and ARIM failed to disclose the error, certain clients continued to sustain losses from an error that could have been but was not promptly corrected.

30. BRRC also failed to conduct any meaningful materiality analysis of the error's impact. BRRC knew that its clients used the Model to manage their clients' portfolios, and that the error could potentially have adverse effects on the performance of portfolios managed using the Model. Yet, BRRC only performed rudimentary and limited analyses to estimate the error's impact.

**BRRC's Violations of Section 206(4) of the Advisers Act and Rule 206(4)-7
Thereunder**

31. As a result of the conduct described above, BRRC also willfully violated Advisers Act Section 206(4) and Rule 206(4)-7 thereunder. Rule 206(4)-7 requires investment advisers to “[a]dopt and implement written policies and procedures reasonably designed to prevent violation” of the Advisers Act and the rules thereunder by their supervised persons. The Commission has stated that an adviser’s failure “to have adequate compliance policies and procedures in place will constitute a violation of our rules independent of any other securities law violation.” Compliance Programs of Investment Companies and Investment Advisers, Advisers Act Rel. No. 2204, 68 F.R. 74714, 74715 (Dec. 24, 2003) (“Compliance Release”). The Compliance Release also states that “[e]ach adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm’s particular operations, and then design policies and procedures that address those risks.” 68 F.R. at 74716.

32. BRRC was not subject to fundamental compliance procedures and controls. BRRC violated Rule 206(4)-7 by failing to adopt and implement policies and procedures reasonably designed to ensure that it did not make false and misleading statements and/or omissions to clients and investors, including failing to ensure that the Model performed as represented, in violation of the antifraud provisions in the Advisers Act. BRRC claimed that its Model would, among other things, assess common factor risks. Yet, BRRC did not have reasonable procedures in place to ensure that the Model would assess those risk factors as intended. Similar to many quantitative investment advisers, BRRC utilizes a complex computer program to implement its strategies. For the Risk Model rolled out in April 2007, ARG failed to conduct sufficient quality control over the coding process before putting that model into production. The coding process itself represented a serious risk exposure for BRRC and its clients because accurate coding is required for the Model to function properly and as represented to clients. Because BRRC’s compliance program did not sufficiently identify and mitigate the risks associated with the Model’s development, testing, and change control procedures, the coding error operated undetected for more than two years.

Respondents’ Remedial Efforts

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

Undertakings

Respondent has undertaken as follows:

33. **Compensatory Payment to Clients and Self-Administered Distribution**

a. ARG has retained Cornerstone Research, Inc. (“Cornerstone”), an independent economic and financial analysis firm, to assess the coding error’s impact on

clients. Cornerstone developed a methodology not unacceptable to the Commission staff that (i) estimated the potential greater exposure to common factor risk components for each month that a client account was impacted by the coding error; (ii) estimated the aggregate (across each of the affected factors) return implication of the potential greater exposure within each month and applied that return implication to an estimate of the monies invested in each portfolio in each client account within the month; and (iii) assumed that this estimated monthly impact would be reinvested back into the client's account to derive an estimate of that account's corrected return performance through the end of the account's error period. Using this methodology, Cornerstone determined that the error resulted in approximately \$216,806,864 in losses across 608 client portfolios.

b. Respondents have undertaken to make, within 60 days of the date of entry of this Order, a payment, jointly and severally, in the amount of \$216,806,864 to compensate ARIM and Affiliated Adviser clients for the harm caused by the conduct set forth in this Order (the "Compensatory Payment").

c. Respondents shall be responsible for self administering the distribution of the Compensatory Payment. Respondents shall:

i. deposit the Compensatory Payment into escrow accounts within 20 days of the date of entry of the Order;

ii. submit to the Commission staff a plan of allocation developed by Cornerstone that identifies (1) each ARIM and Affiliated Adviser client that will receive a portion of the Compensatory Payment, (2) the exact amount of that payment as to each client, and (3) the methodology used to determine the exact amount of that payment as to each client, within 30 days after the date of entry of the Order; and

iii. complete transmission of the Compensatory Payment to all affected ARIM and Affiliated Adviser clients pursuant to the plan of allocation within 60 days after the date of entry of the Order.

d. Any amounts remaining after distribution, and any amounts Respondents are unable, due to factors beyond their control, to pay to any affected client, shall be transferred to the Securities and Exchange Commission when the final accounting is submitted and shall be (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (iv) submitted under cover letter that identifies that identifies ARG, ARIM and BRRC as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Bruce Karpati, Co-Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, NY 10281.

e. Respondents agree to be responsible for all tax compliance responsibilities associated with the Compensatory Payment and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and shall not be paid out of the Compensatory Payment.

f. Within 90 days after the date of entry of the Order, Respondents shall submit to the Commission staff for its approval a final accounting and certification of the disposition of the Compensatory Payment. The final accounting and certification shall include but not be limited to: (1) the amount paid to each payee, (2) the date of each payment, (3) the check number or other identifier of money transferred, (4) the date and amount of any returned payment, (5) a description of any effort to locate a prospective payee whose payment was returned, or to whom payment was not made due to factors beyond Respondents' control, (6) any amounts to be paid to the Commission pursuant to paragraph 33.d above with respect to any prospective payee whom Respondents were unable to pay due to factors beyond their control; and (7) an affirmation that the Compensatory Payment represents a fair and reasonable calculation of harm caused by the error prior to its correction in the Model. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request. Respondents shall cooperate with reasonable requests for information in connection with the accounting and certification.

g. After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send the remaining residual amount to the United States Treasury.

34. Oversight of BRRC. ARG shall subject BRRC to all of its internal controls and compliance policies and procedures and include a provision that BRRC's Director shall report to ARG's Global CEO.

35. Global Compliance and Ethics Oversight Structure. Through at least 2015 ARG shall maintain a global compliance and ethics oversight structure encompassing itself, BRRC, ARIM, and the Affiliated Advisers with the following attributes:

a. ARG shall maintain a Global Compliance and Ethics Oversight Committee ("Global Compliance Committee") for all matters relating to its Code of Ethics, Escalation Policy, and compliance policies and procedures. The Global Compliance Committee shall be comprised of senior executives from ARG, BRRC, ARIM, and the Affiliated Advisers. The Global Compliance Committee shall hold quarterly meetings to review violations or potential violations of the Code of Ethics, Escalation Policy, and compliance policies and procedures and shall report all violations thereof to ARG's Global CEO and Board of Directors.

b. ARG shall maintain a Compliance Controls Sub-Committee (the "Sub-Committee") within the Global Compliance Committee, chaired by ARG's Chief Compliance Officer and comprised of senior executives from ARG, ARIM, BRRC, and

the Affiliated Advisers. The Sub-Committee shall review compliance issues throughout the business of ARG, endeavor to develop solutions to those issues, and oversee the implementation of those solutions. The Sub-Committee shall provide reports on internal compliance matters to the Global Compliance Committee at least quarterly.

c. ARG shall require its Chief Compliance Officer to report to ARG's Global CEO and Board of Directors any breach of fiduciary duty or any violation of a federal securities law of which the Chief Compliance Officer becomes aware in the course of carrying out his or her duties on at least a quarterly basis; provided, however, that any material breach (i.e., any breach that would be important, qualitatively or quantitatively, to a reasonable client) shall be reported immediately.

d. ARG shall maintain a reporting system whereby its employees or the employees of BRRC, ARIM, and the Affiliated Advisers can report, on an anonymous basis, directly to the Global Compliance Committee, any breaches of fiduciary duty or violations or potential violations of ARG's Code of Ethics, Escalation Policy, compliance policies and procedures, or of the federal securities laws.

36. Independent Compliance Consultant.

a. ARG shall retain, within 30 days of the date of entry of this Order, the services of an Independent Compliance Consultant not unacceptable to the staff of the Commission and a majority of ARG's Board of Directors. ARG shall ensure that the Independent Compliance Consultant has experience and expertise in quantitative investment techniques (or the Independent Compliance Consultant can contract to obtain such experience or expertise), including, but not limited to, the control and auditing environments applicable to quantitative investment computer programs such as the Model. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by ARG. ARG shall require the Independent Compliance Consultant to conduct a comprehensive review of ARG's, BRRC's, ARIM's, and the Affiliated Advisers' supervisory, compliance, and other policies and procedures designed to detect and prevent breaches of fiduciary duty, breaches of ARG's Code of Ethics or violations of the federal securities laws by ARG, BRRC, ARIM, the Affiliated Advisers and their employees. This review shall include, but shall not be limited to, the following:

(i) Disclosure. The Independent Compliance Consultant will review ARG's, BRRC's, ARIM's, and the Affiliated Advisers' disclosures about the coding process, identify any weaknesses in that process, and make recommendations as to the appropriate disclosures relating to the coding of the Model to investors.

(ii) Reporting. The Independent Compliance Consultant will review BRRC's reporting of errors or other issues that arise after changes to the Model go into production, and make appropriate recommendations as to the inclusion of compliance personnel, policies, and procedures into that reporting process.

(iii) Recordkeeping. The Independent Compliance Consultant will review BRRC's approach to documenting errors in the Model, the retention of versions of the computer code that animate the Model, and make appropriate recommendations as to how to document and retain changes that occur in the code.

ARG shall cooperate fully with the Independent Compliance Consultant and shall provide the Independent Compliance Consultant with access to files, books, records, and personnel as reasonably requested for the review.

b. ARG shall require that, at the conclusion of the review, which in no event shall be more than 180 days after the date of entry of this Order, the Independent Compliance Consultant shall submit a Report to ARG and the staff of the Commission. The Report shall address the issues described in paragraph 36.a above, and shall include a description of the review performed, the conclusions reached, the Independent Compliance Consultant's recommendations for changes in or improvements to policies and procedures for ARG, BRRC, ARIM, and the Affiliated Advisers, and a procedure for implementing the recommended changes in or improvements to those policies and procedures.

c. ARG, BRRC, ARIM, and the Affiliated Advisers shall adopt all recommendations contained in the Report of the Independent Compliance Consultant; provided, however, that, within 210 days after the date of entry of this Order, ARG, BRRC, ARIM and the Affiliated Advisers shall, in writing, advise the Independent Compliance Consultant and the staff of the Commission of any recommendations that one or more of them considers to be unnecessary or inappropriate. With respect to any such recommendation, ARG, BRRC, ARIM and the Affiliated Advisers need not adopt that recommendation at that time but shall propose, in writing, an alternative policy, procedure or system designed to achieve the same objective or purpose.

d. As to any recommendation with respect to the policies and procedures of ARG, BRRC, ARIM, and/or the Affiliated Advisers on which one or more of them and the Independent Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 240 days of the date of entry of this Order. In the event ARG, BRRC, ARIM and/or the Affiliated Advisers and the Independent Compliance Consultant are unable to agree on an alternative proposal, ARG, BRRC, ARIM and the Affiliated Advisers shall abide by the determinations of the Independent Compliance Consultant.

e. ARG, ARIM, BRRC, and the Affiliated Advisers shall conduct compliance training for all of their employees no later than 300 days after the date of entry of this Order or 90 days following adoption by ARG, BRRC, ARIM, and the Affiliated Advisers of all recommendations contained in the Report of the Independent Compliance Consultant.

f. ARG shall not terminate the Independent Compliance Consultant without the prior written approval of the majority of ARG's Board of Directors and the

staff of the Commission. ARG shall compensate the Independent Compliance Consultant for services rendered pursuant to this Order at its reasonable and customary rates. Neither ARG nor any of its affiliates shall be in or have an attorney-client relationship with the Independent Compliance Consultant and neither ARG nor its affiliates shall seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Compliance Consultant from transmitting any information, reports, or documents to the staff of the Commission.

g. ARG shall require that the Independent Compliance Consultant, for the period of the engagement and for a period of two years from completion of the engagement, shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with ARG or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. ARG shall require that any firm with which the Independent Compliance Consultant is affiliated in the performance of his, her or its duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with ARG or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

37. Periodic Compliance Review. At the end of ARG's fiscal years 2012 and 2013, ARG, BRRC, ARIM and the Affiliated Advisers shall undergo a compliance review by the Independent Compliance Consultant. At the conclusion of the review, the Independent Compliance Consultant shall issue a report of its findings and recommendations concerning the supervisory, compliance, and other policies and procedures at ARG, BRRC, ARIM and the Affiliated Advisers designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by ARG, BRRC, ARIM, the Affiliated Advisers, and their employees. Each report shall be promptly delivered to ARG's Board of Directors and the Global Compliance Committee.

38. Certification. Respondents shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondents agree to provide such evidence. The certification and supporting material shall be submitted to the Assistant Regional Director for the Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, Los Angeles, California, 90036, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

39. Recordkeeping. Respondents shall preserve for a period not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of their compliance with the undertakings set forth above.

40. Deadlines. The staff of the Commission may extend any of the procedural dates set forth above for good cause shown.

41. Ongoing Cooperation. Respondents shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Respondents shall:

a. Produce, without service of a notice or subpoena, any and all non-privileged documents and other information requested by the Commission staff subject to any restrictions under the law of any foreign jurisdiction;

b. Use their best efforts to cause their officers, employees, and directors to be interviewed by the Commission staff at such time as the staff reasonably may direct;

c. Use their best efforts to cause their officers, employees, and directors to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission staff; and

d. In connection with any testimony of Respondents' officers, employees, and directors to be conducted at deposition, hearing, or trial pursuant to a notice or subpoena, Respondents:

(i) Agree that any such notice or subpoena for Respondents' officers', employees', and directors' appearance and testimony may be served by regular or electronic mail on: Fred W. Reinke, Esq., Mayer Brown LLP, 1999 K Street, N.W., Washington, DC 20006-1101; freinke@mayerbrown.com or Lee H. Rubin, Esq., Mayer Brown LLP, Two Palo Alto Square, Suite 300, Palo Alto, CA 94306; lrubin@mayerbrown.com.

(ii) Agree that any such notice or subpoena for Respondents' officers', employees', and directors' appearance and testimony in any action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

IV.

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

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

A. Respondent ARG cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

B. Respondent ARIM cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

C. Respondent BRRC cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

D. Respondents ARG, ARIM, and BRRC are censured.

E. Respondents shall, jointly and severally, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$25 million 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 wire transfer, 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 ARG, ARIM and BRRC as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Bruce Karpati, Co-Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, NY 10281.

F. Respondents shall comply with the undertakings enumerated in Paragraphs 34 to 40 above.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Walter
Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63829 / February 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14225

In the Matter of

TD AMERITRADE, INC.,

Respondent.

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

I.

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

II.

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

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

From approximately January 18, 2007 through September 16, 2008 (the "relevant period"), Respondent failed reasonably to supervise its registered representatives with a view to preventing their violations of Section 17(a)(2) of the Securities Act of 1933 ("Securities Act") in connection with their offer and sale of shares in the Reserve Yield Plus Fund, a mutual fund managed by The Reserve (the "RYP Fund" or "Fund"). Although Respondent developed and deployed training materials specifically regarding the Fund, in offering the Fund to Respondent's customers during the relevant period, Respondent's representatives at times mischaracterized the Fund as a money market fund, as safe as cash, or as an investment with guaranteed liquidity, and other times failed to disclose the nature or risks of the Fund. Respondent failed to establish policies and procedures and a system to implement the procedures which would reasonably be expected to prevent and detect such violative conduct by its representatives in the offer and sale of the Fund.

Respondent

1. Respondent, a New York corporation headquartered in Omaha, Nebraska, is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of the Financial Industry Regulatory Authority. Respondent is a wholly-owned subsidiary of TD Ameritrade Online Holdings Corp. Respondent was formed as a result of the consolidation of retail brokerage operations of Ameritrade, Inc. and TD Waterhouse Investor Services, Inc. following Ameritrade Holding Corporation's acquisition of TD Waterhouse Group, Inc. on January 24, 2006.

Facts

The RYP Fund and the Current Status of Fund Redemptions to Respondent's Customers

2. The RYP Fund was a diversified mutual fund that sought to provide higher returns than a money market fund while seeking to maintain a net asset value ("NAV") of \$1.00. The RYP Fund generally invested in instruments comparable to those of a money market fund, except that it purchased longer-term investments to generate higher returns.

3. As described in the Fund's Form N-Q filed August 26, 2008 for the quarter ended June 30, 2008, among the Fund's investments was commercial paper issued by Lehman Brothers Holdings, Inc. ("Lehman"). The Reserve wrote down these Lehman investments to a value of zero

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 September 16, 2008, after Lehman filed for bankruptcy the preceding day. As a result, the Fund's NAV fell to \$0.97. The Reserve ceased to honor redemption requests for the Fund and, on October 9, 2008, announced that the Fund would be liquidated. On October 24, 2008, the Commission issued an order under Section 22(e)(3) of the Investment Company Act of 1940 permitting the RYP Fund to suspend redemptions as of October 8, 2008. Since then, and as part of the RYP Fund's plan to liquidate its assets, the Fund has made five separate distributions to Fund shareholders totaling approximately \$1.1 billion, representing the return of approximately 95 percent of shareholders' principal. The Fund has retained approximately \$39 million for possible future distribution.

4. During the relevant period, Respondent's representatives offered and sold two classes of shares in the RYP Fund to customers: Class R shares (RYPQX) and Class Treasurer's shares (RYPTX). As of July 2008, most of the total amount invested in these two classes of shares was held by Respondent's customers. Thousands of Respondent's customers continue to hold a majority of the Fund's shares in these classes.

Respondent Begins Offering the Fund

5. During the latter part of 2006, and in response to customer requests, Respondent sought to identify a higher yielding alternative to money market funds. After researching products that might meet this need, Respondent selected the RYP Fund.

6. In connection with the rollout of the Fund, Respondent designed a compilation of training materials specific to the Fund. These materials, which included the Fund prospectus, accurately characterized the Fund, emphasized that the Fund was not a money market fund, and described the various risks associated with investing in the Fund. After the training materials had been distributed in January 2007, Respondent authorized many of its representatives to offer the RYP Fund to customers.

7. Thereafter, throughout the relevant period, Respondent's representatives offered and sold the RYP Fund through the following four sales channels: (1) the Branch Offices; (2) the National Branch; (3) the Fixed Income Guidance Group ("FIGG"); and (4) Investor Services. Respondent's representatives and managers received no enhanced compensation for selling the Fund relative to other products offered and sold by Respondent.

The Violative Sales Practices of Respondent's Representatives

8. During the relevant period, representatives within the four sales channels at times mischaracterized the Fund as a "money market fund," an "enhanced money market fund" or a "higher yielding money market." Respondent's representatives also at times equated the Fund to money market funds in terms of "safety and liquidity" or stated that the Fund was insured by the Federal Deposit Insurance Corporation or the Securities Investor Protection Corporation. Other times, representatives offered the Fund in response to a customer's specific request for a money market fund or an instrument with similar risk, without discussing the nature or risks of the Fund. As described above, Fund-specific training materials that accurately characterized the Fund and

that described the various risks associated with investing in the Fund were available for these representatives' review and use when selling this product.

Respondent's Procedures and Systems for Applying Such Procedures to Prevent and Detect Its Representatives' Violative Conduct

Training and Education Regarding the Fund

9. Respondent first trained some of its representatives on how to offer the RYP Fund beginning in January 2007 after Respondent had determined to allow its representatives to recommend the Fund.

10. Respondent's procedures provided that the representatives' direct managers were to conduct in-person training sessions with their respective groups of representatives using the written training materials. Beginning in January 2007, Respondent disseminated the training materials via email to all managers in the Branch Offices, the National Branch, and the FIGG with instruction to train their respective groups. However, Respondent did not disseminate such materials to all managers within the Investor Services sales channel at that time. Rather, various Investor Services managers received the training materials on an ad hoc basis throughout 2007 without any specific instruction to train the representatives they managed. Representatives within Investor Services were generally unfamiliar with the prescribed procedures by which representatives were to recommend sales of the Fund.

11. Despite its training efforts, Respondent had no system to implement procedures during the relevant period that was reasonably designed to ensure that representatives actually received the training from their managers and understood the materials. Respondent did not take adequate steps, such as providing additional training, refresher courses, or continuing education on the RYP Fund, to ensure that its representatives understood this product. While the FIGG conducted a training session in June 2008 regarding short-term instruments, including the RYP Fund, that representatives could offer, the training materials used at this training session mischaracterized the RYP Fund as a money market fund.

12. Many new hires whom Respondent employed after the initial dissemination of the training materials did not receive training about the Fund. Respondent did not include information regarding the RYP Fund as part of the curriculum that Respondent used for purposes of its training program for new hires.

13. As set forth above, although Respondent developed materials and procedures to train its representatives specifically regarding the Fund, it did not have a system to implement such procedures which was reasonably designed to prevent and detect the representatives' violative conduct.

Supervisory Oversight and Review

14. During the relevant period, Respondent's four sales channels employed different supervisory structures and procedures for the review of trades, including purchases of the RYP Fund.

15. At the time Respondent disseminated the training materials in January 2007, all of its Branch Offices and its National Branch were separately designated as an Office of Supervisory Jurisdiction ("OSJ"). According to Respondent's policies and procedures, the representatives' direct managers were responsible for reviewing any solicited trades in the RYP Fund and were required to review other available documentation to ensure that the trades were suitable for customers. However, the procedures did not require managers to perform any supervisory review to ensure that representatives provided proper disclosures to customers regarding the Fund.

16. In March 2007, Respondent changed its branch office supervisory structure by removing the OSJ designation from all but one of the branch offices and creating a centralized, independent branch supervision and controls group which then became the registered OSJ for the branch offices. This group functioned through four Divisional Operations Managers ("DOMs"), each of whom had direct oversight over one of the four regions in which the branch offices operated and one of whom also assisted the National Branch with its supervision.

17. In conjunction with this restructuring, Respondent revised its written supervisory procedures for the Branch Offices and National Branch to place primary responsibility upon the DOMs for reviewing sales of the RYP Fund. The DOMs' review focused upon ensuring that representatives updated suitability information for each account to determine whether the Fund was suitable for the purchasing customer, but these reviews did not focus on whether representatives had provided the proper disclosures regarding the Fund.

18. Subsequently during the relevant period, Respondent revised the procedures by which the DOMs conducted their review of the Fund transactions. Specifically, Respondent implemented a computer-based system that was intended to assist management's supervisory review of customer transactions. Regarding Fund transactions, the system generated various exception reports for further review by the DOMs based upon certain rules. However, the system was incapable of reviewing Fund transactions to determine whether representatives had made proper disclosures regarding the Fund. As a result, and as with Respondent's earlier procedures, these revised procedures were not reasonably designed to prevent and detect any misrepresentations or omissions by Respondent's representatives.

19. During the relevant period, the FIGG was designated as a separate OSJ and had a supervisory structure and procedures separate from the National Branch and Branch Offices. For most of the period, the FIGG did not employ any procedures for supervisory review of its representatives' sales of the Fund. In June 2008, the FIGG implemented procedures for review of Fund solicited transactions that mirrored the suitability reviews implemented in Respondent's National Branch and Branch Offices. The FIGG's supervisory review of Fund transactions was also not reasonably designed to prevent and detect the representatives' violative conduct.

20. During the relevant period, Investor Services was also designated as a separate OSJ and had its own set of supervisory procedures. However, Investor Services did not have established procedures for the supervisory review of solicited transactions in the Fund to determine whether representatives provided customers with proper disclosures. While Investor Services revised its procedures in August 2007 to require supervisory review of solicited orders in general, this review focused primarily on a suitability analysis for an exchange traded fund that Respondent began offering at that time. During the relevant period, Respondent did not implement supervisory procedures within Investor Services reasonably designed to identify representatives' misrepresentations and omissions regarding the RYP Fund.

21. As set forth above, Respondent did not have policies and procedures regarding supervisory oversight and review of its representatives' solicited trades in the RYP Fund which were reasonably designed to prevent and detect violative conduct by its representatives.

Violations

Respondent's Representatives Violated Section 17(a)(2) of the Securities Act

22. As a result of the sales practices concerning the RYP Fund as described above, Respondent's representatives violated Section 17(a)(2) of the Securities Act, which prohibits the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

Respondent Failed Reasonably to Supervise Its Representatives

23. Section 15(b)(4)(E) of the Exchange Act requires broker-dealers to supervise reasonably, with a view to preventing violations of the federal securities laws, persons subject to their supervision. The responsibility of broker-dealers to supervise reasonably their employees by means of effective, established procedures is a critical component of the federal regulatory scheme. See In the Matter of Goldman, Sachs & Co., Exch. Act Rel. No. 33576 (Feb. 3, 1994).

24. As described above, Respondent failed to have a system to implement procedures for the training and education of its representatives regarding the RYP Fund which would reasonably be expected to prevent and detect violative conduct by its representatives. In addition, Respondent failed to establish policies and procedures for the supervisory oversight and review of its representatives' solicited trades in the RYP Fund which would reasonably be expected to prevent and detect violations by the representatives.

25. Because Respondent's representatives violated Section 17(a)(2) of the Securities Act, and Respondent failed to implement adequate policies and procedures and a system for applying established procedures reasonably designed to prevent or detect such violations, Respondent failed reasonably to supervise its representatives within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Remedial Efforts

26. In determining to accept the Offer of Settlement by Respondent, the Commission considered remedial acts voluntarily undertaken by Respondent to make improvements to its supervisory system.

Undertakings

27. Respondent has undertaken to distribute to Eligible Customers (as defined below) \$0.012 for each share of the Fund held by such Eligible Customers as specified under the terms set forth below, which is expected to total approximately \$10 million. In determining whether to accept Respondent's Offer, the Commission has considered these undertakings.

A. Definition – "Eligible Customers." As used in these undertakings, "Eligible Customers" shall mean all current and former account owners who purchased Fund shares at Respondent during the relevant period and continue to hold such shares as of the date of this Order. Notwithstanding the foregoing definition, the term "Eligible Customers" shall not include account owners who purchased the Fund at Respondent during the relevant period in accounts owned, managed or advised by or through independent registered investment advisers.

B. Respondent's Distribution to Eligible Customers. Within thirty (30) days after the date of this Order ("Distribution Deadline"), Respondent shall distribute to Eligible Customers \$0.012 for each share of the Fund held by such Eligible Customers (the "Distribution").

C. Customer Notification Procedures

1. Customer Notice. For Eligible Customers who continue to hold an account with Respondent as of the Distribution Deadline, Respondent shall provide written notice of this Order and that Respondent is making the Distribution to such Eligible Customers by the Distribution Deadline or by the date of the next account statement following the Distribution Deadline. For Eligible Customers who no longer hold an account with Respondent as of the Distribution Deadline, Respondent shall provide written notice of this Order and that Respondent is making the Distribution to such Eligible Customers by no later than the date of Distribution to such Eligible Customers.

2. Customer Internet Page. No later than two (2) business days after the date of this Order, Respondent shall establish a public Internet page on its corporate Web site(s), with a prominent link to that page appearing on Respondent's relevant homepage(s), to provide information concerning the terms of this Order. Respondent shall maintain the Internet page through at least thirty (30) days following the Distribution Deadline.

D. Other Proceedings/Relief. Eligible Customers who receive a Distribution from Respondent pursuant to this Order are not prohibited from pursuing any remedies against Respondent available under the law subject to any defenses Respondent may have.

E. Reports. Within thirty (30) days after completion of its undertakings described above, Respondent shall submit a written report detailing its compliance with such undertakings. The report shall be submitted to Noel M. Franklin, Esq., U.S. Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver, Colorado 80202 or as directed in writing by the Commission Staff. The reporting requirements and deadlines set forth above may be amended or modified with agreement from the Commission Staff.

IV.

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

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

A. Respondent TD Ameritrade, Inc. is censured; and

B. The Commission is not imposing a penalty against Respondent at this time. However, in the event the Division of Enforcement ("Division") believes that Respondent has not complied with its undertakings as more fully described above, the Division may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider the appropriateness of a penalty; and (2) seek an order directing payment of up to the maximum civil penalty allowable under the law. In determining whether to impose a penalty, the Commission will take into consideration its traditional criteria in determining whether to assess civil penalties, including the extent to which Respondent has satisfied its undertakings and cooperated with the Commission and other regulators in their investigations. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Jill M. Peterson
Assistant Secretary

*Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63833 / February 3, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3240 / February 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14226

In the Matter of

DAVID E. WATSON, CPA

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO RULE
102(e) OF THE COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS

I.

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

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

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

II.

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

III.

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

1. Watson, age 55, a resident of Kansas City, Missouri, was hired by American Italian Pasta Company ("AIPC") as its chief financial officer in 1994. From approximately October 2000 through March 2003, Watson served as AIPC's executive vice president of operations and corporate development. From approximately April 2003 through December 2003, when he left AIPC, Watson served as AIPC's executive vice president of corporate development and strategy. From approximately January 2004 through December 2005, Watson agreed to consult with AIPC on an as-needed basis. Watson was licensed as a certified public accountant in Missouri and Kansas, but allowed his licenses to expire in 1994.

2. At all relevant times, AIPC was a Delaware corporation with its principal place of business in Kansas City, Missouri. AIPC is a producer and marketer of dry pasta. At all relevant times, AIPC's common stock was registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"). The company filed annual, quarterly, and current reports with the Commission on Forms 10-K, 10-Q, and 8-K, respectively. At all relevant times, AIPC stock was traded on the New York Stock Exchange ("NYSE"). In July 2010, Ralcorp Holdings, Inc. acquired AIPC.

3. On October 22, 2008, the Commission filed its amended complaint against Watson in the United States District Court for the Western District of Missouri (Civil Action No. 4:08-cv-0067). On January 28, 2011, the court entered an order permanently enjoining Watson, by consent, from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1, and 13b2-2 thereunder, and from aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder. By consent, the court further ordered that Watson pay \$397,113 in disgorgement; \$189,464 in prejudgment interest; and a \$75,000 civil money penalty. The court further ordered by consent that Watson be prohibited, for five (5) years following the date of the court's order, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

4. The Commission's amended complaint alleged, among other things, that Watson and others at AIPC engaged in a fraudulent scheme that hid from the investing public the true financial state of the company by filing materially false and misleading statements in the company's annual reports on Forms 10-K, quarterly reports on Forms 10-Q, and current reports on Forms 8-K for AIPC's fiscal years 2002, 2003, and 2004. The complaint alleged that to meet aggressive external targets, Watson and others engaged in numerous fraudulent accounting practices that departed from generally accepted accounting principles, including, among other things, capitalizing improperly millions of dollars of normal operating costs; overstating improperly by millions of dollars the company's spare parts inventory; and structuring round-trip cash transactions.

IV.

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

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

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

B. After five (5) years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63834 / February 3, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3152 / February 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14229

In the Matter of

JACK C. SMITH, JR.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934 AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jack C. Smith, Jr. ("Smith" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions (the "Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

These proceedings arise out of Respondent's failure to supervise Dennis Lee Keating II ("Keating"), a part-owner and registered representative at Torrey Pines Securities, Inc. ("Torrey Pines"), a registered broker-dealer. Between August 2006 and November 2008, Keating acted as an unregistered broker-dealer by conducting an unregistered private securities offering outside the scope of his employment with Torrey Pines. By not separately registering as a broker-dealer for purposes of the offering, Keating violated Section 15(a) of the Securities Exchange Act, the broker-dealer registration provision of the federal securities laws.

Smith failed reasonably to supervise Keating in connection with his registration violations because Smith did not establish reasonable policies and procedures to assign responsibility for supervising Keating, causing Keating to supervise himself. Smith also failed to develop systems to implement the firm's procedures regarding outside business activities by registered representatives. In particular, Smith failed to develop systems for supervisors and the compliance department to monitor registered representatives' outside business activities to detect and remedy violations of Section 15(a) of the Exchange Act and NASD Rule 3040, which prohibits a registered representative from selling securities outside the authority of a firm. Smith also failed to develop systems to require supervisors and/or compliance staff to adequately follow-up on outside activities that might signal violations of the firm's prohibition against selling securities outside the authority of Torrey Pines. Had such systems been in place, Keating's outside activities that violated the broker-dealer registration provisions of the federal securities laws likely would have been prevented and detected.

Respondent

1. **Jack C. Smith, Jr.**, age 61, resides in San Diego, California. Smith has had an ownership interest in Torrey Pines since November 1987, and during the relevant period, he was president, chief executive officer, and had overall supervisory responsibility for the firm. In 2009, Smith sold the majority of his ownership interest in Torrey Pines.

Other Relevant Entity and Person

2. **Torrey Pines Securities, Inc.** is a broker-dealer headquartered in Del Mar, California. Torrey Pines has been registered with the Commission since 1985, and the firm is also registered in California and Nevada as an investment adviser.

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.

3. **Dennis Lee Keating, II**, age 46, resides in Highland, Utah. In April 2006, Keating joined Torrey Pines as a part-owner and registered representative, working in and supervising the Corona, California branch office. Keating resigned from Torrey Pines in November 2008, and sold his ownership interest. Keating was permanently enjoined on June 28, 2010 for violations of the securities and broker-dealer registration and antifraud provisions, specifically Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder. *SEC v. Dennis Lee Keating, II*, Case No. 2:10cv419 (Dist. Utah filed May 6, 2010). On July 6, 2010, the Commission barred Keating from associating with a broker-dealer or investment adviser. *Dennis Lee Keating, II*, Admin. Proc. File No. 3-13957 (July 6, 2010).

Background

4. Smith formed Torrey Pines in 1987 and was its sole owner until 2006 when Keating and a third individual purchased interests in Torrey Pines. These three individuals remained part-owners from 2006 through 2008. During the relevant period, Smith was the president and chief executive officer and had overall supervisory responsibility for the firm. Torrey Pines is headquartered in Del Mar, California, and had four branch offices, three in California and one in Florida.

Keating's Unregistered Offering

5. Keating joined Torrey Pines in April 2006, opening the Torrey Pines Corona, California branch office (the "Corona Office"). Keating, along with an office assistant, and, for a short time, one other representative, worked in the Corona Office. Keating had overall supervisory responsibility for the Corona Office.

6. In August 2006, Keating formed a privately-held company and until April 2007, he raised over \$17 million from friends, family, and Torrey Pines's customers in a private, unregistered offering of securities. Until at least November 2008, Keating also continued lulling investors with false assurances that they would receive a return on their investments. Keating acted as an unregistered broker-dealer in violation of Section 15(a) of the Exchange Act, as he conducted the offering outside the scope of his employment with Torrey Pines.

Smith Failed to Establish Reasonable Procedures and Systems to Supervise Keating; Keating Left to Supervise Himself

7. During the relevant period, according to Torrey Pines' written supervisory procedures manual (the "Manual"), Smith was responsible for establishing the firm's supervisory policies and procedures, as well as systems to implement them, at Torrey Pines. In practice, Smith also had the ability and authority to establish policies and procedures, and to implement supervisory systems that would apply to Keating.

8. Smith failed to establish reasonable policies and procedures to assign responsibility for supervising Keating. When Keating became a part-owner of Torrey Pines, Smith did not revise the Manual or create other policies or procedures for Keating to be

supervised reasonably at the firm's Corona Office. Although Smith delegated to the resident manager the responsibility of supervising Keating's trading activities, no one other than Keating oversaw the other daily activities of the Corona Office. No one reviewed Keating's daily correspondence or telephone calls, other than in cursory annual audits. Smith's delegation of most of the Corona Office's daily responsibilities to Keating resulted in Keating supervising himself. If Keating had not been left to supervise himself, his outside sales activities, which violated Section 15(a) of the Securities Exchange Act likely would have been prevented and detected.

**Smith Failed to Establish Systems to Implement and Enforce Policies
Regarding Outside Business Activities and Selling Away**

9. Although Torrey Pines had a policy prohibiting selling securities outside of the firm, to comply with Securities Exchange Act Section 15(a) and NASD Rule 3040, and a policy for registered representatives to report outside business activities, Smith failed to develop systems for supervisors and the compliance department to monitor for adherence with the provisions, e.g., reviewing documents relating to registered representatives' outside business activities to ensure that the activities did not involve selling any private securities transactions outside the scope of a representative's employment in violation of Section 15(a) of the Exchange Act. If Smith had established systems providing for better monitoring for adherence with those provisions at Torrey Pines, a supervisor or the compliance officer would reasonably have been expected to detect that Keating's outside real estate investment business was a private, securities-related offering and that Keating violated Section 15(a) by engaging in that business without registering as a broker-dealer.

10. From August 2006 through late 2007, Smith and/or the compliance officer had many encounters relating to Keating's outside business activities, including oral and written complaints to Smith and Torrey Pines, respectively, from an individual who had invested in Keating's private offering. If Smith had put procedures and systems in place at Torrey Pines requiring supervisors or the compliance officer to follow-up on outside activities that might signal violations of the firm's prohibition against selling securities outside the firm, Smith might have prevented and detected Keating's violations of Section 15(a)(1) of the Exchange Act.

Violations

11. As a result of the conduct described above, Keating violated Section 15(a) of the Exchange Act.

12. Section 15(b)(4)(E) of the Exchange Act requires broker-dealers reasonably to supervise persons subject to their supervision, with a view toward preventing violations of the federal securities laws. See, e.g., *Dean Witter Reynolds, Inc.*, Exchange Act Rel. No. 46578 (October 1, 2002). The Commission has emphasized that the "responsibility of broker-dealers to supervise their employees by means of effective, established procedures is a critical component in the federal investor protection scheme regulating the securities markets." *Id.* Section 15(b)(4)(E) of the Exchange Act provides for the imposition of a sanction against a broker or dealer who "has

failed reasonably to supervise, with a view to preventing violations of the securities laws, another person who commits such a violation, if such other person is subject to his supervision." Section 15(b)(6)(A)(i) incorporates by reference Section 15(b)(4)(E) and provides for the imposition of sanctions against persons associated with a broker-dealer. Similarly, Section 203(f) of the Advisers Act, incorporating by reference Section 203(e)(6) of the Advisers Act, authorizes the Commission to sanction a person who is associated, or at the time of the alleged misconduct was associated, with an investment adviser for failing reasonably to supervise, with a view to preventing violations of the federal securities law, another person who commits such a violation, if that person is subject to the person's supervision.

13. As a result of the conduct described above, Smith failed reasonably to supervise Keating within the meaning of Section 15(b)(4)(E) of the Exchange Act, and within the meaning of Section 203(f) of the Advisers Act, when he failed to supervise Keating with a view to preventing and detecting violations of Section 15(a) of the Exchange Act.

IV.

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

Accordingly, pursuant to Sections 15(b) of the Exchange Act and Section 203(f) of the Advisers Act it is hereby ORDERED that:

A. Respondent Smith be, and hereby is, suspended from supervision associated with any broker or dealer or investment adviser for a period of nine (9) months, effective on the second Monday following the entry of this Order.

B. Respondent Smith shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$25,000 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 wire transfer, 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 Smith as Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Michele Wein Layne, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., 11th Floor, Los Angeles, California 90036.

By the Commission.

Elizabeth M. Murphy
Secretary

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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. 63835 / February 3, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3153 / February 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14230

In the Matter of

TORREY PINES
SECURITIES, INC.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDING PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934 AND SECTION 203(e) OF THE
INVESTMENT ADVISERS ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Torrey Pines Securities, Inc. ("Torrey Pines" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Torrey Pines Securities, Inc. is a broker-dealer headquartered in Del Mar, California. Torrey Pines has been registered as a broker-dealer with the Commission since 1985 (File No. 8-35004). Torrey Pines has also been registered in California and Nevada as an investment adviser since 2001 and 2007, respectively.

B. OTHER RELEVANT ENTITY AND INDIVIDUALS

2. Jack C. Smith, Jr. ("Smith"), age 61, resides in San Diego, California. Smith has had an ownership interest in Torrey Pines since November 1987, and during the relevant

period, he was president, chief executive officer, and had overall supervisory responsibility for the firm. In 2009, Smith sold the majority of his ownership interest in Torrey Pines to a third party individual's trust.

3. **Dennis Lee Keating, II** ("Keating"), age 46, resides in Highland, Utah. In April 2006, Keating joined Torrey Pines as a part-owner and registered representative, working in and supervising the Corona, California branch office. Keating resigned from Torrey Pines in November 2008, and individual's trust purchased Keating's ownership shares. Keating was permanently enjoined on June 28, 2010 for violations of the securities and broker-dealer registration and antifraud provisions, specifically Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder. *SEC v. Dennis Lee Keating, II*, Case No. 2:10cv419 (Dist. Utah filed May 6, 2010). On July 6, 2010, the Commission barred Keating from associating with a broker-dealer or investment adviser. *Dennis Lee Keating, II*, Admin. Proc. File No. 3-13957 (July 6, 2010).

C. KEATING'S UNREGISTERED OFFERING

5. Keating joined Torrey Pines in April 2006, opening the Torrey Pines Corona, California branch office (the "Corona Office"). Keating, along with an office assistant, and, for a short time, one other representative, worked in the Corona Office. Keating had overall supervisory responsibility for the Corona Office.

6. In August 2006, Keating formed a privately-held company and until April 2007, he raised over \$17 million from friends, family, and Torrey Pines's customers in a private, unregistered offering of securities. Until at least November 2008, Keating also continued lulling investors with false assurances that they would receive a return on their investments. Keating acted as an unregistered broker-dealer in violation of Section 15(a) of the Exchange Act, as he conducted the offering outside the scope of his employment with Torrey Pines.

D. TORREY PINES FAILED TO ESTABLISH REASONABLE SUPERVISORY PROCEDURES AND SYSTEMS

7. Torrey Pines failed to establish reasonable policies and procedures to assign responsibility for supervising Keating. When Keating became a part-owner of Torrey Pines, Torrey Pines did not revise its written supervisory procedures manual or create other policies or procedures for Keating to be supervised reasonably at the firm's Corona Office. No one other than Keating oversaw the daily activities of the Corona Office. No one reviewed Keating's daily correspondence or telephone calls, other than in cursory annual audits. The delegation of the Corona Office's daily responsibilities to Keating resulted in Keating supervising himself. If Keating had not been left to supervise himself, his outside sales activities, which violated Section 15(a) of the Exchange Act, likely would have been detected.

8. Although Torrey Pines had a policy prohibiting selling securities outside of the firm, and a policy for registered representatives to report outside business activities, the firm failed to develop systems for supervisors and the compliance department to monitor for adherence with the provisions, e.g., reviewing documents relating to registered representatives'

outside business activities to ensure that the activities did not involve selling any private securities transactions outside the scope of a representative's employment in violation of Section 15(a) of the Exchange Act. If Torrey Pines had established systems providing for better monitoring for adherence with those provisions, a supervisor or the compliance officer would reasonably have been expected to detect that Keating's outside investment business involved a private, securities-related offering and that Keating violated Section 15(a) of the Exchange Act by conducting this activity without registering as a broker-dealer.

9. From August 2006 through January 2008, a number of suspicious events concerning Keating's outside business activities came to the attention of supervisors and/or compliance staff at Torrey Pines in various ways, including through oral and written complaints to Torrey Pines from an individual who had invested in Keating's private offering. If Torrey Pines had put procedures and systems in place requiring supervisors or the compliance officer to follow-up on suspicious activities that might signal violations of the firm's prohibition against selling securities outside the firm, Torrey Pines might have prevented and detected Keating's violations of Section 15(a)(1) of the Exchange Act.

E. VIOLATIONS

10. As a result of the conduct described above, Torrey Pines failed reasonably to supervise Keating within the meaning of Section 15(b)(4)(E) of the Exchange Act and Section 203(e) of the Advisers Act.

III.

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

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 3, 2011

In the Matter of

Advantage Life Products, Inc., and
B-Teller, Inc.
(n/k/a CA Goldfields, 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 Advantage Life Products, Inc. because it has not filed any periodic reports since the period ended September 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of B-Teller, Inc. (n/k/a CA Goldfields, Inc.) because it has not filed any periodic reports since the period ended October 31, 2005.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on February 3, 2011, through 11:59 p.m. EST on February 16, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By **Jill M. Peterson**
Assistant Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 4, 2011

In the Matter of

**ActiveCore Technologies, Inc.,
Battery Technologies, Inc.,
China Media1 Corp.,
Dura Products International, Inc.
(n/k/a Dexe Corp.),
Global Mainframe Corp.,
GrandeTel Technologies, Inc.,
Magna Entertainment Corp.
(n/k/a Reorganized Magna Entertainment Corp.), and
649 Com, Inc.
(n/k/a Infinite Holdings Group, 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 ActiveCore Technologies, 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 Battery Technologies, Inc. because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of China Media1 Corp. 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 Dura Products International, Inc. (n/k/a Dexe Corp.) because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Global Mainframe Corp. because it has not filed any periodic reports since the period ended April 30, 2007.

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Magna Entertainment Corp. (n/k/a Reorganized Magna Entertainment Corp.) because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of 649 Com, Inc. (n/k/a Infinite Holdings Group, Inc.) because it has not filed any periodic reports since the period ended March 31, 2006.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on February 4, 2011, through 11:59 p.m. EST on February 17, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63841 / February 4, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14231

In the Matter of

ActiveCore Technologies, Inc.,
Battery Technologies, Inc.,
China Media1 Corp.,
Dura Products International, Inc.
(n/k/a Dexe Corp.),
Global Mainframe Corp.,
GrandeTel Technologies, Inc.,
Magna Entertainment Corp.
(n/k/a Reorganized Magna
Entertainment Corp.), and
649 Com, Inc.
(n/k/a Infinite Holdings Group, 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 ActiveCore Technologies, Inc., Battery Technologies, Inc., China Media1 Corp., Dura Products International, Inc. (n/k/a Dexe Corp.), Global Mainframe Corp., GrandeTel Technologies, Inc., Magna Entertainment Corp. (n/k/a Reorganized Magna Entertainment Corp.), and 649 Com, Inc. (n/k/a Infinite Holdings Group, Inc.).

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II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. ActiveCore Technologies, Inc. ("ATVE")¹ (CIK No. 1011601) is a revoked Nevada corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ATVE 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 \$11,183,325 for the prior nine months. As of January 25, 2011, the common stock of ATVE was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).
2. Battery Technologies, Inc. ("BTIOQ") (CIK No. 910654) is an Ontario corporation located in Richmond Hill, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BTIOQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a net loss of \$1,826,000 Canadian for the prior year. As of January 25, 2011, the common stock of BTIOQ was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).
3. China Media1 Corp. ("CMDA") (CIK No. 1202081) is a Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CMDA 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 \$3,101,148 for the prior nine months. As of January 25, 2011, the common stock of CMDA was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).
4. Dura Products International, Inc. (n/k/a Dexx Corp.) ("DXXFF") (CIK No. 1043407) is an Ontario corporation located in Etobicoke, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DXXFF is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a net loss of \$3,251,959 Canadian for the prior year. As of January 25, 2011, the common shares of DXXFF were quoted on OTC Link, had five market makers, and were eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).
5. Global Mainframe Corp. ("GMFCF") (CIK No. 1292428) is an Alberta corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GMFCF is delinquent in its

¹The short form of each issuer's name is also its stock symbol.

periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended April 30, 2007, which reported a net loss of \$40,908 for the prior year. As of January 25, 2011, the common stock of GMFCF was quoted on OTC Link, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. GrandeTel Technologies, Inc. ("GDTGF") (CIK No. 828809) is a British Columbia corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GDTGF 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 January 31, 2002, which reported a net loss of \$39,935,000 Canadian for the prior year. As of January 25, 2011, the common stock of GDTGF was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Magna Entertainment Corp. (n/k/a Reorganized Magna Entertainment Corp.) ("MECAQ") (CIK No. 1093273) is a Delaware corporation located in Aurora, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MECAQ 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, 2008, which reported a net loss of \$114,716,000 for the prior nine months. On March 5, 2009, MECAQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was still pending as of January 26, 2011. As of January 25, 2011, the Class A subordinate voting stock of MECAQ was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

8. 649 Com, Inc. (n/k/a Infinite Holdings Group, Inc.) ("IHGO") (CIK No. 1098344) is a forfeited Texas corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IHGO 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, 2006, which reported a net loss of \$13,026 for the prior three months. As of January 25, 2011, the common stock of IHGO was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

9. As described 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


By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63849 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14232

In the Matter of

EUGENE C. GEIGER,

Respondent.

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

I.

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

II.

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

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III.

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

1. From 1990 through December, 2000, Geiger was a registered representative associated with Spencer Edwards, Inc. ("SEI"), a broker-dealer registered with the Commission. Geiger, 45 years old, is a resident of Denver, Colorado.

2. On January 28, 2011, a final judgment was entered by consent against Geiger, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Eugene C. Geiger, Civil Action Number 10-CV-00128 (consolidated with Civ. A. No. 10-CV-00129), in the United States District Court for Colorado.

3. In the Commission's consolidated case, the complaints alleged the following facts: During the time period of December, 1999 through June 2000, Geiger knowingly participated in a scheme to manipulate price of stocks of two issuers: AbsoluteFuture.com ("AFTI") and Wamex Holdings, Inc. ("WAMX"). During this time period, AFTI and WAMX were penny stocks traded over-the-counter and quoted on the NASD's Bulletin Board quotation system. As a part of the scheme, Geiger purchased at least 13 blocks of AFTI and Wamex stock at then-prevailing market prices in exchange for a secret discount of 50% or higher through a privately-arranged transfer of additional shares from the seller at no cost. In addition, in 12 of the 13 transactions, Geiger further agreed to manipulate the volume of AFTI and Wamex stock trading by inter-posing a straw market-maker into the market portion of the block transaction, which doubled the reported volume of the trades, but served no other benefit to Geiger's client or the seller. Prior to the entry of each block deal, Geiger and the seller reached specific agreement as to: (a) the amount of stock to be purchased "through the market" in a reported transaction; (b) the price at which the transaction would be reported to the public; (c) the amount of stock that would be transferred to Geiger's client's account to affect the unreported discount; and (d) the market-maker brokerage firm where Geiger and the seller would direct their buy and orders. At the same time Geiger knowingly arranged these manipulative trades to increase the price and volume of AFTI and WAMX stocks, Geiger sold his client's holdings back into the public markets at ever-increasing, manipulated prices, reaping millions of dollars in gains for his client and hundreds of thousands of dollars in commissions for SEI and himself.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL 111-203, July 21, 2010, 124 Stat. 1376, Respondent Geiger be, and hereby is barred from association with any investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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.

Respondent be, and hereby is, barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9182 / February 7, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3154 / February 7, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29575 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14233

In the Matter of	:	ORDER INSTITUTING
Alpine Woods Capital Investors,	:	ADMINISTRATIVE AND CEASE-AND-
LLC and Samuel A. Lieber,	:	DESIST PROCEEDINGS PURSUANT TO
Respondents.	:	SECTION 8A OF THE SECURITIES
	:	ACT OF 1933, SECTIONS 203(e), (f) AND (k)
	:	OF THE INVESTMENT ADVISERS
	:	ACT OF 1940, AND SECTIONS 9(b) AND (f)
	:	OF THE INVESTMENT COMPANY ACT OF
	:	OF 1940, MAKING FINDINGS AND IMPOSING
	:	REMEDIAL SANCTIONS AND A
	:	CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 203(e) and (k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and (f) of the Investment Company Act ("Investment Company Act") against Alpine Woods Capital Investors, LLC and Sections 203(f) and (k) of the Advisers Act and Section 9(b) of the Investment Company Act against Samuel A. Lieber.

II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (together, "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

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findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 203(e), (f) and (k) of the Investment Advisers Act of 1940, and Sections 9(b) and (f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that:

RESPONDENTS

1. **Alpine Woods Capital Investors, LLC ("Alpine")**, located in Purchase, New York, has been registered with the Commission since December 16, 1997 as an investment adviser. It is one of two operating entities of a privately-owned investment management firm, Alpine Woods, L.P., d/b/a Alpine Woods Investments, a partnership owned 51% by Samuel A. Lieber and 49% by his father, Stephen A. Lieber. Alpine provides discretionary and non-discretionary investment advisory and management services to registered investment companies and other advisory clients pursuant to investment advisory agreements. Alpine's discretionary accounts currently include 13 open-end mutual funds and 3 closed-end investment companies. Alpine charges its funds an annual management fee, charged monthly in arrears, of 1% of the average daily net assets.

2. **Samuel A. Lieber**, age 54, is and was during the Relevant Period (as defined below) the Chief Executive Officer of Alpine. Samuel Lieber is the majority owner of Alpine Woods, L.P., d/b/a Alpine Woods Investments, which is the sole member of Alpine. Samuel Lieber is and was during the Relevant Period the portfolio manager or co-portfolio manager for several funds, including the Alpine Dynamic Innovators Fund.

RELATED ENTITIES

3. **Alpine Series Trust ("Trust")** is a Delaware statutory trust organized on June 5, 2001. The Trust is a registered open-end management investment company, organized as a series company, and includes, among others, the Alpine Dynamic Financial Services Fund and the Alpine Dynamic Innovators Fund, each a series of the Trust. Each fund is functionally a registered investment company. The Trust is governed by a Board of Trustees, which supervises the management of each series within the Trust. Alpine provides investment advisory services pursuant to investment advisory agreements entered into with the Trust.

4. **Alpine Dynamic Innovators Fund ("Innovators Fund")**, a series of the Trust, began investment operations on July 11, 2006. Its stated investment objective is capital

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

appreciation with a focus on domestic and foreign equities offering significant growth potential. The Innovators Fund's total assets grew from approximately \$1 million at inception to approximately \$5 million as of October 31, 2006, and to approximately \$60.1 million as of January 31, 2008.

5. **Alpine Dynamic Financial Services Fund ("Financial Services Fund")**, a series of the Trust, began investment operations on November 1, 2005, having been spun-off from one of the firm's hedge funds focused on the financial services industry (Alpine Woods Growth Values Financial Equities, L.P.). Its stated investment objective is long term capital growth and consistent above average returns with a focus on domestic and foreign equities in the financial services industry. The Financial Services Fund's total assets grew from approximately \$545,000 at inception to approximately \$7.4 million as of October 31, 2006, and to approximately \$11.1 million as of January 31, 2008.

SUMMARY

6. Between 2003 and 2007, Alpine launched a number of new funds and experienced significant growth in assets under management. As a result of the growth in Alpine's commission-generating business, Alpine had greater opportunity to obtain shares in initial public offerings ("IPOs"). Alpine was the investment adviser for multiple funds and could determine to which funds IPO shares should be allocated. Alpine's compliance policies and procedures mandated that IPO allocations among clients be made "fairly and equitably" according to a "specific and consistent basis..." Similar disclosures contained within Alpine's Form ADV during 2006 and 2007 advised investors that trade allocations would be made according to the "risk tolerance and account objective guidelines of its clients" and in a manner that was "fair and equitable, consistent with the requirements of the Investment Advisers Act of 1940 and the Investment Company Act of 1940." In practice, Alpine's portfolio managers were expected to make themselves aware of upcoming IPOs, decide whether or not to participate and communicate initial indications of interest to Alpine's traders. Those initial indications of interest were not well documented; documentation that did exist was generally not retained. Although the allocation of IPO shares was typically made *pro rata* according to the initial indications of interest, in at least two instances Alpine's CEO, Samuel Lieber, made a decision to allocate IPO shares in a way that was not consistent with *pro rata* allocation.

7. As a result of the IPO allocation practices at Alpine, during the period February 1, 2006 through January 31, 2008 (the "Relevant Period"), Alpine's two smallest, most recently-opened funds, the Financial Services and Innovators funds (together, the "Relevant Funds"), participated in a disproportionate number of IPOs compared to Alpine's other existing funds (going strictly by size and assuming the other funds had expressed interest in participating in the IPOs). After receiving IPO shares, the Relevant Funds, in most instances, sold some or all of the shares within 3 days after their initial purchase. IPO trading by the Relevant Funds materially contributed to the positive performance of the Relevant Funds during Alpine's fiscal year ending October 31, 2007 ("FY 2007"). Alpine nonetheless failed to disclose to the Board of Trustees for the Alpine Series Trust or to fund investors the extent to which the Relevant Funds invested in IPOs and the material impact IPO trading had on the performance of the Relevant Funds. In addition, Alpine failed to implement written policies and procedures reasonably designed to

prevent violations of the Advisers Act, including policies regarding the allocation of IPO shares. Finally, Alpine committed, and caused the Trust to commit, books and records violations by failing to make and keep true and accurate order memoranda in connection with the purchase of IPOs.

BACKGROUND

A. Alpine's Trading in IPOs

8. The price of IPO shares often increases from the offering price in the period immediately following its initial trading. If demand for an IPO is particularly strong, it is expected that trading in the aftermarket will occur at a significant premium. Therefore IPOs in general, and IPOs for which there is strong demand in particular, typically represent valuable investment opportunities because they tend to increase in price in the immediate aftermarket.

9. In 2003, Alpine had approximately \$807 million in assets under management. By October 2006, the assets under the management of Alpine had grown to approximately \$3 billion and, by January 2008, Alpine managed approximately \$11.1 billion in assets. This growth gave Alpine greater access to IPO opportunities.

10. During the Relevant Period, Alpine's two smallest mutual funds in terms of asset size, the Financial Services and the Innovators Funds, participated in a disproportionate number of IPOs relative to Alpine's other funds. Alpine's trading records show that Alpine received approximately 219 overall IPO allocations during that period. Alpine then allocated those IPOs among the firm's various funds, resulting in 399 total IPO allocations, approximately 135 of which were allocated to the Financial Services Fund and approximately 69 of which were allocated to the Innovators Fund. After receiving IPO shares, the Relevant Funds, in most instances, sold some or all of the shares within 3 days after their initial purchase.

11. The Relevant Funds were significantly smaller than Alpine's other existing funds. By January 2008, the Financial Services Fund had approximately \$11.1 million under management and the Innovators Fund had approximately \$60.1 million. At that time, however, Alpine was managing approximately \$11.1 billion in total assets. The Alpine Dynamic Dividend Fund, for instance, another of Alpine's open-end funds, had approximately \$1.3 billion of assets under management during this time and was eligible to invest in IPOs but invested in far fewer IPOs than the Relevant Funds. However, most of the IPOs Alpine received during the Relevant Period were invested in by, and allocated to, in whole or in part, one or both of the Relevant Funds where the impact of IPOs on performance was maximized.

12. During Alpine's FY 2007, trading in IPOs had a material impact on the performance of the Relevant Funds. During this period, the Financial Services Fund produced a 21.6% return with IPO trading; without IPO trading, its return would have been -14.7%. During this period, the Innovators Fund produced a 39.5% return with the IPO trading; without IPO trading, its return would have been 25.3%.²

² The methodology used by the Commission for calculating the "without IPO trading" performance results for the Relevant Funds is a first-day profitability analysis. A first-day profitability analysis essentially focuses on

B. Failure to Disclose that IPO Trading Materially Contributed to the Performance of the Relevant Funds

13. Alpine presented the returns of the Relevant Funds to investors and prospective investors without disclosing the impact of these IPOs on the performance of the Funds during Alpine's FY 2007. Mutual funds are required in their annual shareholder reports to "[d]iscuss the factors that materially affected the Fund's performance during the most recently completed fiscal year, including the relevant market conditions and the investment strategies and techniques used by the Fund's investment adviser."³ Disclosure of the material, positive impact of the IPO trading on the performance of the Relevant Funds would have been material to an investor's overall decision whether to invest in or redeem from either of the Relevant Funds.

14. Although the disclosure documents for the Financial Services and Innovators Funds for this period, including their annual report, prospectuses and Statements of Additional Information ("SAIs"), discussed certain strategies that contributed to the Relevant Funds' performance, those documents contained no disclosure regarding the fact of IPO trading or the significant contribution that IPO trading made to the Relevant Funds' performance.

15. The disclosure documents also contained discussion of the risks associated with each of the Financial Services and Innovators Funds. None of these documents, however, contained any disclosure regarding the risks of the short-term IPO trading, including the risks that the returns might not be sustained because the continued availability of IPOs was uncertain and the impact of short-term trading of IPOs on the Relevant Funds' performance could lessen if the Relevant Funds experienced significant growth in assets under management.

16. Specifically, the discussion of each of the Relevant Funds contained within the annual report for the Alpine Series Trust for FY 2007 identified the strategies of "actively investing in a full range of sub-sectors within the Financial Services industry" and "finding companies which may participate in the industry consolidation" as factors that contributed to the 21.64% total return of the Financial Services Fund. The 2007 annual report identified "substantial short-term capital gains" and "corporate acquisitions" as contributing to the 39.47% total return of the Innovators Fund. Although the 2007 annual report contained discussion about the risks of each fund, such as liquidity and volatility concerns as a result of investing in smaller companies and foreign securities, it did not disclose the significant effect that the IPO trading had on the performance of the Relevant Funds, including the risks that the returns might not be sustained because the continued availability of IPOs was uncertain and that the impact of short-

the benefit of receiving a substantially discounted purchase price – the allocation price – by substituting for it the price of each security at the closing price on the day that trading began. This method calculates the benefit to the Relevant Funds of any first-day increase in price, whether or not the Relevant Funds actually sold the shares that day. Respondents calculated "without IPO trading" performance results for the Relevant Funds by removing IPO trades completely, based on the notion that Alpine purchased IPO shares before trading began and the Relevant Funds did not in every instance sell all of the shares each received on the first day that trading began. Respondents' analysis resulted in a smaller disparity between the reported performance numbers and what the performance would have been "without IPO trading."

³ See Form N-1A, Item 27(b)(7)(ii).

term trading of IPOs on the Relevant Funds' performance could lessen if the Relevant Funds experienced significant growth in assets under management.

17. With respect to performance, the February 28, 2008 prospectus for the Relevant Funds showed positive total returns for 2007, best and worst returns by quarter and average total returns for benchmarks. It did not contain disclosures concerning the effect of IPO trading on the performance of each of the Relevant Funds. In addition, the 2008 SAI for the Relevant Funds included a lengthy discussion of the types of securities in which each of the Relevant Funds invested, including equities, convertible securities, warrants, foreign securities, illiquid securities, sovereign debt obligations and mortgage and asset backed securities. These documents, however, did not disclose that Alpine engaged in short-term trading in IPOs for the Relevant Funds in FY 2007.

18. Alpine also failed to disclose to the Board of Trustees for the Series Trust ("Board of the Series Trust") the extent to which the Relevant Funds were investing in IPOs and the material impact IPO trading had on the performance of the Relevant Funds in FY 2007.

C. Alpine Failed to Implement Written Policies and Procedures Reasonably Designed to Prevent Violations of the Advisers Act and Rules Thereunder

19. Alpine had policies related to both the disclosure of performance information, including within advertising and marketing materials, and the allocation of IPO shares. Alpine's compliance manual in effect during 2006 and 2007 (dated October 5, 2004 and updated on December 18, 2006) ("Compliance Manual") prohibited any advertising or performance materials from being misleading and required that such materials comply with regulatory guidelines. According to Alpine's Compliance Manual, therefore, in connection with the use of performance results, "[f]ailing to disclose any material conditions, objectives, or investment strategies used to obtain the performance advertised" could be misleading.

20. Alpine's Compliance Manual assigned Samuel Lieber with the specific responsibility of reviewing, approving and documenting his approval of, all advertising or marketing materials containing investment performance information in order to ensure those materials were consistent with Alpine's policy and regulatory requirements. However, the compliance review of advertising and performance disclosures to investors was not adequate and failed to ensure that the "conditions," "objectives" and "strategies" used to obtain the performance advertised were identified and disclosed.

21. Alpine's Compliance Manual also mandated that IPO shares be allocated "fairly and equitably among [Alpine's] advisory clients according to a specific and consistent basis so as not to ... favor or disfavor any client, or group of clients, over any other." The Compliance Manual designated Samuel Lieber as having responsibility for ensuring this provision was implemented.

22. In addition, Alpine's Schedule F of Form ADV Part II dated March 15, 2006, pursuant to Item 9D, stated that Alpine "allocates its participation in [IPOs] according to the risk tolerance and account objective guidelines of its clients." Alpine's Schedule F of Form ADV

Part II dated February 25, 2007, pursuant to Item 9D, stated that Alpine would “allocate orders on a basis that Applicant believes to be fair and equitable, consistent with the requirements of the Investment Advisers Act of 1940 and the Investment Company Act of 1940.” With respect to IPO allocation specifically, Item 9E of the same Schedule F also stated that Alpine “allocates its participation in initial public offerings of securities (IPOs) according to the risk tolerance and account objective guidelines of its clients. [Alpine] evaluates a potential IPO investment in terms of its industry sector, market geography, income and growth potential, and risk and/or company specific characteristics. Based on these factors, [Alpine] then selects the most appropriate accounts for participation in any underwriting allocation [Alpine] may receive.”

23. Alpine did not sufficiently implement these policies regarding the allocation of IPO shares. Samuel Lieber did not take steps to ensure that IPO shares were actually allocated in accordance with Alpine’s policies and procedures nor did Samuel Lieber direct anyone at Alpine to conduct a review of the IPO allocation process to ensure that the allocation of IPO shares was consistent with Alpine’s policies and procedures. In addition, no review was done of the periodic reports to ensure they adequately disclosed the IPOs’ contribution to the performance of each of the Relevant Funds.

24. According to Samuel Lieber’s description of Alpine’s IPO allocation procedures during the 2006 and 2007 time period, portfolio managers were expected to make themselves aware of IPOs and determine if they wanted to participate in a particular IPO. If they did, they would submit an indication of interest to the head trader. Samuel Lieber himself, however, allocated IPO shares in a manner inconsistent with a *pro rata* allocation based on the portfolio managers’ initial indications of interest in at least two instances, favoring the Financial Services Fund both times. One of the factors Samuel Lieber considered in determining to change those two IPO allocations was the asset size of the affected funds – a factor not set forth in Alpine’s policies. These allocation changes were made prior to the opening of trading. The portfolio managers of the affected funds were not consulted before the allocations were changed.

25. Underlying the failures described above was the fact that Alpine’s compliance program did not have adequate resources to implement necessary policies. Despite the significant increase in assets and funds under Alpine’s management between 2003 and 2007, Alpine, through Samuel Lieber, failed to provide adequate resources and staff to support a compliance program which could implement the necessary policies and procedures.

26. During the Relevant Period, Alpine’s Chief Compliance Officer (CCO) was expected to fulfill that executive role on a full-time basis along with his three other full-time executive roles as the firm’s Chief Operating Officer, Chief Financial Officer and Chief Administrative Officer, with little to no staff helping him perform any of those roles. Thus, the CCO was required to devote his time to numerous other tasks rather than spending his full time ensuring that Alpine had adequate policies and procedures and that those policies and procedures were being followed. The CCO himself had little prior compliance experience or training, a fact which Samuel Lieber acknowledged he knew at the time. The CCO recognized that the compliance program needed additional resources, which the CCO requested. Nevertheless, Alpine did not provide its compliance program with adequate resources in a timely manner.

D. Written Documentation of Brokerage Orders

27. In general, Alpine received a smaller number of IPO shares than it initially sought and conveyed through its indications of interest. According to Alpine, once the total number of IPO shares the firm would receive was conveyed to Alpine, these shares were generally divided between or among funds *pro rata*, based on the indications of interest that the portfolio managers had submitted to the head trader. However, neither Samuel Lieber nor anyone else at Alpine established a procedure to document and retain the records of the initial indications of interest. Instead, Alpine portfolio managers apparently often communicated their indications orally to the head trader. Consequently, Alpine failed to create, keep or maintain, sufficient documentation reflecting the portfolio managers' indications of interest for IPOs. While the head trader stated that he ordinarily documented portfolio managers' indications of interest on a prospectus cover or, from time to time, in the perforated portion of an order ticket, these documents were largely discarded. The indications of interest for IPOs should have been retained as part of the terms and conditions of each IPO order.

28. Alpine's order memoranda for IPO purchases also contained other deficiencies. Most were partially completed and time-stamped only at or around the time a trader received a fill for the order from the broker. Many of the order memoranda also failed to identify the persons who recommended and placed the order.

VIOLATIONS

29. An investment adviser has a fiduciary duty to act in the utmost good faith with respect to its clients, to provide full and fair disclosure of all material facts, and affirmatively employ reasonable care to avoid misleading clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). A fact is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available." *Basic v. Levinson*, 485 U.S. 224, 231-32 (1988).

30. Reasonable investors would consider the fact that a significant portion of the performance of each of the Relevant Funds in Alpine's FY 2007 was attributable to IPO shares as significantly altering the total mix of information available, particularly since the vagrant nature of IPO trading calls into doubt the ability of the Relevant Funds to continue to trade in IPOs and experience substantially similar performance. *See Matter of Van Kampen Investment Advisory Corp. and Alan Scahleben*, I.A. Rel. No. 1819 (Sept. 8, 1999). Thus, Alpine's failure to disclose the strategy of IPO trading and the significant impact that strategy had on the performance of the Relevant Funds in Alpine's FY 2007 rendered Alpine's performance disclosures for the Relevant Funds materially misleading.

31. Alpine, as adviser to the Trust, had a fiduciary duty to provide accurate information to the Board of the Series Trust. Alpine failed to disclose to the Board of the Series Trust the extent to which the Relevant Funds were investing in IPOs and the material impact these strategies had on the Relevant Funds' performance in Alpine's FY 2007.

32. As a result of the conduct described above, Alpine willfully⁴ violated Section 17(a)(3) of the Securities Act, Sections 206(2) and (4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.⁵ Section 17(a)(3) prohibits any person, in the offer or sale of securities, from engaging in any transaction, practice or course of business which operates as fraud or deceit upon the purchaser. Section 206(2) prohibits any investment adviser from engaging in any transaction, practice or course of business which operates as fraud or deceit upon any client or prospective client. Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder prohibits an investment adviser to a pooled investment vehicle from engaging in any act, practice or course of business which is fraudulent, deceptive or manipulative.

33. As a result of the conduct described above, Alpine willfully violated, and Samuel Lieber willfully aided and abetted and caused Alpine's violations of, Section 206(4) of the Advisers Act with respect to Rule 206(4)-7 promulgated thereunder, which requires that investment advisers adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules that the Commission has adopted under the Act.

34. As a result of the conduct described above, Alpine willfully violated Section 34(b) of the Investment Company Act, by filing, transmitting and/or keeping prospectuses, SAIs and annual reports for the Relevant Funds containing misleading statements of material fact or omissions of fact necessary in order to prevent the statements made in those documents, in light of the circumstances in which they are made, from being materially misleading. *See Matter of Davis Selected Advisers-NY Inc.*, I.A. Rel. No. 2055 (Sept. 4, 2002).

35. As a result of the conduct described above, Alpine caused the Trust to violate Rule 31a-1(b)(5) promulgated under Section 31(a) of the Investment Company Act, requiring a registered investment company to maintain and preserve a record of each brokerage order given by, or in behalf of the investment company for, or in connection with, the purchase or sale of securities, whether executed or unexecuted, which include the name of the broker, the terms and conditions of the order and any modification or cancellation thereof, the time of entry or cancellation, the price at which executed, the time of receipt of report of execution and the name of the person who placed the order on behalf of the investment company.

⁴ With respect to direct violations, a "willful" violation of the securities laws means that the violator merely intended to do the act which constitutes the violation. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart v. Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

⁵ Proof of scienter is not required to establish a violation of Section 17(a)(3) of the Securities Act, *Aaron v. SEC*, 446 U.S. 680, 696-97, 100 S.Ct. 1945, 1956 (1980), or Section 206(2) of the Advisers Act, *SEC v. Capital Gains Research Bureau Inc.*, 375 U.S. 180, 195, 84 S.Ct. 275, 284 (1963). Nor is proof of scienter required to establish a violation of Section 206(4) of the Advisers Act or Rule 206(4)-8 thereunder. *Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, IA Rel. No. 2628, at 12-13 (Sept. 10, 2007) (citing *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992)).

36. As a result of the conduct described above, Alpine violated Section 204 of the Advisers Act and Rule 204-2(a)(3) promulgated thereunder, requiring registered investment advisers to make and keep true and accurate order memoranda for the purchase and sale of any security on behalf of a client.

37. Before the Commission staff's investigation, Alpine hired a Chief Operations Officer and Chief Financial Officer. During the Commission staff's investigation, Alpine voluntarily replaced its Chief Compliance Officer. Alpine also voluntarily retained an independent compliance consultant ("Compliance Consultant")⁶ for the purpose of: (a) reviewing the risks and effectiveness of existing written supervisory and compliance policies and procedures; (b) reviewing the effectiveness of Alpine's books and records; (c) assisting in the preparation of additional written policies and procedures for adoption and implementation by Alpine; and (d) assisting in the preparation of additional written disclosure statements for Alpine's use with actual and prospective clients.

RESPONDENTS' REMEDIAL EFFORTS

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

UNDERTAKINGS

39. Alpine undertakes:

- a. To continue to retain, at Alpine's own expense, the Compliance Consultant described in paragraph 37. Alpine and its employees shall cooperate fully with the Compliance Consultant and shall provide the Compliance Consultant with access to files, books, records, and personnel as reasonably requested for the review;
- b. To require the Compliance Consultant, in addition to the itemized scope of engagement described in paragraph 37, above, and in paragraph 37 of the Offer of Settlement of Alpine Woods Capital Investors, LLC, to conduct a review of Alpine's written policies and procedures to ensure that they are reasonably designed to prevent violations of the securities laws, including review of the following: Alpine's existing methodology for calculating and disclosing the impact of IPO trading on the performance of its funds; Alpine's implementation of its IPO allocation policies; Alpine's methodology for determining and disclosing the conditions, objectives and strategies used to obtain advertised fund performance; Alpine's policies and procedures for reporting fund performance to the Board(s) of Trustees; and Alpine's creation and maintenance of required books and records
- c. To require the Compliance Consultant to prepare, within 150 days of the entry of this Order, a written Report. The Report shall address the issues and reviews

⁶ Prior to this engagement, this consultant had no previous relationship with Alpine or its principals.

described in paragraphs 37 and 39(a) and (b) of this Order, and shall include a description of: the review performed; the conclusions reached; the Compliance Consultant's recommendations for changes in and/or improvements to Alpine's policies, practices and procedures; and the Compliance Consultant's recommendations for a procedure to implement the recommended changes to the policies, practices and procedures, with a copy of such recommendation to be given simultaneously to the staff of the Commission's New York Regional Office (NYRO), the management of Alpine and the boards of directors of Alpine's investment companies;

- d. Alpine shall adopt all recommendations with respect to it and to its subsidiaries contained in the Report of the Compliance Consultant; provided, however, that within 30 days after the date of the submission of the Report described in paragraph 39(c), above, Alpine shall in writing advise the Compliance Consultant and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Alpine considers unnecessary or inappropriate, Alpine need not adopt that recommendation at that time but shall propose in writing an alternative policy, practice, procedure or system designed to achieve the same objective or purpose;
- e. As to any recommendation with respect to Alpine's policies, practices and procedures on which Alpine and the Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 60 days of the date of the Report. In the event Alpine and the Compliance Consultant are unable to agree on an alternative proposal acceptable to the staff of the Commission, Alpine will abide by the determinations of the Compliance Consultant;
- f. To apply to the Commission's staff for any extension of the deadlines set forth above, before their expiration, and upon a showing of good cause by Alpine, the Commission's staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate;
- g. To agree that Alpine:
 - 1) shall not have authority to terminate the Compliance Consultant without prior approval of the Commission's staff;
 - 2) shall compensate the Compliance Consultant and persons engaged to assist the consultant for services rendered pursuant to this Order at their reasonable and customary rates;
 - 3) shall require the Compliance Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Compliance Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Alpine, or any of its present or former

affiliates, directors, officers, employees, or agents acting in such capacity. The agreement will also provide that the Compliance Consultant will require that any firm with which it/he/she is affiliated or of which it/he/she is a member, and any person engaged to assist the Compliance Consultant in performance of his/her duties under this Order shall not, without prior written consent of the NYRO, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Alpine, or any of its present or former affiliates, directors, officers, employees, or agents acting in such capacity as such for the period of the engagement and for a period of two years after the engagement. However, Alpine may apply to the Commission's staff for authorization to continue to retain and compensate at reasonable and customary rates the Compliance Consultant for services in furtherance of the objectives stated in paragraphs 37 and 39(a) and (b) of this Order after the completion of the engagement;

- h. To certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Alpine agrees to provide such evidence. The certification and supporting material shall be submitted to Alison T. Conn, Assistant Regional Director, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 203(e), (f) and (k) of the Advisers Act and Sections 9(b) and (f) of the Investment Company Act, **IT IS HEREBY ORDERED** that:

A. Alpine cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act, Sections 204 and 206(2) and (4) of the Advisers Act and Rules 204-2(a)(3), 206(4)-7 and 206(4)-8 thereunder, Section 34(b) of the Investment Company Act and Rule 31a-1(b)(5) promulgated under Section 31(a) of the Investment Company Act.

B. Samuel Lieber cease and desist from committing or causing any violations or future violations of Section 206(4) of the Advisers Act with respect to Rule 206(4)-7 promulgated thereunder.

C. Alpine is censured.

D. Alpine shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$650,000 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 wire transfer, 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 Alpine Woods Capital Investors, LLC as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Andrew M. Calamari, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York 10281.

E. Samuel Lieber shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$65,000 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 wire transfer, 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 Samuel A. Lieber as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Andrew M. Calamari, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York 10281.

F. Alpine shall comply with the undertakings enumerated above.

By the Commission.

Elizabeth M. Murphy
Secretary


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

*Commissioner Aguilar
Commissioner Yaredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3156 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14238

In the Matter of

MARK KURLAND,

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Mark Kurland ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 and 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.

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III.

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

1. Kurland, 61 years old, is a resident of Mount Kisco, New York. Kurland was a Senior Managing Director and General Partner at New Castle Funds, LLC ("New Castle"), a Delaware limited liability company and registered investment adviser based in White Plains, New York, that was formerly part of Bear Stearns Asset Management. He has held Series 7, 16, 24, 63 and 65 securities licenses.

2. On October 16, 2009, the Commission filed a civil action against Kurland in SEC v. Galleon Management, LP, et al., Civil Action No. 1:09-CV-8811 (SDNY). On January 31, 2011, the Court entered an order permanently enjoining Kurland, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. The Commission's complaint alleged that, in connection with the purchase, offer or sale of securities, Kurland knew, recklessly disregarded, or should have known, that the material non-public information he received from a tipper was disclosed or misappropriated in breach of a fiduciary duty, or similar relationship of trust and confidence, and Kurland is liable for the trading that occurred in New Castle funds because he effectuated trades on behalf of New Castle, controlled New Castle and/or unlawfully tipped inside information to New Castle.

4. On May 21, 2010, Kurland pled guilty to one count of securities fraud and one count of conspiracy to commit securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff and 18 U.S.C. § 371 before the United States District Court for the Southern District of New York in United States v. Mark Kurland, 10-CR-0069. A judgment was entered on May 26, 2010. Kurland was sentenced to a term of 27 months imprisonment, 2 years supervised release and ordered to pay criminal forfeiture of \$900,000.

5. The counts of the criminal information to which Kurland pled guilty alleged, inter alia, that Kurland, and others, participated in a scheme to defraud by executing securities trades based on material, nonpublic information regarding certain inside information concerning public companies that had been misappropriated in violation of duties of trust and confidence, and that he unlawfully, willfully and knowingly did so, directly and indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Kurland be, and hereby is barred from association with any investment adviser.

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Watter
Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63862 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14240

In the Matter of

FREDERICK J. BIRKS,

Respondent.

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

I.

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

II.

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

III.

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

1. From May 2004 through May 2005, Birks was a registered representative associated with a broker-dealer registered with the Commission. Birks is a resident of New Jersey.

2. On August 18, 2010, a final judgment was entered by consent against Birks permanently enjoining him from future violations of Section 5 of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Section 15(a) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Dean A. Esposito, et al., Civil Action Number 08-80130, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that Birks participated in the manipulation of the common stock, and acted as an unregistered broker selling unregistered securities, of Weida Communications, Inc., a publicly-traded company based in Florida.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary


By: Jill M. Peterson
Assistant Secretary

*Commissioner Walter
Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63863 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14241

In the Matter of

DEAN A. ESPOSITO,

Respondent.

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

I.

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

II.

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

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III.

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

1. From May 2004 through May 2005, Esposito was a registered representative associated with a broker-dealer registered with the Commission. Esposito is a resident of Boca Raton, Florida.

2. On August 18, 2010, a final judgment was entered by consent against Esposito permanently enjoining him from future violations of Section 5 of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Section 15(a) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Dean A. Esposito, et al., Civil Action Number 08-80130, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that Esposito participated in the manipulation of the common stock, and acted as an unregistered broker selling unregistered securities, of Weida Communications, Inc., a publicly-traded company based in Florida.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63864 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14242

In the Matter of

JOSEPH DeVITO,

Respondent.

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

I.

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

II.

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

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III.

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

1. From February 2004 through April 2005, DeVito was a person associated with a broker-dealer registered with the Commission. DeVito is a resident of Boca Raton, Florida.

2. On August 18, 2010, a final judgment was entered by consent against DeVito, permanently enjoining him from future violations of Section 5 of the Securities Act of 1933 and Section 15(a) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Dean A. Esposito, et al., Civil Action Number 08-80130, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that DeVito acted as an unregistered broker selling unregistered securities of Weida Communications, Inc., a publicly-traded company based in Florida, from at least February 2004 through April 2005.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act that Respondent DeVito be, and hereby is, barred from association with any broker or dealer with the right to reapply for association after a period of eighteen months 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

2
By: 
Jill M. Peterson
Assistant Secretary

*Commissioner Walter
Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63865 / February 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14243

In the Matter of

WALTER A. TYE,

Respondent.

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

I.

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

II.

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

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III.

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

1. From February 2004 through April 2005, Tye was a former registered representative who was seeking to become associated with a broker-dealer registered with the Commission. Tye is a resident of Boca Raton, Florida.

2. On August 18, 2010, a final judgment was entered by consent against Tye, permanently enjoining him from future violations of Section 5 of the Securities Act of 1933 and Section 15(a) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Dean A. Esposito, et al., Civil Action Number 08-80130, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that Tye acted as an unregistered broker selling unregistered securities of Weida Communications, Inc., a publicly-traded company based in Florida, from at least February 2004 through April 2005.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act that Respondent Tye be, and hereby is barred from association with any broker or dealer with the right to reapply for association after a period of eighteen months 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

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By: 
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63868 / February 8, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14244

In the Matter of

**Cellpoint, Inc.,
Centacom Technologies, Inc. (n/k/a
Telycom Technologies, Inc.), and
Centaur Mining & Exploration Ltd.,**

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 Cellpoint, Inc., Centacom Technologies, Inc. (n/k/a Telycom Technologies, Inc.), and Centaur Mining & Exploration Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Cellpoint, Inc. (CIK No. 1046607) is a permanently revoked Nevada corporation located in Kista, Sweden with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cellpoint is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended June 30, 2002, which reported a net loss of over \$11 million for the prior twelve months. On April 7, 2003, Cellpoint filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Nevada, and the case was terminated on December 8, 2003. As of February 2, 2011, the company's common stock (symbol "CLPTQ") was traded on the over-the-counter markets.

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2. Centacom Technologies, Inc. (n/k/a Telycom Technologies, Inc.) (CIK No. 352903) is a void Delaware corporation located in Alicante, Spain with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Centacom is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the transition period from January 1, 2001 through March 31, 2001, which reported a net loss of \$11,953 for the prior three months.

3. Centaur Mining & Exploration Ltd. (CIK No. 1029632) is an Australian corporation located in Victoria, Australia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Centaur Mining 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 June 30, 2000, which reported a net loss of over \$23 million for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

4. 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.

5. 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.

6. 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

*Commissioner Walter
not participating*

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933
Release No. 9185 / February 8, 2011**

**SECURITIES EXCHANGE ACT OF 1934
Release No. 63867 / February 8, 2011**

**ADMINISTRATIVE PROCEEDING
File No. 3-14153**

In the Matter of

**BANC OF AMERICA
SECURITIES LLC**, now known as
Merrill Lynch, Pierce, Fenner &
Smith Incorporated, successor by
merger,

Respondent.

**ORDER UNDER SECTION 27A(b) OF THE
SECURITIES ACT OF 1933 AND SECTION
21E(b) OF THE SECURITIES EXCHANGE
ACT OF 1934, GRANTING WAIVERS OF
THE DISQUALIFICATION PROVISIONS
OF SECTION 27A(b)(1)(A)(ii) OF THE
SECURITIES ACT OF 1933 AND SECTION
21E(b)(1)(A)(ii) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Banc of America Securities LLC, now known as Merrill Lynch Pierce Fenner & Smith Incorporated, successor by merger ("BAS"),¹ has submitted a letter on behalf of themselves and any of their current and future affiliates, dated December 8, 2010, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from its settlement of an administrative proceeding instituted by the Commission.

On December 7, 2010, pursuant to an Offer of Settlement submitted by BAS, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") against BAS. The Order found that BAS violated Exchange Act Section 15(c)(1)(A) by engaging in certain improper bidding practices involving the temporary investment of proceeds of tax-exempt municipal securities in reinvestment products; ordered BAS to cease and desist from committing or causing any violations and any future violations of that section; and required that BAS pay disgorgement plus prejudgment interest in the total amount of \$36,096,442.

¹ On November 1, 2010, BAS was merged into Merrill Lynch, Pierce, Fenner & Smith Incorporated, an indirect wholly-owned subsidiary of Bank of America Corporation that is registered with the Commission as a broker-dealer.

4

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial or administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in BAS's December 8, 2010 request, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the issuance of the Order is appropriate and should be granted.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to BAS and any current or future affiliates resulting from the issuance of the Commission's Order against BAS is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63871 / February 9, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14245

In the Matter of

ATC HEALTHCARE, INC.,

Respondent.

ORDER INSTITUTING PROCEEDINGS, MAKING
FINDINGS, AND REVOKING REGISTRATION OF
SECURITIES PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against ATC Healthcare, Inc. ("ATC Healthcare" 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, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. ATC Healthcare (CIK Nos. 720480) is a Delaware corporation located in Lake Success, New York. At all times relevant to this proceeding, the securities of ATC Healthcare have been registered under Exchange Act Section 12(g). As of December 20, 2010, the company's stock (symbol "AHNA") was quoted on the Pink Sheets operated by

Pink OTC Markets, Inc., had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. ATC Healthcare has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended May 31, 2007.

IV.

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

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

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act 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. 63872 / February 9, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14246

In the Matter of
HEMIWEDGE INDUSTRIES, INC.,
Respondent.

ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Hemiwedge Industries, Inc. ("Hemiwedge Industries" 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, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

A. Hemiwedge (CIK No. 1085254) is a Delaware corporation located in Conroe, Texas. At all times relevant to this proceeding, the securities of Hemiwedge have been registered under Exchange Act Section 12(g). As of November 17, 2010, the company's stock (symbol "HWEG") was quoted on the Pink Sheets operated by Pink OTC

Markets, Inc., had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. Hemiwedge has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended March 31, 2009.

IV.

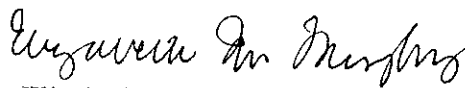
Section 12(j) of the Exchange Act provides as follows:

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

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

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

By the Commission.


Elizabeth M. Murphy
Secretary

*Commissioner Paredes
not participating*

**UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934
Release No. 63879 / February 9, 2011**

**ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3241 / February 9, 2011**

**ADMINISTRATIVE PROCEEDING
File No. 3-14247**

**In the Matter of
RODNEY B. JOHNSON,
Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO RULE
102(e) OF THE COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS**

I.

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

¹ Rule 102(e)(3)(i) provides, in relevant part, that: The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

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

III.

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

1. Rodney B. Johnson, age 58, of Centennial, Colorado, was the chief financial officer, vice president of finance, and secretary of Fischer Imaging Corporation ("Fischer") from August 2000 until he left Fischer in October 2002. Johnson was licensed as a CPA in 1982. His CPA license became inactive in 1994 and expired in 2004.
2. Fischer, during the relevant period, was a Delaware corporation with its principal place of business in Denver, Colorado. Fischer was dissolved as of May 18, 2007, pursuant to a Chapter 11 Liquidating Plan. Prior to its dissolution, Fischer designed, manufactured, and marketed specialty medical imaging systems used for the diagnosis and screening of disease. Fischer's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and Fischer was required to file periodic reports with the SEC on Forms 10-K and 10-Q. In 2004, the Commission imposed a cease-and-desist order against Fischer for violations of the anti-fraud, reporting, internal controls and books and records provisions of the federal securities laws resulting from improper revenue recognition and other accounting misstatements. In the Matter of Fischer Imaging Corporation, (Exch. Act Rel. No. 50663).
3. On June 7, 2005, the Commission filed a civil injunctive action in the U. S. District Court for the District of Colorado against Johnson and five other Fischer executives and board members based on their alleged roles in improper revenue recognition and other accounting misstatements by Fischer. SEC v. Louis E. Rivelli et al., Civil Action No. 1:05-cv-01039 (D.Colo). On May 6, 2008, the Commission filed its First Amended Complaint ("Complaint"). On January 31, 2011, the court entered an order permanently enjoining Johnson, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act, and Rules 10b-5, 13b2-1, 13b2-2 and 13a-14 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. Johnson was also ordered to pay disgorgement and prejudgment interest totaling \$60,029 and was prohibited from serving as an officer or director of a public company for five years. Based on his sworn statement of financial condition and other

documents and information provided to the Commission, the court did not order Johnson to pay a civil penalty.

4. The Commission's Complaint alleged, among other things, that Johnson knowingly or recklessly engaged in a fraudulent revenue recognition scheme that resulted in false and misleading statements in Fischer's filings on Forms 10-K and 10-Q and other filings and public statements from Fischer's third quarter of 2000 through its second quarter of 2002. The complaint alleged that Johnson was involved in Fischer's improper recognition of revenue upon shipment of products to storage facilities rather than upon shipment to customers or customer designated locations. The complaint also alleged that Johnson knew or was reckless in not knowing that Fischer improperly recognized revenue from orders subject to material contingencies and other terms rendering revenue recognition inappropriate under Generally Accepted Accounting Principles. In addition, the complaint alleged that Johnson failed to disclose information and made false and misleading statements to Fischer's auditors relating to Fischer's improper revenue recognition practices. The complaint further alleged that Johnson circumvented or failed to implement a system of accounting controls at Fischer, falsified or directly or indirectly caused to be falsified certain books, records or accounts of Fischer, and aided and abetted Fischer's violations of certain reporting, internal controls, and books and records provisions of the federal securities laws.

IV.

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

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

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

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

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

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

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

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

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

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that he has resolved all disciplinary issues with the applicable state boards of accountancy. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63882 / February 9, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14248

In the Matter of

SCOTT D. FARAH,

Respondent.

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

I.

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

II.

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

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III.

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

1. Farah, age 47, was the president and founder of Financial Resources Mortgage, Inc. ("FRM"), a New Hampshire based mortgage brokerage company. His primary duties at FRM involved soliciting investor lenders and borrowers for construction and other loans. From March 1999 through October 2002, Farah was a registered representative of Franklin Financial Services Corporation (now known as American General Equity Services Corporation), a registered broker-dealer. From October 2002 through December 2002, Farah was a registered representative of American General Securities, Inc., a registered broker-dealer and investment adviser. Farah is a resident of Meredith, NH.

2. On October 4, 2010, Farah pled guilty to one count of mail fraud in violation of Title 18, United States Code, Section 1341 and one count of wire fraud in violation of Title 18, United States Code, Section 1343 before the United States District Court for the District of New Hampshire, in United States v. Scott Farah, Crim. Indictment No. 1:10-CR-44-01. Farah was sentenced on January 19, 2011 to fifteen years in prison.

3. The counts of the criminal indictment to which Farah pled guilty alleged, inter alia, that Farah defrauded investors and obtained money and property by means of materially false and misleading statements and that he used the United States mails and the wires to solicit investments of money from investors by falsely representing that the money would be used for the exclusive purpose of funding specific private mortgages while instead using that money for numerous other undisclosed purposes. On April 9, 2010, the Commission filed a civil injunctive action in the United States District Court for the District of New Hampshire based on the same underlying facts as alleged in the criminal indictment.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL 111-203, July 21, 2010, 124 Stat. 1376, Respondent Farah be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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.

Respondent be, and hereby is, barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63883 / February 9, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3242 / February 9, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14249

	:	
In the Matter of	:	ORDER INSTITUTING CEASE-AND-DESIST
	:	PROCEEDINGS PURSUANT TO SECTION
ARTHROCARE CORPORATION	:	21C OF THE SECURITIES EXCHANGE ACT
	:	OF 1934, MAKING FINDINGS, AND
	:	IMPOSING A CEASE-AND-DESIST ORDER
Respondent.	:	
	:	

I.

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

II.

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

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

1. Respondent ArthroCare is a Delaware corporation headquartered in Austin, Texas. ArthroCare's stock is registered under Section 12(b) of the Exchange Act and is traded on NASDAQ. ArthroCare is a medical device company that develops, manufactures and markets surgical products, including products with the trade name SpineWands that were used by surgeons in the treatment of patients with spinal injuries.

2. DiscoCare, Inc. was a privately owned Delaware corporation incorporated in 2005. Based in Palm Beach, Florida, DiscoCare distributed ArthroCare products (especially SpineWands) until December 31, 2007, when it was acquired by ArthroCare. ArthroCare was DiscoCare's only supplier. At various times, DiscoCare was ArthroCare's largest distributor of SpineWands.

3. Between the fourth quarter of 2005 and the first quarter of 2008 (the "restatement period"), ArthroCare materially overstated and prematurely recognized revenue, primarily on sales of SpineWands to certain of ArthroCare's agents and distributors, including DiscoCare. Most of these transactions occurred at or near quarter-end and were intended to help the company reach aggressive internal revenue targets and satisfy analysts' revenue expectations. ArthroCare lacked an effective system of internal controls over sales, particularly with respect to its Spine Business Unit, where most of the improprieties occurred. This allowed ArthroCare sales personnel to withhold critical information on revenue recognition from the company's accounting staff.

4. During the restatement period, ArthroCare repeatedly turned to DiscoCare to help it overcome quarterly revenue shortfalls, by recording revenue from large orders shipped to DiscoCare at or near quarter-end. ArthroCare should not have recognized revenue from these shipments. The orders were initiated by ArthroCare employees for the purpose of filling shortfalls in meeting internal and external revenue targets. DiscoCare had no need for the excessive inventory and no reasonable likelihood of selling the products within a reasonable timeframe. Furthermore, ArthroCare accommodated DiscoCare by providing significantly extended payment terms, while also explicitly or impliedly agreeing that DiscoCare did not have to pay for the products until it had sufficient funds to do so.²

5. In addition, shortly after the close of the second quarter of 2006, ArthroCare employees arranged for DiscoCare to return products shipped just before quarter-end, while concealing from

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

² See Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* ("FAS 48"), ¶ 6(b), which requires the buyer to have paid the seller, or the buyer to be obligated to pay the seller and the obligation not to be contingent on resale of the product, and ¶ 22, which clarifies ¶ 6(b) and provides "... if ... the buyer's obligation to pay is contractually or implicitly excused until the buyer resells the product, then the condition (for recording revenue in ¶6(b)) is not met."

ArthroCare's accounting staff the true reason for the product return. In fact, ArthroCare requested the product return only because the shipment had caused ArthroCare to exceed securities analysts' revenue targets, and the employees were concerned that this would cause analysts to set the next quarter's estimates too high. ArthroCare's recognition of revenue from sales to DiscoCare violated Generally Accepted Accounting Principles ("GAAP").³

6. ArthroCare also inflated revenue by mischaracterizing volume-based commission payments to distributors as fees for services. This enabled ArthroCare to record the gross amount of the sale as revenue and expense the commission, rather than recording the net revenue of the sale, as required by GAAP.⁴

7. Finally, on several occasions during the restatement period, ArthroCare recognized revenue from shipments of products to customers that did not conform to the customers' orders. ArthroCare also recognized revenue from products that it shipped after the products' expiration date had passed, which meant the products were not usable by an ultimate customer and therefore immediately returnable. ArthroCare's recognition of revenue from these sales violated GAAP.⁵

8. As a result of the conduct described above, ArthroCare violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to 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.

9. As detailed above, ArthroCare's books, records, and accounts did not, in reasonable detail, properly reflect its sales and payments to distributors. As a result, ArthroCare violated Exchange Act Section 13(b)(2)(A).

10. In addition, ArthroCare failed to implement internal accounting controls relating to distributor sales to ensure these sales were accurately stated in accordance with generally accepted accounting principles and accurately reflected on its books and records. As a result, ArthroCare violated Exchange Act Section 13(b)(2)(B).

³ FAS 48, ¶ 6(b); *see also* Statement of Financial Accounting Concepts No. 5 ("CON 5"), ¶¶ 83-84, which states that revenues cannot be recognized until they are realized/realizable and earned. Revenues are realized when "products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash." Revenues are earned when "the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. An entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its on-going major or central operations"; *cf.* AICPA Statement of Position 97-2, *Software Revenue Recognition*, ("SOP 97-2"), ¶ 8.

⁴ *See* EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*, ¶ 9.

⁵ *See* CON 5, ¶¶ 83-84; SOP 97-2, ¶ 8.

Cooperation and Remediation

In determining to accept the Offer, the Commission considered remedial acts undertaken by ArthroCare and the substantial cooperation provided by the company in connection with the Commission's investigation.

ArthroCare replaced its senior management team. In addition, ArthroCare (i) expanded its legal department and created a compliance department led by a newly hired Compliance Officer; (ii) hired a new Corporate Controller and International Controller, (iii) expanded its internal audit function; (iv) instituted enhanced preventative and detective controls relating to revenue recognition; (v) instituted quarterly ethics communications from senior management to employees; (vi) implemented a sub-certification process as part of its quarterly and annual financial reporting; (vii) adopted standard customer contracts and established rigorous approval requirements for modifying contracts; (viii) hired a contract administrator; and (ix) provided regular training on proper revenue recognition accounting and appropriate procedures for handling contracts.

During the investigation, ArthroCare (i) regularly updated the staff on its internal investigation; (ii) provided critical documents (organized by subject matter and witness) without waiting for staff requests or subpoenas; (iii) responded promptly and completely to the staff's requests for additional information; (iv) routinely granted the staff access to the company's consulting expert to discuss accounting and internal controls issues; (v) voluntarily produced for testimony witnesses who resided outside the United States and were beyond the staff's subpoena power; and (vi) provided the staff with a detailed analysis of its restatement, including a schedule of restatement categories and the impact on the company's historical financial statements.

IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 21C of the Exchange Act, ArthroCare 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.

By the Commission.

Elizabeth M. Murphy
Secretary


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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 229, 230, 232, 239, 240, and 249

[Release No. 33-9186; 34-63874; File No. S7-18-08]

RIN 3235-AK18

SECURITY RATINGS

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: This is one of several releases that we will be considering relating to the use of security ratings by credit rating agencies in our rules and forms. In this release, pursuant to the provisions of Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, we propose to replace rule and form requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934 for securities offering or issuer disclosure rules that rely on, or make special accommodations for, security ratings (for example, Forms S-3 and F-3 eligibility criteria) with alternative requirements.

DATES: Comments should be received on or before March 28, 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/proposed.shtml>); or
- Send an E-mail to rule-comments@sec.gov. Please include File Number S7-18-08 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 S7-18-08. 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: Blair Petrillo, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, or with respect to issuers of insurance contracts, Keith E. Carpenter, Senior Special Counsel in the Office of Disclosure and Insurance Product Regulation, Division of Investment Management, at (202) 551-6795, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing amendments to rules and forms under the Securities Act of 1933 (Securities Act),¹ and the Securities Exchange Act of 1934 (Exchange Act).² Under the Securities Act, we are proposing to amend Rules

¹ 15 U.S.C. 77a *et seq.*

² 15 U.S.C. 78a *et seq.*

134,³ 138,⁴ 139,⁵ 168,⁶ Form S-3,⁷ Form S-4,⁸ Form F-3,⁹ and Form F-4.¹⁰ We are further proposing to rescind Form F-9¹¹ and amend the Securities Act and Exchange Act forms and rules that refer to Form F-9 to eliminate those references.¹² We are also proposing to amend Schedule 14A¹³ under the Exchange Act.

I. Introduction

We are proposing today to remove references to credit ratings in rules and forms promulgated under the Securities Act and the Exchange Act. We proposed similar changes in 2008 but did not act on those proposals.¹⁴ We are reconsidering the proposals at this time in light of the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”).¹⁵ Section 939A of the Dodd-Frank Act requires that we “review any regulation issued by [us] that requires the use of

³ 17 CFR 230.134.

⁴ 17 CFR 230.138.

⁵ 17 CFR 230.139.

⁶ 17 CFR 230.168.

⁷ 17 CFR 239.13.

⁸ 17 CFR 239.25.

⁹ 17 CFR 239.33.

¹⁰ 17 CFR 239.34.

¹¹ 17 CFR 239.39.

¹² We propose to remove references to Form F-9 in Securities Act Forms F-8 (17 CFR 239.38); F-10 (17 CFR 239.40); F-80 (17 CFR 239.41); and Form F-X (17 CFR 239.42), in Exchange Act Form 40-F (17 CFR 249.240f), and in the following rules: 17 CFR 200.800, 17 CFR 229.10, 17 CFR 230.134, 17 CFR 230.436, 17 CFR 230.467, 17 CFR 230.473, and 17 CFR 232.405.

¹³ 17 CFR 240.14a-101.

¹⁴ See Security Ratings, Release No. 33-8940 (July 1, 2008) [73 FR 40106] (“2008 Proposing Release”). In 2009, we re-opened the comment period for the release for an additional 60 days. See References to Ratings of Nationally Recognized Statistical Rating Organizations, Release No. 33-9069 (Oct. 5, 2009) [74 FR 52374]. Public comments on both of these releases were published under File No. S7-18-08 and are available at <http://www.sec.gov/comments/s7-18-08/s71808.shtml>. Comments also are 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.

¹⁵ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

an assessment of the credit-worthiness of a security or money market instrument and any references to or requirements in such regulations regarding credit ratings.” Once we have completed that review, the statute provides that we modify any regulations identified in our review to “remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness” as we determine to be appropriate.¹⁶

The amendments we are proposing today are substantially similar to those proposed in 2008.¹⁷ Through both the 2008 comment period and the 2009 comment period, we received 49 comment letters. As discussed in more detail below, most of the commentators were opposed to the proposal to amend Form S-3 and other related forms and rules.¹⁸ However, because the Dodd-Frank Act now provides that we remove references to credit ratings from our regulations, we are re-proposing these amendments to solicit comment on whether the proposed approach is appropriate, what the impact on issuers and other market participants would be and whether there are alternatives that we should consider. We expect that we may receive additional and different comments now

¹⁶ See Section 939A of the Dodd-Frank Act.

¹⁷ The 2008 Proposing Release also included proposals related to offerings of asset-backed securities where the requirements contained references to credit ratings, a proposal to amend Rule 436(g) to apply to credit rating agencies that are not NRSROs, and a proposal to remove references to credit ratings in the U.S. GAAP reconciliation requirements. Those proposals are not being addressed in this release. In April 2010 we proposed to remove references to credit ratings as a requirement for shelf eligibility for offerings of asset-backed securities. See Asset-Backed Securities, Release No. 33-9117 (Apr. 7, 2010) [75 FR 23328]. Among other things, the proposal would have required risk retention by the sponsor as a condition to shelf eligibility. Section 941 of the Dodd-Frank Act contains a requirement that we issue rules jointly with bank regulators regarding risk retention. In light of that requirement, we are not currently addressing rules related to shelf-eligibility for asset-backed offerings. In addition, Section 939G of the Dodd-Frank Act provides that Rule 436(g) shall have no force or effect. Finally, the proposals adopted in Foreign Issuer Reporting Enhancements, Release No. 33-8959 (Sept. 23, 2008)[73 FR 58300], provide that, for fiscal years ending on or after December 15, 2011, all foreign private issuers must provide financial statements in accordance with Item 18 of Form 20-F, which eliminates the reference to credit ratings in that form with respect to reconciliation requirements.

¹⁸ See Section II.A.2 below.

that the modifications to our rules and forms to remove references to credit ratings are set forth pursuant to statute.

We have considered the role of credit ratings in our rules under the Securities Act on several occasions.¹⁹ While we recognize that credit ratings play a significant role in the investment decision of many investors, we want to avoid using credit ratings in a manner that suggests in any way a “seal of approval” on the quality of any particular credit rating or nationally recognized statistical rating organization (“NRSRO”). Similarly, the legislative history indicates that Congress, in adopting Section 939A, intended to “reduce reliance on credit ratings.”²⁰ In today’s proposals, we seek to reduce our reliance on credit ratings for regulatory purposes while also preserving the use of Form S-3 (and similar forms) for issuers that we believe are widely followed in the market. Nevertheless, our proposal would cause some issuers that have relied or that could rely upon the investment-grade criteria to lose eligibility for Form S-3 or Form F-3. To the extent the proposals may result in loss of Form S-3 or Form F-3 eligibility for issuers currently eligible to use the form, we are also requesting comment on other or additional eligibility criteria that may be appropriate to retain eligibility for these issuers.

¹⁹ See the 2008 Proposing Release for a discussion of the history and background of references to credit ratings in rules and regulations under the Securities Act. See also Credit Ratings Disclosure, Release No. 33-9070 (Oct. 7, 2009) [74 FR 53086], which includes a proposal to require disclosure regarding credit ratings under certain circumstances.

²⁰ See Report of the House of Representatives Financial Services Committee to Accompany H.R. 4173, H. Rep. No. 111-517 at 871 (2010). The legislative history does not, however, indicate that Congress intended to change the types of issuers and offerings that could rely on the Commission’s forms.

II. Proposed Amendments

A. Primary Offerings of Non-convertible Securities

1. Background of Form S-3 and Form F-3

Forms S-3 and F-3 are the “short forms” used by eligible issuers to register securities offerings under the Securities Act. These forms allow eligible issuers to rely on reports they have filed under the Exchange Act to satisfy many of the disclosure requirements under the Securities Act. Form S-3 and Form F-3 eligibility for primary offerings also enables form eligible issuers to conduct primary offerings “off the shelf” under Securities Act Rule 415.²¹ Rule 415 provides considerable flexibility in accessing the public securities markets in response to changes in the market and other factors. Issuers that are eligible to register these primary “shelf” offerings under Rule 415 are permitted to register securities offerings prior to planning any specific offering and, once the registration statement is effective, offer securities in one or more tranches without waiting for further Commission action. To be eligible to use Form S-3 or F-3, an issuer must meet the form’s eligibility requirements as to registrants, which generally pertain to reporting history under the Exchange Act,²² and at least one of the form’s transaction requirements.²³ One such transaction requirement permits registrants to register primary

²¹ 17 CFR 230.415.

²² See General Instruction I.A. to Forms S-3 and F-3. In order to satisfy the issuer eligibility requirements of Form S-3 and Form F-3 for non-ABS offerings, an issuer must be a U.S. company (for Form S-3 only), must have a class of securities registered under Section 12(b) or 12(g) of the Securities Exchange Act of 1934 or be required to file reports pursuant to Section 15(d) of the Exchange Act, must have been a reporting company for at least 12 months, must have filed its reports timely during that 12 month period, and must not have defaulted on any debt or failed to pay a dividend with respect to preferred stock since the end of the last fiscal year.

²³ See General Instruction I.B to Forms S-3 and F-3. In addition to permitting offerings of investment grade securities, an issuer who meets the eligibility criteria in Instruction I.A. may use Form S-3 or Form F-3 for primary offerings if the issuer has a public float in excess of \$75 million (or for other primary offerings if the issuer does not have the minimum public float as described in note 31 below), transactions involving secondary offerings, and rights offerings, dividend

offerings of non-convertible securities if they are rated investment grade by at least one NRSRO.²⁴ Instruction I.B.2. provides that a security is "investment grade" if, at the time of sale, at least one NRSRO has rated the security in one of its generic rating categories, typically the four highest, which signifies investment grade.

The Form S-3 investment grade requirement was originally proposed in 1981.²⁵ In 1954, the Commission adopted a short form registration statement on Form S-9, which permitted the registration of issuances of certain high quality debt securities.²⁶ The criteria for use of Form S-9 related primarily to the quality of the issuer.²⁷ While these eligibility criteria set forth the type of issuer of high quality debt for which Form S-9 was intended, the Commission believed that certain of its requirements may have overly restricted the availability of the form.²⁸ At that time, the Commission believed that credit ratings were a more appropriate standard on which to base Form S-3 eligibility than specified quality of the issuer criteria, citing letters from commentators indicating that

reinvestment plans, warrants and options. In addition, certain subsidiaries are eligible to use Form S-3 or Form F-3 for debt offerings if the parent company satisfies the eligibility requirements in Instruction I.A. and provides the subsidiary a full and unconditional guarantee of the obligations being registered by the subsidiary.

²⁴ See General Instruction I.B.2. to Forms S-3 and F-3.

²⁵ See Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, Release No. 33-6331 (Aug. 6, 1981) [46 FR 41902] ("the S-3 Proposing Release").

²⁶ Form S-9 was rescinded on December 20, 1976, because it was being used by only a very small number of registrants. The Commission believed the lack of usage was due in part to interest rate increases which made it difficult for many registrants to meet the minimum fixed charges coverage standards required by the form. Adoption of Amendments to Registration Forms and Guide and Rescission of Registration Form, Release No. 33-5791 (Dec. 20, 1976) [41 FR 56301].

²⁷ The criteria included requiring net income during each of the registrant's last five fiscal years, no defaults in the payment of principal, interest, or sinking funds on debt or of rental payments for leases, and various fixed charge coverages. The use of fixed charges coverage ratios, typically 1.5, was common in state statutes defining suitable debt investments for banks and other fiduciaries.

²⁸ See the S-3 Proposing Release, supra note 25.

short form prospectuses are appropriate for investment grade debt because such securities are generally purchased on the basis of interest rates and security ratings.²⁹

When the Commission adopted Form S-3, it included a provision that a primary offering of non-convertible debt securities may be eligible for registration on the form if rated investment grade.³⁰ This provision provided issuers of debt securities whose public float did not reach the required threshold, or that did not have a public float, with an alternate means of becoming eligible to register offerings on Form S-3.³¹ Consistent with Form S-3, the Commission adopted a provision in Form F-3 providing for the eligibility of a primary offering of investment grade non-convertible debt securities by eligible foreign private issuers.³²

Since the adoption of those rules relating to security ratings and Form S-3 and Form F-3, other Commission forms and rules relating to securities offerings or issuer

²⁹ See Adoption of Integrated Disclosure System, Release No. 33-6383 (Mar. 3, 1982) [47 FR 11380]. Later, in 1992, the Commission expanded the eligibility requirement to delete references to debt or preferred securities and provide Form S-3 eligibility for other investment grade securities (such as foreign currency or other cash settled derivative securities). See Simplification of Registration Procedures for Primary Securities Offerings, Release No. 33-6964 (Oct. 22, 1992) [57 FR 48970].

³⁰ See General Instruction I.B.2. of Form S-3.

³¹ Pursuant to the revisions to Form S-3 and Form F-3 adopted in 2007, issuers also may conduct primary securities offerings on these forms without regard to the size of their public float or the rating of debt securities being offered, so long as they satisfy the other eligibility conditions of the respective forms, have a class of common equity securities listed and registered on a national securities exchange, and the issuers do not sell more than the equivalent of one-third of their public float in primary offerings over any period of 12 calendar months. See Revisions to Eligibility Requirements for Primary Offerings on Forms S-3 and F-3, Release No. 33-8878 (Dec. 19, 2007) [72 FR 73534].

³² General Instruction I.B.2. of Form F-3. See Adoption of Foreign Issuer Integrated Disclosure System, Release No. 33-6437 (Nov. 19, 1982) [47 FR 54764]. In 1994, the Commission expanded the eligibility requirement to delete references to debt or preferred securities and provide Form F-3 eligibility for other investment grade securities (such as foreign currency or other cash settled derivative securities). See Simplification of Registration of Reporting Requirements for Foreign Companies, Release No. 33-7053A (May 12, 1994) [59 FR 25810].

disclosures have included requirements that likewise rely on securities ratings.³³ Among them are Form F-9,³⁴ Forms S-4 and F-4,³⁵ and Exchange Act Schedule 14A.³⁶

As discussed in more detail below, we are proposing today to revise Instruction I.B.2. of Form S-3 and Form F-3 to provide that an offering of non-convertible securities is eligible to be registered on Form S-3 and Form F-3 if the issuer has issued at least \$1 billion of non-convertible securities in transactions registered under the Securities Act, other than equity securities, for cash during the past three years (as measured from a date within 60 days of the filing of the registration statement) and satisfies the other relevant requirements of Form S-3 or Form F-3.

2. Comments Received on the 2008 Proposing Release

In 2008, we proposed to replace the investment grade criterion in Instruction I.B.2. in Form S-3 (and the corresponding provision in Form F-3) with the requirement that the issuer has issued at least \$1 billion of non-convertible securities in transactions registered under the Securities Act, other than equity securities, for cash during the past three years (as measured from a date within 60 days of the filing of the registration statement) and satisfied the other relevant requirements of Form S-3 or Form F-3. As noted above, we received 49 comment letters regarding the 2008 Proposing Release.

Most commentators opposed the proposal to modify Form S-3 and Form F-3 to remove

³³ This release addresses rules and forms filed by issuers under the Securities Act and Schedule 14A under the Exchange Act. In separate releases to be considered at a later date, the Commission intends to propose rules to address other rules and forms that rely on an investment grade ratings component.

³⁴ See General Instruction I. of Form F-9.

³⁵ See General Instruction B.1 of Form S-4 and General Instruction B.1(a) of Form F-4.

³⁶ See Note E and Item 13 of Schedule 14A.

references to credit ratings.³⁷ When the 2008 Proposing Release was published (and when we sought additional comment in 2009), however, we were not subject to Section 939A of the Dodd-Frank Act.

In addition to the commentators who were generally opposed to amending Form S-3 and Form F-3, several commentators were opposed to replacing the reference to credit ratings with a requirement that in order to be eligible to use Form S-3 and Form F-3, companies would have to have issued at least \$1 billion of non-convertible securities in offerings registered under the Securities Act, other than equity securities, for cash during the previous three years.³⁸ Two commentators believed the proposal would make Form S-3 less available to high quality investment grade issuers, weakening their ability to efficiently raise funds in the public market while potentially opening up short form registration to non-investment grade issuers.³⁹ One commentator believed that the amount of its outstanding debt securities is not relevant to its market following and that

³⁷ See letters from American Bar Association dated September 12, 2008 (“ABA I”) and October 10, 2008 (“ABA II”); American Electric Power dated September 4, 2008 (“AEP”); Boeing Capital Corporation dated September 24, 2008 (“Boeing”); Charles Schwab & Co., Inc. dated September 5, 2008 (“Schwab”); Constance Curnow dated August 28, 2008 (“Curnow”); Davis Polk & Wardwell dated September 4, 2008 (“Davis Polk”); Debevoise & Plimpton dated September 3, 2008 (“Debevoise”); Dominion Resources, Inc. dated September 5, 2008 (“Dominion”); Edison Electric Institute dated September 5, 2008 (“EEI I”) and December 3, 2009 (“EEI II”); Incapital, LLC dated September 5, 2008 (“Incapital”); Manulife Financial Corporation dated September 5, 2008 (“Manulife”); Mayer Brown LLP dated September 4, 2008 (“Mayer Brown”); Mortgage Bankers Association dated September 5, 2008 (“MBA”); PNM Resources, Inc. dated September 5, 2008 (“PNM I”) and December 8, 2009 (“PNM II”); Securities Industry and Financial Markets Association dated September 4, 2008 (“SIFMA I”) and December 8, 2009 (“SIFMA II”); Southern Company dated September 5, 2008 (“Southern I”) and December 8, 2009 (“Southern II”); WGL Holdings, Inc. dated September 10, 2008 (“WGL”); Wisconsin Energy Corporation dated September 5, 2008 (“Wisconsin Energy”); and Xcel Energy Inc. dated December 8, 2009 (“Xcel”).

³⁸ See letters from AEP, Boeing, Dominion, EEI I, EEI II, Southern I, Southern II, PNM I, PNM II, WGL, Wisconsin, ABA II, Xcel.

³⁹ See letters from SIFMA and Boeing.

increasing the amount of debt issued would not increase its market following.⁴⁰ Some commentators thought the \$1 billion threshold should be lower.⁴¹ One commentator suggested that a range of \$300 to \$500 million would be more consistent with the threshold for equity issuers.⁴² Several commentators objected to the three year look-back period.⁴³ Some of these commentators thought that the amount of outstanding debt (as opposed to the amount of debt issued over a three-year period) of an issuer provides a more reliable measure of market interest for debt securities than public float provides for investors in equity securities.⁴⁴

Commentators also disputed our preliminary belief that few issuers who are currently eligible to use Form S-3 and Form F-3 would not be eligible to use Form S-3 and Form F-3 if the proposal were adopted.⁴⁵ One commentator estimated that 25-30 electric utilities would be adversely affected by the proposal.⁴⁶ We received specific comments from utility companies, real estate investment trusts (REITs) and commentators representing issuers of insurance contracts stating that the proposal would

⁴⁰ See letter from WGL.

⁴¹ See letters from National Association of Real Estate Investment Trusts dated September 5, 2008 (“NAREIT”); Xcel, PNM II, Southern II and EEI II.

⁴² See letter from NAREIT.

⁴³ See letters from Dominion, EEI I, EEI II, PNM II, Southern II and Xcel.

⁴⁴ See letters from WGL and NAREIT.

⁴⁵ In the 2008 Proposing Release, we estimated that six issuers who had filed on Form S-3 in the first half of 2008 would have been required to use Form S-1 if the proposal had been in place. See 2008 Proposing Release, supra note 14, at 40111. Commentators indicated that they thought a greater number of issuers would be affected if the proposal were adopted. See letters from ABA II, EEI II, Southern II and PNM II.

⁴⁶ See letter from EEI I.

no longer allow them to use Form S-3 and the shelf offering process.⁴⁷ Some commentators also believed that if the proposal were adopted these companies would conduct more private and offshore offerings.⁴⁸ Some of these commentators also believed that if the proposals were adopted raising funds in the private markets would increase the cost of capital.⁴⁹

As discussed in more detail below, the 2008 Proposing Release also included proposed changes to other Securities Act and Exchange Act rules and forms similar to those proposed today, although we did not receive significant feedback on those proposed changes.

3. Proposal

(i) Replace Investment Grade Rating Criterion with Minimum Registered Debt Issuance Threshold

Today we are proposing to revise the transaction eligibility criteria for registering primary offerings of non-convertible securities on Forms S-3 and F-3. Notwithstanding the comments we received on the 2008 Proposing Release, we preliminarily believe that the proposal discussed below is the most workable alternative for determining whether an issuer is widely followed in the marketplace so that Form S-3 and Form F-3 eligibility and access to the shelf offering process is appropriate. Nevertheless, as discussed in section (ii) below, we also recognize that this proposal would cause some issuers that have used or that could rely upon the investment-grade criteria to lose Form S-3 or Form

⁴⁷ See letters from AEP, APS, Dominion, EEI I, EEI II, Manulife, Merrill, PNM I, PNM II, Southern I, Southern II, WGL, Wisconsin Energy, NAVA, Inc., dated September 5, 2008 ("NAVA"), NAREIT, Sutherland dated September 5, 2008 ("Sutherland I"), Sutherland dated December 8, 2009 ("Sutherland II"), and Xcel.

⁴⁸ See letters from ABA I, ABA II, PNM II, Southern II and Xcel.

⁴⁹ See letters from Xcel, EEI II and Southern II.

F-3 (and thereby shelf) eligibility. The legislative history does not indicate that Congress intended to change the types of issuers and offerings that could rely on the Commission's forms. Accordingly, we have considered several mechanisms to avoid this consequence, including attempting to replace the investment grade criteria with other criteria intended to replicate key characteristics of investment-grade securities, identifying certain classes or characteristics of issuers that are most likely to rely solely upon the investment grade criteria for Form S-3 or Form F-3 eligibility in order to craft special eligibility criteria for these issuers, or providing for "grandfathering" in the application of new rules removing the investment-grade criteria in order to allow issuers that have recently offered securities on Form S-3 or Form F-3 in reliance on the investment grade criteria to retain Form S-3 or Form F-3 eligibility. Each of these mechanisms is a means to provide consistency in the treatment of these issuers for purposes of establishing eligibility for Form S-3 or Form F-3. We have included extensive requests for comment regarding potential mechanisms that might allow more consistent treatment of these issuers to the greatest extent possible.

As proposed, the instructions to Forms S-3 and F-3 would no longer refer to security ratings by an NRSRO as a transaction requirement to permit issuers to register primary offerings of non-convertible securities for cash. Instead, these forms would be available to register primary offerings of non-convertible securities if the issuer has issued (as of a date within 60 days prior to the filing of the registration statement) for cash at least \$1 billion in non-convertible securities in offerings registered under the Securities Act, other than common equity, over the prior three years.⁵⁰

⁵⁰ See proposed General Instruction I.B.2. of Forms S-3 and F-3. We are also proposing to delete Instruction 3 to the signature block of Forms S-3 and F-3.

We are proposing to revise the form eligibility criteria using the same method and threshold by which the Commission defined an issuer of non-convertible securities, other than common equity, that does not meet the public equity float test as a “well-known seasoned issuer” (WKSIs).⁵¹ Similar to our approach with WKSIs, we believe that having issued \$1 billion of registered non-convertible securities over the prior three years would generally correspond with a wide following in the marketplace. These issuers generally have their Exchange Act filings broadly followed and scrutinized by investors and the markets.⁵² We believe that a wide following in the marketplace makes Form S-3 and Form F-3 appropriate for these issuers because information about them is generally readily available. As a result, we believe replacing the investment grade criterion with a standard based on the definition of WKSIs is appropriate. This approach is designed to identify those issuers that are followed by the markets such that it is appropriate to allow incorporation by reference of subsequently filed Exchange Act reports into the Securities Act registration statement and delayed offerings off of the shelf. We realize, however, that some offerings by issuers of lower credit quality may be registered for sale on Form S-3 and Form F-3 if our proposal is adopted. We solicit comment on whether our proposal would result in companies for whom Form S-3 and Form F-3 would not be appropriate now being able to register offerings on Form S-3 or Form F-3.⁵³

⁵¹ See Securities Offering Reform, Release No. 33-8591 (Jul. 19, 2005) [70 FR 44722]. For purposes of debt issuers, an issuer is a well-known seasoned issuer if it satisfies the various requirements for WKSIs in Securities Act Rule 405 (such as not being an “ineligible issuer” or an issuer of asset-backed securities) and it has issued within the last three years at least \$1 billion aggregate principal amount of non-convertible securities, other than equity, for cash in primary offerings registered under the Securities Act.

⁵² See Securities Offering Reform, Release No. 33-8501 (Nov. 3, 2004) [69 FR 67392].

⁵³ All issuers also would be required to satisfy the other conditions of the Form S-3 and Form F-3 eligibility requirements, including those regarding reporting status.

In determining compliance with the proposed \$1 billion threshold, we would use the same standards that are used in determining whether an issuer is a WKSI.⁵⁴

Specifically:

- issuers would be permitted to aggregate the amount of non-convertible securities, other than common equity, issued in registered primary offerings during the prior three years;
- issuers would be permitted to include only such non-convertible securities that were issued in registered primary offerings for cash – they would not be permitted to include registered exchange offers;⁵⁵ and
- parent company issuers only would be permitted to include in their calculation the principal amount of their full and unconditional guarantees, within the meaning of Rule 3-10 of Regulation S-X,⁵⁶ of non-convertible securities, other than common equity, of their majority-owned subsidiaries issued in registered primary offerings for cash during the three-year period.

Also consistent with the WKSI standard, the aggregate principal amount of non-convertible securities that would be permitted to be counted toward the \$1 billion issuance threshold would be issued in any registered primary offering for cash, on any

⁵⁴ See *Securities Offering Reform*, *supra* note 51.

⁵⁵ Issuers would not be permitted to include the principal amount of securities that were offered in registered exchange offers by the issuer when determining compliance with the \$1 billion non-convertible securities threshold. A substantial portion of these offerings involve registered exchange offers of substantially identical securities for securities that were sold in private offerings. In those cases, the original sale to an “initial purchaser” in a private offering is made in reliance upon, for example, the exemption of Securities Act Section 4(2), and is often immediately followed by a resale by the initial purchasers to investors pursuant to the safe harbor provided by Rule 144A. Such a transaction is not registered and is not carried out under the Securities Act’s disclosure or liability standards. Moreover, in the subsequent registered exchange offers, purchasers may not be able, in certain cases, to avail themselves effectively of the remedies otherwise available to purchasers in registered offerings for cash.

⁵⁶ 17 CFR 210.3-10.

form (other than Form S-4 or Form F-4). In calculating the \$1 billion amount, issuers generally would be permitted to include the principal amount of any debt and the greater of liquidation preference or par value of any non-convertible preferred stock that were issued in primary registered offerings for cash.⁵⁷

Although the proposed standard and the WKSI standard are both based on a \$1 billion minimum offering history, issuers seeking to rely on the new standard would not be required to qualify as a WKSI. Specifically, unlike WKSI, the new Form S-3 and Form F-3 eligibility test could be met by issuers that are “ineligible issuers” as defined in Rule 405.

(ii) Impact of Proposals

We preliminarily anticipate that under the proposed threshold some high yield debt issuers that are not currently eligible to use Form S-3 would become eligible. On the other hand, the proposed changes would result in some issuers currently eligible to use Form S-3 and Form F-3 becoming ineligible. Based on a review of non-convertible securities issued in the U.S. from January 1, 2006 through August 15, 2008, we estimate that approximately 45 issuers who were previously eligible to use Form S-3 (and who had made an offering during the review period) would no longer be able to use Form S-3 for

⁵⁷ In determining the dollar amount of securities that have been registered during the preceding three years, issuers would use the same calculation that they use to determine the dollar amount of securities they are registering for purposes of determining fees under Rule 457. 17 CFR 230.457.

offerings of non-convertible securities other than equity securities.⁵⁸ As noted below, the data does not measure the effect of the proposed rules on issuers who were previously eligible to use Form S-3 but did not make a public offering during the review period. We further estimate that approximately eight issuers who were previously ineligible to use Form S-3 or Form F-3 would be eligible to use those forms if the proposals are adopted.

⁵⁸

Our staff used a commercial database to determine offerings of non-convertible debt and preferred securities made during the review period. They then used filters available through other commercial databases to exclude from the sample issuers of unregistered offerings (when identifiable), issuers with a free float capitalization in excess of \$75 million and issuers who had guarantees from a parent with a free float capitalization in excess of \$75 million. Free float capitalization is the proportion of shares available to ordinary investors (generally excluding employee holdings and holdings of 5% or more of the shares) multiplied by the market capitalization of the company. As a result, free float capitalization excludes shares in its calculation that would be included in the determination of market capitalization for purposes of determining eligibility under Instruction I.B.1. of Form S-3. The staff believes that using the free float definition did not affect the estimate of companies who made offerings during the review period who would no longer be eligible to use Form S-3 because it resulted in additional companies in the review sample. The staff then used additional computer-based filters to estimate the number of issuers who made offerings during the review period who would not have satisfied the eligibility criteria for Form S-3 and F-3 if the proposal was adopted because they had issued less than \$1 billion of non-convertible securities over the previous three years. Because the commercial databases used do not unambiguously identify registered offerings and because commercial databases sometimes contain data-entry errors, the staff then reviewed this set of issuers manually by comparing the issuance data from the commercial databases to filings in the EDGAR database. The staff's review resulted in the exclusion of issuers who did not appear in the EDGAR database (and had thus never made a registered offering), issuers who appear in EDGAR but had either never made a registered offering or who had not completed a registered offering within the timeframe for the sample and whose registered offerings were so rare that they likely would not have been included in the data set even if the timeframes had been shifted forward or back, issuers who had filed automatic shelf registration statements, issuers whose debt was guaranteed by a parent who was eligible to use Form S-3 or Form F-3, issuers of asset-backed securities, issuers who had registered offerings on Form N-2 and issuers who had issued in excess of \$1 billion of non-convertible securities within the previous three years. This review resulted in an estimate of approximately 40 companies who made offerings during the review period who would no longer be eligible to use Form S-3 or Form F-3 if the proposals are adopted. Based on a review of filings made by issuers of certain insurance company contracts during the review period, the staff estimates that approximately five issuers of certain insurance contracts registered on Form S-3 during this time period would be ineligible to use Form S-3 if the proposals are adopted. Those five issuers have been included in the 45 issuers noted in the text above. See note 61 and related text for a discussion of the insurance contracts.

While the data may be helpful in considering the potential general effect of the proposed amendment, the scope of the data is limited. We note that a survey covering a different time period would have produced different results, particularly in light of market volatility in the time period. In addition, the data reviewed does not take into account issuers who would have been eligible to offer non-convertible securities on Form S-3 solely in reliance on Instruction I.B.2., but chose not to do so.

Request for Comment

We request comment on all aspects of the proposal. We have included specific questions below in order to facilitate responses from interested parties. In particular, in light of comments received on the 2008 Proposal, we have included requests for comment related to provisions of the proposals that may have a significant effect on utility companies, issuers of insurance contracts and REITs. We also seek comment from other categories of issuers who would be similarly affected by our proposals.

1. We recognize that the proposals, if adopted, could change the number and types of issuers currently eligible to use Form S-3 or Form F-3. Should Section 939A of the Act be read as simply requiring the removal of references to credit ratings but otherwise have no effect on the number and type of issuers eligible to use our forms? If so, should the new eligibility criteria be designed to replicate, as closely as possible, the existing pool of eligible issuers? What would be the advantages and disadvantages of such an approach?
2. Is the cumulative registered offering amount for the most recent three-year period the appropriate threshold at which to differentiate issuers? If so, is \$1 billion appropriate? If not, should the threshold be higher (e.g., \$1.25 billion) or lower (e.g., \$500 or \$750 million), and, if so, at what level should it be set? Please explain your reasoning for a different threshold.

We estimate, based on our staff's review of non-convertible offerings, that a threshold of \$750 million would result in approximately four of the companies excluded under the \$1 billion threshold being eligible to use

Form S-3, and that a threshold of \$500 million would result in approximately 11 of the issuers excluded under the \$1 billion threshold being eligible to use Form S-3.

3. Are there any transactions that currently meet the requirements of current General Instruction I.B.2. that would not be eligible to use the form under the proposed revision? Are there any transactions that do not meet the current Form S-3 or Form F-3 eligibility requirements for investment grade securities, but now would be eligible under the proposed revision, that should not be eligible? If practicable, provide information on the frequency with which such offerings are made.
4. We understand based on comments received on the 2008 Proposing Release and our staff's review of offerings of non-convertible securities that wholly owned, state-regulated operating subsidiaries of utility companies currently are eligible to register offerings in reliance on Instruction I.B.2. of Form S-3 and would no longer be eligible to use Form S-3 if the proposals are adopted because they would not be able to satisfy the \$1 billion threshold.⁵⁹ Should we include a provision in Forms S-3 and F-3 that would allow these companies to continue to register offerings of non-convertible securities on Form S-3 or Form F-3 even if they do not satisfy the \$1 billion threshold? Would the regulation by state utility commissions indicate that Form S-3 and Form F-3 are appropriate for

⁵⁹ Our staff review of filings between January 1, 2006 and August 15, 2008 indicates that an estimated 29 utility companies that used Form S-3 during the relevant period would be ineligible under the proposed amendments. One commentator on the 2008 Proposing Release indicated that the proposal would affect 25-30 utility companies. See note 46 above.

these issuers?⁶⁰ Should we condition such eligibility on the issuer's parent also being eligible to register a primary offering on Form S-3 or F-3? Are there other conditions we should consider? Are there reasons these companies should not be able to file on Form S-3 or F-3? Would such a provision result in issuers who are not currently eligible to use Form S-3 or F-3 becoming eligible? If so, would this result be appropriate? If such a provision would result in issuers who are not currently eligible to use Form S-3 or F-3 becoming eligible, what would be the impact on the substance of information available to investors and its accessibility? If it should be limited, how could the provision be tailored so that it would be limited to issuers currently eligible to file on Form S-3 or F-3? Should a provision for Form S-3 eligibility have different conditions than a provision for Form F-3 eligibility?

5. We understand based on comments received on the 2008 Proposing Release and our staff's review of offerings of non-convertible securities that issuers of certain insurance contracts (e.g., contracts with so-called "market value adjustment" features⁶¹ and contracts that provide

⁶⁰ One commentator on the 2008 Proposing Release indicated that "state regulators, typically through public utility commissions, regulate the operations of many U.S. investor owned electric utilities. Typically, a regulated utility may not issue debt securities without the prior approval of its state utility commission, which premises approval on a determination that the issuance is consistent with the public good." See letter from EEI.

⁶¹ Market value adjustment ("MVA") features have historically been associated with annuity and life insurance contracts that guarantee a specified rate of return to purchasers. In order to protect the insurer against the risk that a purchaser may take withdrawals from the contract at a time when the market value of the insurer's assets that support the contract has declined due to rising interest rates, insurers sometime impose an MVA upon surrender. Under an MVA feature, the insurer adjusts the proceeds a purchaser receives upon surrender prior to the end of the guarantee period to reflect changes in the market value of its portfolio securities supporting the contract.

guaranteed benefits in connection with assets held in an investor's mutual fund, brokerage, or investment advisory account) currently eligible to register offerings in reliance on Instruction I.B.2. of Form S-3 would no longer be eligible to use Form S-3 if the proposals are adopted because they would not be able to satisfy the \$1 billion threshold.⁶² Should we include a provision in Forms S-3 and F-3 that would allow these companies to continue to register offerings of such contracts on Form S-3 or Form F-3 even if they do not satisfy the \$1 billion threshold? Should such a provision be limited to companies that are subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of a state or territory of the United States or the District of Columbia? Should we also limit eligibility to an issuer that files an annual statement of its financial condition with, and is supervised and its financial condition examined periodically by, the insurance commissioner, bank commissioner, or any agency or officer performing like functions of the issuer's domiciliary jurisdiction? Should we condition eligibility for such a provision on the issuer's capital adequacy as assessed with reference to risk-based capital standards under the insurance laws of the issuer's state of domicile or other relevant jurisdiction? If so, what level of risk-based capital should be required? Should we condition eligibility for such a provision on the issuer's parent being eligible to register a primary offering on Form S-3 or F-3? Should

⁶² As discussed in note 58 above, we estimate that five of these issuers that used Form S-3 during the relevant period would be ineligible to use Form S-3 if the proposal is adopted.

we also require that the securities offered not constitute an equity interest in the issuer and be subject to regulation under the insurance laws of the domiciliary jurisdiction of the issuer? Should we also provide that the value of the securities to be offered does not vary according to the investment experience of a separate account? Are there other conditions we should consider?

6. Would a provision like that described in the preceding question result in issuers of insurance contracts who are not currently eligible to use Form S-3 or F-3 becoming eligible? If so, would this result be appropriate? If such a provision would result in issuers who are not currently eligible to use Form S-3 or F-3 becoming eligible, what would be the impact on the substance of information available to investors and its accessibility? How could the provision be tailored so that it would be limited to issuers of insurance contracts that are currently eligible to file on Form S-3 or F-3? Should a provision for Form S-3 eligibility have different conditions than a provision for Form F-3 eligibility?
7. We understand based on comments received on the 2008 Proposing Release and our staff's review of offerings of non-convertible securities that wholly-owned operating partnerships of exchange-listed REITS currently are eligible to register offerings in reliance on Instruction I.B.2. of Form S-3 and would no longer be eligible to use Form S-3 if the proposals are adopted because they would not be able to satisfy the \$1

billion threshold.⁶³ Should we include a provision in Forms S-3 and F-3 that would allow these companies to continue to register offerings of non-convertible securities on Form S-3 or F-3 even if they do not satisfy the \$1 billion threshold? Should we condition such eligibility on the issuer's parent also being eligible to register a primary offering on Form S-3 or F-3? Are there other conditions we should consider? Are there reasons these companies should not be able to file on Form S-3 or F-3? Would such a provision result in issuers who are not currently eligible to use Form S-3 or F-3 to become eligible? If so, would this result be appropriate? If such a provision would result in issuers who are not currently eligible to use Form S-3 or F-3 becoming eligible, what would be the impact on the substance of information available to investors and its accessibility? If it should be limited, how could the provision be tailored so that it would be limited to issuers currently eligible to file on Form S-3 or F-3? Should a provision for Form S-3 eligibility have different conditions than a provision for Form F-3 eligibility?

8. Assuming there are issuers currently eligible to use Form S-3 or Form F-3 that would not be eligible to use those forms if the proposals are adopted, should such issuers be eligible under the new rules? If so, should we provide for their continued eligibility through "grandfathering?" If we were to adopt rules that have the effect of "grandfathering" currently eligible issuers, how should such a provision be crafted? Should issuers'

⁶³ We estimate that approximately six operating partnership subsidiaries of REITs that used Form S-3 or Form F-3 during the relevant period would be ineligible to register offerings on Form S-3 or F-3 if the proposals are adopted.

eligibility be measured from the date of the enactment of the Dodd-Frank Act, the date of this proposal, or some other date? Why? How would we determine the population of issuers eligible for any “grandfathering?”

Would these issuers have an investment grade “issuer rating,” or would ratings typically used to meet the current Form S-3 and Form F-3 eligibility requirements be issued for each security on an offering by offering basis? If the ratings are issued in connection with each offering of a security, then how could we determine whether such an issuer is eligible under a “grandfathering provision?” Should we provide that issuers that have relied on the investment grade eligibility criterion in the past may continue to use Form S-3 or Form F-3 for offerings of non-convertible securities if the issuers are otherwise eligible to use the forms? Would that approach be consistent with Section 939A of the Dodd-Frank Act? If so, should there be a timing requirement, such as requiring that an issuer have conducted an offering under current Instruction I.B.2. within the past three years? Should there be other conditions? Should there be a time limit going forward, such as allowing these “grandfathered” issuers to use Form S-3 and Form F-3 for three years from the effective date of the proposed amendments? Are there other ways these issuers could remain eligible to use Form S-3 or Form F-3? Are there specific characteristics that should be required to be met that would enable these issuers to retain Form S-3 or Form F-3 eligibility? Assuming there are issuers currently ineligible to use Form S-3 and Form F-3 that would

become eligible if the proposals are adopted, should we condition their eligibility on any specific characteristics?

9. Is there a reason that this Form S-3 and Form F-3 eligibility requirement should not mirror the registered offering amount requirement for the debt-only WKSI definition?
10. Should the measurement time period for a dollar-volume issuance threshold (whether set at \$1 billion, as proposed, or at some other level) be longer or shorter than three years (e.g., four or five years or one or two years)? If so, why? Would it be more appropriate for the threshold to include non-convertible securities, other than common equity, outstanding rather than issued in registered transactions over the prior three years?
11. In determining compliance with the dollar-volume threshold, should issuers be permitted to include only securities issued in registered primary offerings for cash, as proposed? Should issuers be permitted to include registered exchange offers or private offerings?
12. Is there a better alternative for Form S-3 and Form F-3 eligibility for non-convertible securities? By what metrics could one measure the market following for debt issuers? Is there an alternative definition of "investment grade debt securities" that does not rely on NRSRO ratings and adequately meets the objective of relating short-form registration to the existence of widespread following in the marketplace?

13. Does the proposed eligibility based on the amount of prior registered non-convertible securities issued serve as an adequate replacement of the investment grade eligibility condition?
14. Is having a wide following in the market an appropriate basis for determining Form S-3 and Form F-3 eligibility criteria? Are there other criteria on which such eligibility should be based? What characteristics should an issuer eligible to use Form S-3 and Form F-3 have? What standard could we use in Form S-3 and Form F-3 to ensure those characteristics are present? If having a wide following in the market is an appropriate standard, would the alternatives on which we have requested comment (e.g., "grandfathering" certain issuers) result in issuers with a wide following in the market being eligible to use Form S-3 and Form F-3?
15. Should there be an eligibility requirement based on a minimum number of holders of non-convertible securities issued pursuant to registered offerings? If so, should this threshold be limited to securities issued for cash, or should securities issued pursuant to registered exchange offerings also be included? Should the number of holders be 300 or 500, by analogy to our registration and deregistration rules relating to equity securities or some other number?⁶⁴ Would linking the eligibility requirement to the number of holders help to assure market following? If the number of holders would be an appropriate alternative, how should

⁶⁴ See Exchange Act Rule 12g-4 [17 CFR 240.12g-4].

that number be determined? For example, if debt securities are registered in the name of the record holder, is there a reliable and workable method for determining the number of beneficial holders?

16. Transactions in most non-asset backed debt securities are currently required to be reported by broker/dealers who are members of the Financial Industry Regulatory Authority (FINRA). Such transactions are reported through the Trade Reporting and Compliance Engine (TRACE) which is administered by FINRA. Instead of, or in addition to, the proposed \$1 billion threshold we have proposed, should we base Form S-3 and Form F-3 eligibility on the average daily volume of trading as reported in TRACE over a specified period of time (e.g., six months or 12 months)? Would issuers be able to manipulate such a standard? Would allowing Form S-3 and F-3 eligibility for companies with an average daily volume of trading as reported in TRACE of all of the securities of a non-ABS issuer that were offered and sold pursuant to a registration statement for the six or 12 months prior to the filing of the registration statement be appropriate? Would using such a standard result in companies' Form S-3 and Form F-3 eligibility changing too frequently? Is this volatility problematic, and are there ways we could mitigate it? How would the number and types of issuers eligible to use Form S-3 and Form F-3 under a TRACE volume standard compare to the number and issuers eligible to use Form S-3 and Form F-3 currently? Would using volume of transactions reported in TRACE instead of the \$1 billion standard result in

a different set of companies being Form S-3 or Form F-3 eligible or would it result in roughly the same companies being Form S-3 or Form F-3 eligible? Are there particular companies who would be eligible to use Form S-3 or Form F-3 under the \$1 billion standard but not under a TRACE volume standard? Are there particular companies that would be eligible to use Form S-3 or Form F-3 under the TRACE volume standard but not under the \$1 billion standard?

17. Should there be a different standard for eligibility of foreign private issuers to use Form F-3? If so, explain why and what a more appropriate criteria would be.
18. Does the \$1 billion threshold of registered offerings in the prior three years present any issues that are unique to foreign private issuers, especially those that may undertake U.S. registered public offerings as only a portion of their overall plan of financing, and how might these problems be addressed? Would it be appropriate to provide a longer time period for measurement, or to include unregistered, public offerings of securities for cash outside the United States?
19. Should we include a Form S-3 eligibility category for any issuer that is subject to substantive state or federal regulation such as broker/dealers that must satisfy net capital requirements? What types of issuers would be able to use Form S-3 under such a provision? Would it result in a significant number of new issuers being eligible to use Form S-3? Is state or federal regulation, or a particular kind of state or federal regulation

(e.g., approval of capital transactions), an appropriate measure for determining Form S-3 eligibility? Why or why not? Should such an approach be even broader and allow for Form S-3 eligibility of issuers that control entities subject to substantive state or federal regulation such as bank holding companies that control banks subject to federal or state regulation? Is there a comparable approach that would be appropriate for foreign private issuers?

20. Should we base Form S-3 and Form F-3 eligibility on the metrics used by NRSROs in determining a rating? Are there certain key metrics such as debt, revenue, profit margin, cash flow to debt ratios, interest coverage ratios and return on assets that we should include? How could we account for differences in industry to make the metrics appropriate for all companies without undue complexity? Would these metrics (or other appropriate metrics) be easy for companies to calculate for purposes of determining Form S-3 and Form F-3 eligibility?
21. Should we base Form S-3 and Form F-3 eligibility on the presence of certain covenants in the indenture? Are there covenants or other provisions that would indicate that an offering was appropriate for Form S-3 and Form F-3 eligibility?⁶⁵ What would those covenants be, and how would they serve as an indicator that Form S-3 and Form F-3 eligibility was appropriate?

⁶⁵ In this regard, we note that the Credit Roundtable has published a white paper setting forth model covenants for investment grade bond deals. The white paper includes model provisions for change of control, step-up coupons, limitation on liens and priority debt, reporting obligations and voting by series. The paper is available at their website www.creditroundtable.org.

22. Are there elements from the proposed rules and the alternatives on which we have requested comment that could be combined into an appropriate standard for determining Form S-3 and Form F-3 eligibility? If so, what would such a standard include?

B. Form F-9

Form F-9 allows certain Canadian issuers⁶⁶ to register investment grade debt or investment grade preferred securities that are offered for cash or in connection with an exchange offer, and which are either non-convertible or not convertible for a period of at least one year from the date of issuance.⁶⁷ Under the form's requirements, a security is rated "investment grade" if it has been rated investment grade by at least one NRSRO, or at least one Approved Rating Organization, as defined in National Policy Statement No. 45 of the Canadian Securities Administrators ("CSA").⁶⁸ This eligibility requirement was adopted as part of a 1993 revision to the MJDS originally adopted by the Commission in 1991 in coordination with the CSA.⁶⁹

In the 2008 Proposing Release, we proposed to eliminate the requirement in Form F-9 that allows Canadian issuers to register certain debt securities if they were rated investment grade by an NRSRO. We did not propose to change the eligibility requirement in Form F-9 that allows Canadian issuers to register certain debt securities if

⁶⁶ Form F-9 is the Multijurisdictional Disclosure System ("MJDS") form used to register investment grade debt or preferred securities under the Securities Act by eligible Canadian issuers.

⁶⁷ Securities convertible after a period of at least one year may only be convertible into a security of another class of the issuer.

⁶⁸ See General Instruction I.A. to Form F-9.

⁶⁹ See Amendments to the Multijurisdictional Disclosure System for Canadian Issuers, Release No. 33-7025 (Nov. 3, 1993) [58 FR 62028]. See also Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 33-6902 (Jun. 21, 1991) [56 FR 30036].

they are rated investment grade by an Approved Rating Organization (as defined under Canadian regulations). We did not receive significant comment on this proposal.

We have considered modifying this 2008 proposal to further revise Form F-9 in order to comply with Section 939A of the Dodd-Frank Act. However, after further analysis, rather than further revising the form, we are instead proposing to rescind Form F-9. Due to Canadian regulatory developments since the publishing of the 2008 Proposing Release, we no longer believe that keeping Form F-9 as a distinct form would serve a useful purpose. Under Form F-9, an eligible issuer has been able to register investment grade securities using audited financial statements prepared pursuant to Canadian generally accepted accounting principles (Canadian GAAP) without having to include a U.S. GAAP reconciliation. In contrast, a MJDS filer must reconcile its home jurisdiction financial statements to U.S. GAAP when registering securities on a Form F-10.⁷⁰ However, the CSA has recently adopted rules that will require Canadian reporting companies to prepare their financial statements pursuant to International Financial Reporting Standards as issued by the International Accounting Standards Board (“IFRS”) beginning in 2011.⁷¹ Foreign private issuers that prepare their financial statements in accordance with IFRS are not required to prepare a U.S. GAAP reconciliation.⁷² Since a Canadian issuer will not have to perform a U.S. GAAP reconciliation under IFRS, the

⁷⁰ See Item 2 under Part I of Form F-10 (17 CFR 239.40). Form F-10 is the general MJDS registration statement that may be used to register securities for a variety of offerings, including primary offerings of equity and debt securities, secondary offerings, and exchange offers pursuant to mergers, statutory amalgamations, and business combinations.

⁷¹ See, for example, CSA IFRS-Related Amendments to Securities Rules and Policies (2010), which are available at: http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20101001_52-107_ifrs-amd-3339-supp3.pdf. Canadian reporting companies that are U.S. registrants may elect to prepare their financial statements in accordance with U.S. GAAP. See Part 3.7 of National Instrument 52-107.

⁷² See Item 17(c) of Form 20-F.

primary difference between Form F-9 and Form F-10 will be eliminated. Once the Canadian IFRS-related amendments become effective,⁷³ the disclosure requirements for an investment grade securities offering registered on Form F-10 will be the same as the disclosure requirements for one registered on Form F-9, resulting in Form F-9 becoming dispensable.

In addition, MJDS filers have infrequently used Form F-9. Since January 1, 2007, only 21 issuers have filed Form F-9 for fewer than 40 registration statements. In light of its infrequent use and dispensability, we propose to eliminate Form F-9 in its entirety.⁷⁴

Request for Comment

23. The Commission requests comment on whether we should rescind Form F-9, as proposed. Is there a reason that we should retain that form despite the pending effectiveness of the CSA IFRS-related amendments and the infrequency of Form F-9's use?
24. Instead of rescinding the form, should we amend Form F-9 to eliminate references to credit ratings by an NRSRO in order to comply with Section 939A of the Dodd-Frank Act by replacing those references with a requirement that an issuer has issued (as of a date within 60 days prior to the filing of the registration statement) for cash at least \$1 billion in non-

⁷³ Canadian reporting issuers and registrants with financial years beginning on or after January 1, 2011, will be required to comply with the new IFRS requirements. For companies with a year-end of December 31, 2011, the initial reporting period under IFRS will be the first quarter ending March 31, 2011. See the "Transition to International Financial Reporting Standards" of the Ontario Securities Commission ("OSC"), which is available at: http://www.osc.gov.on.ca/en/ifrs_index.htm?wloc=141RHEN&id=21789EN.

⁷⁴ We further propose to eliminate all references to Form F-9 in our rules and forms, including the reference to Form F-9 in Form 40-F. As a result, a Form F-9-eligible Canadian company which currently has an Exchange Act reporting obligation solely with respect to investment grade securities would be required to file its annual report on Form 20-F.

convertible securities, other than equity securities, through registered primary offerings over the prior three years?

25. As noted above, in 2008 the Commission's proposal did not change a Canadian issuer's ability to use Form F-9 to register debt or preferred securities meeting the requirements of current General Instruction I.A. if the securities are rated "investment grade" by at least one Approved Rating Organization (as defined in National Policy Statement No. 45 of the Canadian Securities Administrators). If we retain Form F-9, should we, in addition to eliminating the criterion related to securities rated investment grade by an NRSRO, also eliminate the criterion related to securities rated investment grade by an Approved Rating Organization?

In light of Section 939A of the Dodd-Frank Act, would it be appropriate to eliminate the reference to an Approved Rating Organization even though it ultimately refers to Canadian law?

C. Ratings Reliance in Other Forms and Rules

1. Forms S-4 and F-4 and Schedule 14A

Proposals relating to Form S-4, F-4 and Schedule 14A were also included in the 2008 Proposing Release. We did not receive significant separate comment on these proposals and are re-proposing them as they were proposed in the 2008 Proposing Release. Forms S-4 and F-4 essentially include the Form S-3 and Form F-3 eligibility criteria by allowing registrants that meet the registrant eligibility requirements of Form S-3 or F-3 and are offering investment grade securities to incorporate by reference certain

information.⁷⁵ Similarly, Schedule 14A permits a registrant to incorporate by reference if the Form S-3 registrant requirements in Instruction I.A. are met and action is to be taken as described in Items 11, 12 and 14⁷⁶ of Schedule 14A, which concerns non-convertible debt or preferred securities that are "investment grade securities" as defined in General Instruction I.B.2. of Form S-3.⁷⁷ In addition, Item 13 of Schedule 14A allows financial information to be incorporated into a proxy statement if the requirements of Form S-3 (as described in Note E to Schedule 14A) are met. Because the Commission proposes to change the eligibility requirements in Forms S-3 and F-3 to remove references to ratings by an NRSRO, the Commission believes the same standard should apply to the disclosure options in Forms S-4 and F-4 based on Form S-3 or F-3 eligibility. That is, a registrant will be eligible to use incorporation by reference in order to satisfy certain disclosure requirements of Forms S-4 and F-4 to register non-convertible debt or preferred securities if the issuer has issued (as of a date within 60 days prior to the filing of the registration statement) for cash at least \$1 billion in non-convertible securities, other than common equity, through registered primary offerings over the prior three years. Similarly, we propose to amend Schedule 14A to refer simply to the requirements of General Instruction I.B.2. of Form S-3, rather than to "investment grade securities." As a result, an issuer would be permitted to incorporate by reference into a proxy statement if the issuer satisfied the requirements of Instruction I.A. of Form S-3, the matter to be acted upon related to non-convertible securities and was described in Item 11, 12 or 14 of

⁷⁵ See General Instruction B.1 of Forms S-4 and Form F-4.

⁷⁶ Item 11 of Schedule of 14A provides for solicitations related to the authorization or issuance of securities other than an exchange of securities. Item 12 provides for solicitations related to the modification or exchange of securities. Item 14 provides for solicitations related to mergers, consolidations and acquisitions.

⁷⁷ See Note E of Schedule 14A.

Schedule 14A and the issuer had issued (as of a date within 60 days of the date the definitive proxy is first sent to security holders) for cash at least \$1 billion in non-convertible securities, other than common equity, through registered primary offerings over the prior three years.

Request for Comment

26. Are the amendments we have proposed for Forms S-4 and F-4 appropriate?
27. Are the proposed amendments to Schedule 14A appropriate? Would there be a significant impact on the way proxy filings are made as a result of the new criteria?

2. Securities Act Rules 138, 139 and 168

Other Securities Act rules also rely on credit ratings. Rules 138, 139, and 168 under the Securities Act provide that certain communications are deemed not to be an offer for sale or offer to sell a security within the meaning of Sections 2(a)(10)⁷⁸ and 5(c)⁷⁹ of the Securities Act when the communications relate to an offering of non-convertible investment grade securities. These communications include the following:

- under Securities Act Rule 138, a broker's or dealer's publication about securities of a foreign private issuer that meets F-3 eligibility requirements (other than the reporting history requirements) and is issuing non-convertible investment grade securities;
- under Securities Act Rule 139, a broker's or dealer's publication or distribution of a research report about an issuer or its securities where the

⁷⁸ 15 U.S.C. 77b(a)10.

⁷⁹ 15 U.S.C. 77e(c).

issuer meets Form S-3 or F-3 registrant requirements and is or will be offering investment grade securities pursuant to General Instruction I.B.2. of Form S-3 or F-3, or where the issuer meets Form F-3 eligibility requirements (other than the reporting history requirements) and is issuing non-convertible investment grade securities; and

- under Securities Act Rule 168, the regular release and dissemination by or on behalf of an issuer of communications containing factual business information or forward-looking information where the issuer meets Form F-3 eligibility requirements (other than the reporting history requirements) and is issuing non-convertible investment grade securities.

The Commission proposes to revise Rules 138, 139, and 168 to be consistent with the proposed revisions to the eligibility requirements in Forms S-3 and F-3 since in order to rely on these rules the issuer must either satisfy the public float threshold of Form S-3 or F-3, or issue non-convertible investment grade securities as defined in the instructions to Form S-3 or F-3 as proposed to be revised. We included the same proposal in the 2008 Proposing Release and did not receive significant comment separate from the comment on the revised eligibility in Forms S-3 and F-3.

Request for Comment

28. Should the Commission revise Rules 138, 139, and 168 as proposed?

3. Rule 134(a)(17)

Securities Act Rule 134(a)(17)⁸⁰ permits the disclosure of security ratings issued or expected to be issued by NRSROs in certain communications deemed not to be a prospectus or free writing prospectus. In the 2008 Proposing Release, we proposed to revise the rule to allow for disclosure of ratings assigned by any credit rating agency, not just NRSROs. We received little comment on this proposal. One commentator was opposed to the proposal because it would allow unregulated credit rating agencies to publicly disclose ratings “without having published its track record, rating procedures and methodologies” and other information required to be disclosed by NRSROs.⁸¹ We are proposing today to remove Rule 134(a)(17) in order to remove the safe harbor for disclosure of credit ratings assigned by NRSROs, since we believe providing a safe harbor that explicitly permits the presence of a credit rating assigned by an NRSRO is not consistent with the purposes of Section 939A. Although we considered continuing the safe harbor for any disclosure regarding credit ratings, similar to what we proposed in 2008, at this point, we preliminarily believe that such an approach without any limiting principle would not be consistent with the otherwise limited disclosures covered by Rule 134. We note that removing the safe harbor for this type of information would not necessarily result in a communication that included this information being deemed to be a prospectus or a free writing prospectus. The proposal would simply result in there no longer being a safe harbor for a communication that included this information. Instead,

⁸⁰ 17 CFR 230.134(a)(17). These disclosures generally appear in “tombstone” ads or press releases announcing offerings. A communication is eligible for the safe harbor if the information included is limited to such matters as, among others, factual information about the identity and business address of the issuer, title of the security and amount being offered, the price or a bona fide estimate of the price or price range, the names of the underwriters participating in the offering and the name of the exchange where such securities are to be listed and the proposed ticker symbols.

⁸¹ See letter from Realpoint.

the determination as to whether such information constitutes a prospectus would be made in light of all of the circumstances of the communication.

Request for Comment

29. Should we continue to provide a safe harbor for communications that include disclosure of ratings information? Would it be appropriate to allow such communication regarding a security rating assigned by any credit rating agency and not limit the safe harbor to NRSRO ratings? If the credit rating agency is not an NRSRO, is it appropriate to require additional disclosure to that effect? Do issuers include credit ratings in Rule 134 communications?

III. General Request for Comments

We request and encourage any interested person to submit comments regarding:

- the proposed amendments that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors, and other market participants. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

In addition, we request comment on the following:

30. Should the Commission include a phase-in for issuers beyond the effective date to accommodate pending offerings or effective shelf registration

statements on Form S-3 or Form F-3? If so, should a phase-in apply only to particular rules, such as Form S-3 and Form F-3 eligibility? As proposed, compliance with the new standards would begin on the effective date of the new rules. Will a significant number of issuers have their offerings limited by the proposed rules without a phase-in? If a phase-in is appropriate, should it be for a certain period of time (e.g., six months or 12 months) or only for the term of an effective registration statement?

31. What impact on competition should the Commission expect were it to adopt the proposed non-convertible debt eligibility requirements? Would any issuers that currently take advantage, or are eligible to take advantage of the investment grade condition and are planning to do so, be adversely affected? Is the ability to offer debt off the shelf a significant competitive advantage that the Commission should be concerned about limiting only to large debt issuers?
32. How can we balance any competitive issues with limiting shelf eligibility to widely followed issuers?

IV. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rule amendments contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 (PRA).⁸² The Commission is submitting these proposed amendments and proposed rules to the Office

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

of Management and Budget (OMB) for review in accordance with the PRA.⁸³ 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:

“Form S-1” (OMB Control No. 3235-0065) ;

“Form S-3” (OMB Control No. 3235-0073);

“Form F-1” (OMB Control No. 3235-0258);

“Form F-3” (OMB Control No. 3235-0256);

“Form F-9” (OMB Control No. 3235-0377); and

“Form F-10” (OMB Control No. 3235-0380).

We adopted all of the existing regulations and forms pursuant to the Securities Act or the Exchange Act. These regulations and forms set forth the disclosure requirements for registration statements and proxy statements that are prepared by issuers to provide investors with information. Our proposed amendments to existing forms and regulations are intended to replace rule and form requirements of the Securities Act and the Exchange Act that rely on security ratings with alternative requirements.

The hours and costs associated with preparing disclosure, filing forms, and retaining records constitute reporting and cost burdens imposed by the collection of information. There is no mandatory retention period for the information disclosed, and the information disclosed would be made publicly available on the EDGAR filing system.

⁸³ Although we are proposing amendments to Form S-4, Form F-4 and Schedule 14A, we do not anticipate any changes to the reporting burden or cost burdens associated with these forms, or the number of respondents as a result of the proposed amendments.

B. Summary of Collection of Information Requirements

The threshold we are proposing for issuers of non-convertible securities who are otherwise ineligible to use Form S-3 or Form F-3 to conduct primary offerings because they do not meet the aggregate market value requirement is designed to capture those issuers with a wide market following. The Commission expects that under the proposed threshold, the number of companies in a 12-month period eligible to register on Form S-3 or Form F-3 for primary offerings of non-convertible securities for cash will decrease by approximately 14 issuers for Form S-3 and one issuer for Form F-3.⁸⁴ We expect that the issuers filing on Form S-1 and F-1 will increase by the same amounts.

In addition, because these proposed amendments relate to eligibility requirements, rather than disclosure requirements, the Commission does not expect that the proposed revisions will impose any new material recordkeeping or information collection requirements. Issuers may be required to ascertain the aggregate principal amount of non-convertible securities issued in registered primary offerings for cash, but the Commission believes that this information should be readily available and easily calculable.

We are also proposing to rescind Form F-9, which is the form used by qualified Canadian issuers to register investment grade securities. Because of recent Canadian regulatory developments, we no longer believe that keeping Form F-9 as a distinct form

⁸⁴ In note 58 and the related text, we estimate that for offerings that occurred between January 1, 2006 and August 15, 2008 (approximately 31 months) that a net of 37 issuers would have become ineligible to use Form S-3 if the proposals had been adopted (45 issuers who would become ineligible minus eight issuers who would become newly eligible). Applying that number to a 12-month period would result in approximately 14 companies becoming ineligible to use Form S-3 (thus requiring them to use Form S-1). We have further estimated that a proportional number of Form F-3 filers would be required to file on Form F-1 if the proposals are adopted. These estimates are made solely for purposes of the PRA and are intended to reflect our estimate of the average number of respondents in any given year that may be affected by the proposed rules. The number of actual filers may be higher or lower than our estimates.

would serve a useful purpose. In addition, Canadian issuers have infrequently used Form F-9. As a result of the proposal to eliminate Form F-9, we believe there would be an additional five filers on Form F-10.⁸⁵ We do not believe that the burden of preparing Form F-10 will change because the information required by Form F-10 is the same as that required by Form F-9.

C. Paperwork Reduction Act Burden Estimates

For purposes of the Paperwork Reduction Act, we estimate that there will be no annual incremental increase in the paperwork burden for issuers to comply with our proposed collection of information requirements. We do estimate, however, that the number of respondents on Forms S-1, F-1 and F-10 will increase as a result of the proposals. As a result, the aggregate burden hour and professional cost numbers will increase for those forms due to the additional number of respondents. We also expect that the number of respondents will decrease for Forms S-3 and F-3, which will reduce the aggregate burden hour and professional costs for those forms.⁸⁶ These estimates represent the average burden for all companies, both large and small. For each estimate, we calculate that a portion of the burden will be carried by the company internally, and the other portion will be carried by outside professionals retained by the company. The portion of the burden carried by the company internally is reflected in hours, while the portion of the burden carried by outside professionals retained by the company is

⁸⁵ Based on a review of Commission filings, since January 1, 2007, only 21 issuers have filed on Form F-9. As a result, we estimate that over a 12-month period, approximately five additional Form F-10s will be filed.

⁸⁶ We propose to rescind Form F-9, which will eliminate the PRA burden for that form, but we expect that the number of respondents on Form F-10 will increase as a result.

reflected as a cost. We estimate these costs to be \$400 per hour. A summary of the proposed changes is included in the table below.

Table 1: Calculation of Incremental PRA Burden Estimates

	Current Annual Responses (A)	Proposed Annual Responses (B)	Current Burden Hours (C)	Increase/(Decrease) in Burden Hours (D)	Proposed Burden Hours (E) =C+D	Current Professional Costs (F)	Increase/(Decrease) in Professional Costs (G)	Proposed Professional Costs =F+G
Form S-1	768	782	186,414	3,398	189,812	\$223,697,200	\$4,077,814	\$227,775,014
Form S-3	2,065	2,051	236,959	(1,607)	235,352	\$284,350,500	(\$1,927,800)	\$282,422,700
Form F-1	42	43	18,975	452	19,427	\$22,757,400	\$541,843	\$23,299,243
Form F-3	106	105	4,426	(42)	4,384	\$5,310,600	(\$50,100)	\$5,260,500
Form F-10	75	80	469	31	500	\$562,500	\$37,500	\$600,000
Total				2,232			\$2,679,257	

D. 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 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.⁸⁷

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.

⁸⁷ We request comment pursuant to 44 U.S.C. 3506(c)(2)(B).

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. S7-18-08. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-18-08, 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 of publication.

V. Cost-Benefit Analysis

A. Proposed Amendments

As discussed above, we are proposing rule amendments pursuant to Section 939A of the Dodd-Frank Act to eliminate references to credit ratings in our rules in order to reduce reliance on credit ratings.⁸⁸ Today's proposals seek to replace rule and form requirements of the Securities Act and the Exchange Act that rely on security ratings by NRSROs with alternative requirements that do not rely on ratings.

The Commission is proposing to revise the transaction eligibility requirements of Forms S-3 and F-3 and other rules and forms that refer to these eligibility requirements.

⁸⁸ See note 20 above and related text.

Currently, these forms allow issuers who do not meet the forms' other transaction eligibility requirements to register primary offerings of non-convertible securities for cash if such securities are rated investment grade by an NRSRO. The proposed rules would replace this transaction eligibility requirement with a requirement that, for primary offerings of non-convertible securities for cash, an issuer must have issued in the previous three years (as of a date within 60 days prior to the filing of the registration statement) at least \$1 billion aggregate principal amount of non-convertible securities, other than common equity, in registered primary offerings for cash. We are also proposing to remove Rule 134(a)(17) so that disclosure of credit ratings information is no longer covered by the safe harbor that deems certain communications not to be a prospectus or a free writing prospectus. Finally, we are proposing to rescind Form F-9.

We are sensitive to the costs and benefits imposed by our rules. The discussion below focuses on the costs and benefits of the proposals we are making to implement the Dodd-Frank Act within our discretion under that Act, rather than the costs and benefits of the Dodd-Frank Act itself. The two types of costs and benefits may not be entirely separable to the extent that our discretion is exercised to realize the benefits intended by the Dodd-Frank Act.

B. Benefits

The proposed amendments would prescribe a different standard for determining which issuers are eligible to register offerings on Form S-3 or Form F-3. To the extent that some of these issuers were previously unable to avail themselves of the shelf offering process and forward incorporation by reference, they will now have faster access to

capital markets and incur lower transaction costs.⁸⁹ In addition, the new Form S-3 and Form F-3 eligibility requirement of at least \$1 billion of debt issued in registered offerings over the last three years is easily calculable, which will benefit issuers by facilitating their compliance with the requirement.

We believe the benefits of rescinding Form F-9 would be to reduce redundancy by having multiple forms with the same requirements which would streamline the registration process for Canadian issuers.

C. Costs

To the extent that the \$1 billion eligibility threshold results in issuers who were previously eligible to use Forms S-3 and F-3 to register primary offerings of non-convertible securities to register on Form S-1,⁹⁰ this would result in increased costs of preparing and filing registration statements.⁹¹ This would result in additional time spent in the offering process, and issuers would incur costs associated with preparing and filing post-effective amendments to the registration statement. In addition, the resulting loss of the ability to conduct a delayed offering "off the shelf" pursuant to Rule 415 under the

⁸⁹ We estimate that there are approximately eight issuers who will become eligible to use Form S-3 who were not previously eligible. See note 58 and related text.

⁹⁰ We estimate that approximately 45 issuers who were previously eligible to file on Form S-3 will no longer be eligible if the proposals are adopted. See note 58 and related text.

⁹¹ The ability to conduct primary offerings on short form registration statements confers significant advantages on eligible companies in terms of cost savings and capital formation. The time required to prepare and update Form S-3 or F-3 is significantly lower than that required for Forms S-1 and F-1 primarily because registration statements on Forms S-3 and F-3 can be automatically updated. Forms S-3 and F-3 permit registrants to forward incorporate required information by reference to disclosure in their Exchange Act filings. In addition, companies that are eligible to register primary offerings on Form S-3 and Form F-3 generally are able to conduct offerings on a delayed basis "off the shelf" without further staff review and clearance, which results in significant flexibility and efficiency for companies. See Section IV, above, for a discussion of the estimates of the paperwork costs of preparing and filing on Form S-1 associated with the proposed amendments that we have prepared for purposes of the PRA.

Securities Act would result in costs due to the uncertainty an issuer might face regarding the ability to conduct offerings quickly at advantageous times.

We believe that the proposed amendments could result in some issuers who are currently required to file on Form S-1 or Form F-1 becoming eligible to use Form S-3 or Form F-3. This could result in a cost to investors as there would be less information present in the prospectuses for these companies than there was previously. As a result, investors would have to seek out the Exchange Act reports (for example, by accessing the SEC website) of these issuers for company information which would no longer appear in the prospectus. However, we believe these costs would be mitigated to the extent that the proposed \$1 billion eligibility threshold captures issuers with a wide market following for whom incorporation by reference of Exchange Act reports is more appropriate.

We do not expect the elimination of Form F-9 to result in any costs because issuers that would register debt on Form F-9 will be able to register debt on Form F-10. Form F-10's disclosure requirements will be the same as those under Form F-9 once the CSA IFRS-related amendments become effective in 2011.

If the proposed amendment to remove Rule 134(a)(17) is adopted, there could be a cost to investors if ratings information is less available to them, to the extent such ratings information is useful to investors. In addition, to the extent that issuers decide to continue to include ratings information in communications that previously were made in reliance on the Rule 134 safe harbor, they may incur costs in order to ascertain whether including such information would require compliance with prospectus filing requirements.

D. Request for Comments

We request comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed herein. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in each section of this analysis, and request that commentators provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular covered institutions, including small institutions, as well as any other costs or benefits that may result from the adoption of these proposed amendments.

Specifically, we ask the following:

- Would there be any significant transition costs imposed on issuers as a result of the proposals, if adopted? Please be detailed and provide quantitative data or support, as practicable.

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

Section 23(a) of the Exchange Act⁹² 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 which 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 Act⁹³ and Section 3(f) of the Exchange Act⁹⁴ require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public

⁹² 15 U.S.C. 78w(a).

⁹³ 15 U.S.C. 77b(b).

⁹⁴ 15 U.S.C. 78c(f).

interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation.

Our preliminary analysis indicates that the proposed amendments will have two distinct effects. First, some issuers currently eligible to register primary offerings of non-convertible securities on Forms S-3 and F-3 and to use the shelf offering process would lose their eligibility. Second, some issuers will become newly eligible to use Forms S-3 and F-3 and the shelf offering process. We believe that the proposed rules will likely result in a net decrease in eligible issuers, which is why the proposed rules may reduce efficiency and hamper capital formation. Issuers who are no longer eligible to register offerings on Form S-3 and Form F-3 (e.g., investment grade debt issuers who do not meet the proposed \$1 billion eligibility threshold) and avail themselves of the shelf offering process may now face relatively higher issuance costs, which would negatively affect efficiency and capital formation of those issuers. As noted throughout this release, we anticipate that the number of such issuers would be small, and we have requested comment on whether other provisions should be adopted that would further reduce the number of affected issuers.

The Commission believes that the proposal to rescind Form F-9 could reduce confusion regarding the appropriate form to use for the registration of securities by Canadian issuers, which could result in increased market efficiency.

The Commission solicits comment on whether the proposed amendments changing the Forms S-3 and F-3 eligibility requirements for registering primary offerings of non-convertible securities, and rescinding Form F-9 and Rule 134(a)(17), if adopted, would promote or burden efficiency, competition, and capital formation. The

Commission also requests comment on whether the proposed amendments would have harmful effects on investors or on issuers who could use Form S-3 and Form F-3 for primary offerings of non-convertible securities, or on issuers of investment grade securities that would otherwise use Form F-9 and what options would best minimize those effects. Finally, the Commission requests comment on the anticipated effect of disclosure requirements on competition in the market for credit rating agencies. The Commission requests commentators to provide empirical data and other factual support for their views, if possible.

VII. Regulatory Flexibility Act Certification

The Commission hereby certifies, pursuant to 5 U.S.C. 605(b), that the amendments contained in this release, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed amendments would:

- Amend the Securities Act Form S-3 and Form F-3 eligibility requirements for primary offerings of non-convertible securities if the issuer has issued (as of a date within 60 days prior to the filing of the registration statement) for cash at least \$1 billion in non-convertible securities, other than common stock, through registered primary offerings, within the prior three years;
- Amend Forms S-4 and F-4 and Schedule 14A to conform with the proposed Form S-3/F-3 eligibility requirements;
- Amend Securities Act Rules 138, 139, and Rules 168 to be consistent with the proposed Form S-3/F-3 eligibility requirements;
- Remove Rule 134(a)(17); and
- Remove Form F-9 and all references to that form in our forms and rules.

We are not aware of any issuers that currently rely on the rules that we propose to change or any issuers that would be eligible to register under the affected rules that is a small entity. In this regard, we note that credit rating agencies rarely, if ever, rate the securities of small entities. We further note most security ratings are obtained and used by the issuer. Issuers are generally required to pay for these security ratings and the cost of these ratings relative to the size of a debt or preferred securities offering by a small entity would generally be prohibitive. Finally, based on an analysis of the language and legislative history of the Regulatory Flexibility Act, we note that Congress did not intend that the Regulatory Flexibility Act apply to foreign issuers. Accordingly, some of the entities directly affected by the proposed rule and form amendments will fall outside the scope of the Regulatory Flexibility Act.

For these reasons, the proposed amendments would not have a significant economic impact on a substantial number of small entities.

VIII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,⁹⁵ 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 proposal would be a “major rule” for purposes of the Small Business Regulatory Enforcement Fairness Act. We solicit comment and empirical data on:

⁹⁵ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

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

We are proposing the amendments contained in this document under the authority set forth in Sections 6, 7, 10, 19(a) of the Securities Act and Sections 14 and 23(a) of the Exchange Act.

List of Subjects

17 CFR Parts 200, 229, 230, 232, 239, 240, and 249.

Reporting and recordkeeping requirements, Securities.

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 200 -- ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

* * * * *

SubPart N -- Commission Information Collection Requirements Under the Paperwork Reduction Act: OMB Control Numbers

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

Authority: 44 U.S.C. 3506; 44 U.S.C. 3507.

* * * * *

2. Amend §200.800 by removing from paragraph (b):

a. "Form F-9" under the column entitled "Information collection requirement";

b. "239.39" under the column entitled "17 CFR part or section where identified and described"; and

c. "3235-0377" under the column entitled "Current OMB control No."

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

3. The general authority citation for Part 229 continues to read 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, 77iii, 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.

* * * * *

4. Amend §229.10 by removing the penultimate sentence from paragraph (c) and the last sentence from paragraph (c)(1)(i).

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

5. 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, 80a-37, and Pub. L. No. 111-203, §939A, 124 Stat. 1376, (2010) unless otherwise noted.

* * * * *

6. Amend §230.134 by revising paragraph (a) introductory text, revising paragraph (a)(6), and removing and reserving paragraph (a)(17). The revisions read as follows:

§ 230.134 Communications not deemed a prospectus.

* * * * *

(a) Such communication may include any one or more of the following items of information, which need not follow the numerical sequence of this paragraph, provided that, except as to paragraphs (a)(4), (a)(5), and (a)(6) of this section, the prospectus included in the filed registration statement does not have to include a price range otherwise required by rule:

* * * * *

(6) In the case of a fixed income security with a fixed (non-contingent) interest rate provision, the yield or, if the yield is not known, the probable yield range, as specified by the issuer or the managing underwriter or underwriters and the yield of fixed income securities with comparable maturity and security rating;

* * * * *

(17) Removed and reserved.

* * * * *

7. Amend §230.138 by revising paragraph (a)(2)(ii)(B)(2) to read as follows:

§ 230.138 Publications or distributions of research reports by brokers or dealers about securities other than those they are distributing.

(a) * * *

(2) * * *

(ii) * * *

(B) * * *

(2) Is issuing non-convertible securities and the registrant meets the provisions of General Instruction I.B.2. of Form F-3 (referenced in § 239.33 of this chapter); and

* * * * *

8. Amend §230.139 by revising paragraphs (a)(1)(i)(A)(1)(ii) and (a)(1)(i)(B)(2)(ii) to read as follows:

§ 230.139 Publications or distributions of research reports by brokers or dealers distributing securities.

(a) * * *

(1) * * *

(i) * * *

(A)(1) * * *

(ii) At the date of reliance on this section, is, or if a registration statement has not been filed, will be, offering non-convertible securities and meets the requirements for the General Instruction I.B.2. of Form S-3 or Form F-3 (referenced in §239.13 and 239.33 of this chapter); or

* * * * *

(B) * * *

(2) * * *

(ii) Is issuing non-convertible securities and meets the provisions of General Instruction I.B.2. of Form F-3 (referenced in §239.33 of this chapter); and

* * * * *

9. Amend §230.168 by revising paragraph (a)(2)(ii)(B) to read as follows:

§ 230.168 Exemption from sections 2(a)(10) and 5(c) of the Act for certain communications of regularly released factual business information and forward-looking information.

* * * * *

(a) * * *

(2) * * *

(ii) * * *

(B) Is issuing non-convertible securities and meets the provisions of General Instruction I.B.2. of Form F-3 (referenced in §239.33 of this chapter); and

* * * * *

10. Amend §230.467 by removing:

a. "F-9," from the heading;

b. "Form F-9 or" and "239.39 or" from the second sentence of paragraph (a);

and

c. "Form F-9 or" from the first sentence of paragraph (b).

11. Amend §230.473 by removing "F-9 or" and "239.39 or" from paragraph (d).

PART 232 -- REGULATION S-T -- GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

12. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

13. Amend §232.405 by removing:
- a. “both Form F-9 (referenced in §239.39 of this chapter) and” from the second sentence of Preliminary Note 1;
 - b. “either Form F-9 or” from paragraphs (a)(2), (a)(3) and (a)(4); and
 - c. “both Form F-9 and” and “Form F-9 and” in the second sentence of Note to §232.405, and “both Form F-9 and” in the penultimate sentence of Note to §232.405.

PART 239 --FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

14. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, 80a-37, and Pub. L. No. 111-203, §939A, 124 Stat. 1376, (2010) unless otherwise noted.

* * * * *

15. Amend Form S-3 (referenced in §239.13) by:
- a. Revising General Instruction I.B.2.; and
 - b. Removing Instruction 3 to the signature block.

The revision reads as follows:

Note -The text of Form S-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form S-3

* * * * *

B. Transaction Requirements. * * *

2. Primary Offerings of Non-convertible Securities. Non-convertible securities to be offered for cash by or on behalf of a registrant, provided the registrant, as of a date within 60 days prior to the filing of the registration statement on this Form, has issued in the last three years at least \$1 billion aggregate principal amount of non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Act.

* * * * *

16. Amend Form S-4 (referenced in §239.25) by revising General Instruction B.1.a.(ii)(B) to read as follows:

Note – The text of Form S-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM S-4

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

* * * * *

B. Information with Respect to the Registrant.

1. * * *

a. * * *

(ii) * * *

(B) Non-convertible debt or preferred securities are to be offered pursuant to this registration statement and the requirements of General Instruction I.B.2. of Form S-3 have been met; or

* * * * *

17. Amend Form F-3 (referenced in §239.33) by:
 - a. Revising General Instruction I.B.2.; and
 - b. Deleting Instruction 3 to the signature block.

The revision reads as follows:

Note – The text of Form F-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM F-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form F-3

* * * * *

B. Transaction Requirements * * *

2. Primary Offerings of Non-convertible Securities. Non-convertible securities to be offered for cash provided the issuer, as of a date within 60 days prior to the filing of the registration statement on this Form, has issued in the last three years at least \$1 billion aggregate principal amount of non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Act.

* * * * *

18. Amend Form F-4 (referenced in §239.34) by revising General Instruction B.1(a)(ii)(B).

The revision reads as follows:

Note – The text of Form F-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM F-4

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

* * * * *

B. Information with Respect to the Registrant

1. * * *

a. * * *

(ii) * * *

(B) Non-convertible debt or preferred securities are to be offered pursuant to this registration statement and the requirements of General Instruction I.B.2. of Form F-3 have been met; or

* * * * *

19. Amend Form F-8 (referenced in §239.38) by removing “Form F-9,” from each of paragraph A.(3) of General Instruction III and paragraph B. of General Instruction V.

Note – The text of Form F-8 does not, and this amendment will not, appear in the Code of Federal Regulations.

20. Remove and reserve §239.39 (referencing Form F-9).

21. Amend Form F-10 (referenced in §239.40) by removing “Form F-9,” from each of paragraph C.(4) of General Instruction I and paragraph B. of General Instruction III.

Note – The text of Form F-10 does not, and this amendment will not, appear in the Code of Federal Regulations.

22. Amend Form F-80 (referenced in §239.41) by removing “Form F-9,” from each of paragraph A.(3) of General Instruction III and paragraph B. of General Instruction V.

Note – The text of Form F-80 does not, and this amendment will not, appear in the Code of Federal Regulations.

23. Amend §239.42 by removing “F-9,” from the heading and from each of paragraphs (a) and (e).

24. Amend Form F-X (referenced in §239.42) by removing “F-9,” from each of paragraphs (a) and (e) of General Instruction I, and each of paragraphs (a) and (c) of General Instruction II.F.

Note – The text of Form F-X does not, and this amendment will not, appear in the Code of Federal Regulations.

* * * * *

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

25. The general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78o-4, 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.; 18 U.S.C. 1350, 12 U.S.C. 5221(e)(3), and Pub. L. No. 111-203, §939A, 124 Stat. 1376, (2010) unless otherwise noted.

* * * * *

26. Amend § 240.14a-101 by revising Note E(2)(ii) to read as follows:

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

* * * * *

Notes

* * * * *

E. * * *

(2) * * *

(ii) Action is to be taken as described in Items 11, 12, and 14 of this schedule

which concerns non-convertible debt or preferred securities issued by a registrant meeting the requirements of General Instruction I.B.2. of Form S-3 (referenced in §239.13 of this chapter); or

* * * * *

PART 249 -- FORMS, SECURITIES EXCHANGE ACT OF 1934

27. 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.

* * * * *

28. Amend §249.240f by:

a. Removing "F-9," in paragraph (a); and

b. Removing in paragraph (b)(4) the phrase “; provided, however, no market value threshold need be satisfied in connection with non-convertible securities eligible for registration on Form F-9 (§239.39 of this chapter)”.

29. Amend Form 40-F (referenced in §249.240f) by:

a. Removing “F-9,” from paragraph (1) of General Instruction A;

b. Removing from paragraph (2)(iv) of General Instruction A the phrase “; provided, however, that no market value threshold need be satisfied in connection with non-convertible securities eligible for registration on Form F-9”; and

c. Revising paragraph (2) of General Instruction C to read as follows:

(2) Any financial statements, other than interim financial statements, included in this Form by registrants registering securities pursuant to Section 12 of the Exchange Act or reporting pursuant to the provisions of Section 13(a) or 15(d) of the Exchange Act must be reconciled to U.S. GAAP as required by Item 17 of Form 20-F under the Exchange Act, unless this Form is filed with respect to a reporting obligation under Section 15(d) that arose solely as a result of a filing made on Form F-7, F-8, or F-80, in which case no such reconciliation is required.

Note – The text of Form 40-F does not, and this amendment will not, appear in the Code of Federal Regulations.

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: February 9, 2011

Commissioner Watter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE ACT OF 1934
Release No. 63896 / February 11, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3243 / February 11, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-12264

In the Matter of

Dale G. Rasmussen, Esq.

ORDER PERMITTING ATTORNEY TO
RESUME APPEARING AND PRACTICING
UNDER RULE 102(e)(5) OF THE
COMMISSION'S RULES OF PRACTICE

I.

On April 17, 2006, the Commission, pursuant to Rule 102(e)(3)(i) of its Rules of Practice, suspended attorney Dale G. Rasmussen ("Rasmussen") from appearing or practicing as an attorney before the Commission, with the right to apply to resume appearing and practicing after three years. See Opinion and Order, Securities Exchange Act of 1934 Release No. 53662 (April 17, 2006).

In anticipation of the institution of administrative proceedings pursuant to Rule 102(e)(3)(i), Rasmussen consented to the entry of a Commission order dated April 17, 2006. In doing so, Rasmussen did not admit or deny the findings set forth in the Order except as to the Commission's jurisdiction over him and the subject matter of the proceedings, and the findings contained in Section III of the Order, which he admitted. The Order provided that Rasmussen could apply to resume appearing and practicing before the Commission after a period of three years.

II.

On or about July 26, 2010, more than three years after he was suspended, Rasmussen filed an application for reinstatement of the privilege to appear and practice before the Commission. His application includes a personal affidavit in which he swore under penalty of perjury that he has complied with the Commission's April 17, 2006 Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and that he has not been convicted of a felony or misdemeanor involving moral turpitude. Since the entry of the April 17, 2006 Order, no information has come to the attention of the Commission relating to Rasmussen's 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. In addition, Rasmussen has paid the \$1 in disgorgement and the \$30,000 civil penalty ordered by United States District Court for the Southern District of Texas in the related enforcement action.

III.

Based on the foregoing, the Commission has determined that it is appropriate to reinstate Rasmussen, pursuant to Rule 102(e)(5), to appear or practice before the Commission.

Accordingly, it is **HEREBY ORDERED** that Rasmussen may resume practicing as an attorney before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE ACT OF 1934
Release No. 63897 / February 11, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13130

In the Matter of

CHRISTOPHER L. MARTIN

**ORDER PERMITTING ATTORNEY TO
RESUME APPEARING AND PRACTICING
UNDER RULE 102(e)(5) OF THE
COMMISSION'S RULES OF PRACTICE**

I.

On August 13, 2008, the Commission instituted proceedings against attorney Christopher L. Martin ("Martin") pursuant to Rule 102(e)(1)(i) of its Rules of Practice. See Order, Securities Exchange Act of 1934 Release No. 58356 (August 13, 2008). The basis for these proceedings was the permanent injunction against him entered in an action brought by the Commission in the United States District Court for the Southern District of Texas (*SEC v. Christopher L. Martin*, Civil Action No. 4:08-cv-02270). In that action, the Commission alleged that Martin, while General Counsel of HCC Insurance Holdings, Inc. ("HCC"), helped facilitate a scheme to illegally backdate stock-option grants at HCC. On July 22, 2008, Martin consented to the entry of a Final Judgment by the district court permanently enjoining him from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Sections 13(b)(5) and 16(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 13b2-1, 13b2-2, and 16a3, and aiding and abetting future violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act, and Exchange Act Rules 12b-20, 13a-1, 13a-11, 13a-13, 14a-3, and 14a-9.

In anticipation of the institution of that administrative proceeding, Martin consented to entry of the Order without admitting or denying the findings except as to the Commission's jurisdiction over him and the subject matter of the proceedings, and the findings contained in Section III.3 of the Order, which he admitted. The Order provided that Martin could apply to resume appearing and practicing before the Commission after a period of two years upon the submission of an affidavit stating, under penalty of perjury, that he has complied with the Commission's Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and

that he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

II.

On or about August 16, 2010, more than two years after he had been suspended by the Commission, Martin filed an application for reinstatement. His application includes a personal affidavit in which he swore under penalty of perjury that he has complied with the Commission's Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, that he is a member in good standing of the bar of Texas, and that he has not been convicted of a felony or misdemeanor involving moral turpitude. Since the entry of the Order, no information has come to the attention of the Commission relating to Martin's 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. In addition, he has paid the \$50,000 civil penalty required by the Judgment in SEC v. Christopher L. Martin, Civil Action No. 4:08-cv-02270 (S.D. of Texas).

III.

Based on the foregoing, the Commission has determined that it is appropriate to reinstate Martin, pursuant to Rule 102(e)(5), to appear or practice before the Commission.

Accordingly, it is HEREBY ORDERED that Martin may resume practicing as an attorney before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Paredes
not participating*

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934
Release No. 63901 / February 14, 2011**

**INVESTMENT ADVISERS ACT OF 1940
Release No. 3157 / February 14, 2011**

**ADMINISTRATIVE PROCEEDING
File No. 3-14253**

**In the Matter of

Frederick E. Bowers,

Respondent.**

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Frederick E. Bowers ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 and III.4 below, which are admitted,

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Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Frederick E. Bowers, age 42, is a resident of New York, New York. From 1999 through the relevant time period, Bowers was a registered representative associated with Lehman Brothers, Inc. ("Lehman"), a registered broker-dealer and investment adviser.

2. On February 9, 2011, a final judgment was entered by consent against Bowers, permanently enjoining him from future violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5] and Section 14(e) of the Exchange Act [15 U.S.C. § 78n(e)] and Exchange Act Rule 14e-3 [17 C.F.R. § 240.14e-3] in the civil action entitled Securities and Exchange Commission v. Devlin, et al., Civil Action Number 08-CV-11001, in the United States District Court for the Southern District of New York.

3. The Commission's Complaint alleged that Bowers engaged in an illegal insider trading scheme in which he possessed and used material, nonpublic information which he knew, should have known or was reckless in not knowing was obtained in breach of a duty of trust or confidence, and tipped his client who used that material nonpublic information to purchase or sell securities. Specifically, Bowers' business partner at Lehman tipped Bowers with inside information about acquisitions or tender offers involving Abgenix Inc. ("Abgneix"), Aztar Corporation ("Aztar") and Mercantile Bankshares Corporation ("Mercantile"). Bowers' business partner, then also a registered representative at Lehman, misappropriated the confidential nonpublic information about the corporate transactions from his wife, a partner in the New York City office of an international public relations firm involved in the deals. Bowers, in turn, used the material inside information to tip a client with material nonpublic information regarding three prospective deals involving Abgenix, Aztar and Mercantile. Bowers' client traded on this inside information and kicked back cash to Bowers who shared some of it with his business partner at Lehman.

4. On August 5, 2009, Bowers pled guilty to one count of conspiracy to commit securities fraud in violation of Title 18 United States Code, Section 371 and one count of securities fraud in violation of Title 15, United States Code, Sections 78ff and 78j(b) before the United States District Court for the Southern District of New York, in United States v. Bowers, 09 CR 00496 (GBD). On September 17, 2009, a judgment in the criminal case was entered against Bowers. He was sentenced to three years of probation and ordered to pay a fine of \$15,000 and a special assessment of \$200 and to forfeit proceeds traceable to the commission of the offenses up to \$12,000.

5. The two-count criminal information to which Bowers pled guilty alleged, *inter alia*, that Bowers and his business partner agreed to tip one of Bowers' clients with material nonpublic information about the upcoming Aztar tender offer and Mercantile acquisition. The business partner had misappropriated this inside information from his wife. The client illegally traded using this information and then shared a portion of the illegal profits with Bowers and Bowers' business partner.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Frederick E. Bowers be, and hereby is barred from association with any broker, dealer, or investment adviser.

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

By the Commission.

Elizabeth M. Murphy
Secretary


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

*Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63902 / February 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14254

In the Matter of

Thomas Faulhaber,

Respondent.

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

I.

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

II.

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

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III.

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

1. Faulhaber, age 46, is a resident of Saint James, New York. From October 28, 2005 through December 1, 2007, he was affiliated with Opus Trading Fund LLC, a registered broker-dealer. Faulhaber subsequently had been affiliated with Ferris Trading Fund LLC.

2. On February 9, 2011, a final judgment was entered by consent against Faulhaber, permanently enjoining him from future violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5] and Section 14(e) of the Exchange Act [15 U.S.C. § 78n(e)] and Exchange Act Rule 14e-3 [17 C.F.R. § 240.14e-3] in the civil action entitled Securities and Exchange Commission v. Devlin, et al., Civil Action Number 08-CV-11001, in the United States District Court for the Southern District of New York.

3. The Commission's Complaint alleged that Faulhaber engaged in an illegal insider trading scheme in which he possessed and used material, nonpublic information which he knew, should have known or was reckless in not knowing was obtained in breach of a duty of trust or confidence. Specifically, Matthew C. Devlin, a registered representative at Lehman Brothers, Inc. ("Lehman") tipped Frederick E. Bowers, also a registered representative at Lehman, with material nonpublic information about several acquisitions including a tender offer involving the Aztar Corporation and an acquisition involving Mercantile Bankshares Corporation as alleged at paragraphs 121 and 122 of the Complaint. Devlin tipped Bowers in each of the transactions with information Devlin had misappropriated from his wife, a partner in the New York City office of an international public relations firm involved in the deals. Bowers, in turn, used Devlin's material inside information to tip Faulhaber, Bowers' client, with material nonpublic information regarding the deals. The Complaint alleged at paragraphs 121 and 122 that Faulhaber traded in advance of the public announcements and based on the material nonpublic information he received from Bowers.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary


By: Jill M. Peterson
Assistant Secretary

*Commissioner Paredes
not participating*

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934
Release No. 63903 / February 14, 2011**

**INVESTMENT ADVISERS ACT OF 1940
Release No. 3158 / February 14, 2011**

**ADMINISTRATIVE PROCEEDING
File No. 3-14255**

In the Matter of

Jeffrey R. Glover,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jeffrey R. Glover ("Glover" or "Respondent").

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Glover, age 48, is a resident of Bellaire, Texas. Glover's firm, Glover Advisors, LP, a Texas limited partnership, was registered with the State of Texas as an investment adviser from October 26, 2005 through January 26, 2009. Glover also was affiliated with RBC Professional Trader Group, LLC, a registered broker-dealer with offices in New York, New York from October 16, 1998 through December 19, 2008.

2. On February 9, 2011, a final judgment was entered by consent against Glover, permanently enjoining him from future violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5] and Section 14(e) of the Exchange Act [15 U.S.C. § 78n(e)] and Exchange Act Rule 14e-3 [17 C.F.R. § 240.14e-3] in the civil action entitled Securities and Exchange Commission v. Devlin, et al., Civil Action Number 08-CV-11001, in the United States District Court for the Southern District of New York.

3. The Commission's Complaint alleged that Glover engaged in an illegal insider trading scheme in which he possessed and used material, nonpublic information which he knew, should have known or was reckless in not knowing was obtained in breach of a duty of trust or confidence. Specifically, Matthew Devlin tipped Glover with material nonpublic information about acquisitions involving InVision Technologies Inc., Eon Labs, Inc. and Abgenix, Inc., a tender offer involving the Aztar Corporation and a stock repurchase transaction involving Mylan, Inc. Devlin tipped Glover in each of the transactions with information Devlin had misappropriated from his wife, a partner in the New York City office of an international public relations firm involved in the deals. Glover traded based on the material nonpublic information he received from Devlin prior to public announcements in each of the five transactions.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 63904 / February 14, 2011

Administrative Proceedings
File No. 3-11696

In the Matter of

**RS Investment Management, Inc., RS
Investment Management, L.P.,
G. Randall Hecht and Steven M. Cohen,**

Respondents.

**ORDER DISCHARGING FUND
ADMINISTRATOR AND TERMINATING
FAIR FUND**

On October 6, 2004, RS Investment Management, Inc., and RS Investment Management, L.P. (collectively "RS") consented to the entry of an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), which directed, among other things, that RS pay disgorgement of \$11.5 million and a civil money penalty of \$13.5 million. The Order further established a Fair Fund to provide for the distribution of these payments and required that RS retain an independent distribution consultant ("IDC") to develop a plan for distributing the \$25 million to shareholders in the mutual funds affected by the market timing (the "RS Funds").

On May 14, 2007, the Securities and Exchange Commission (the "Commission") issued a Notice of Proposed Distribution Plan and Opportunity for Comment (Exchange Act Release No. 55753) pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. 201.1103. The Commission received comments and, on August 8, 2007, the Commission approved the proposed Plan as modified (Exchange Act Release No. 56222). The Plan provided for the distribution of the Fair Fund to injured investors according to the methodology set forth in the Plan.

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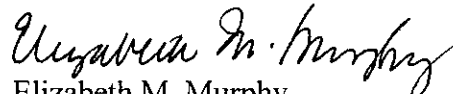
On April 14, 2008, the Commission issued an order directing disbursement of the Fair Fund consisting of a total of \$30,622,346.47. Beginning in April 2008, a total of \$26,970,432.59 was disbursed through wires or checks to injured investors, and on November 19, 2009, the Commission issued an order directing disbursement in the amount of \$3,611,743 to the RS mutual funds harmed by market timing trading activity in proportion to the portion of overall harm each fund suffered. An amount of \$142,673.08 in residual funds remains.

A Final Accounting of the Fair Fund was submitted 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, \$142,673.08 in residual funds is authorized to be transferred to the U.S. Treasury.

Accordingly, IT IS ORDERED that the Fair Fund is terminated.

IT IS FURTHER ORDERED the Fund Administrator, Boston Financial Data Services, Inc., is discharged.

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63908 / February 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14256

In the Matter of

**GLOBAL SENTRY EQUITY
TRANSFER, INC.**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND
CEASE-AND-DESIST
PROCEEDINGS PURSUANT
TO SECTIONS 17A(c)(3)
AND 21C OF THE
SECURITIES EXCHANGE
ACT OF 1934.**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 17A(c)(3) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Global Sentry Equity Transfer, Inc. ("Respondent" or "Global Sentry").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. **Global Sentry Equity Transfer, Inc. ("Global Sentry")** is a Nevada corporation with its principal place of business in Ontario, Canada. Global Sentry has been registered with the Commission as a transfer agent since July 30, 2007, pursuant to Section 17A of the Exchange Act. During 2008, Global Sentry was the transfer agent of record for, among other entities, Infinity Medical Group, Inc. ("Infinity"), Cannon Exploration Inc. ("Cannon"), and China Jiangsu Golden Horse Steel Ball Inc. ("China Jiangsu").

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B. OTHER RELEVANT PERSON AND ENTITIES

1. Christopher Wheeler, age 43, is a resident of Victor, New York. He is the owner of OTCStockExchange.com, a stock promotion website. Wheeler does not hold any securities licenses, and is not associated with any entity that is registered with the Commission.

2. Infinity was incorporated in Nevada in 1989 as D.V. Holdings, Inc. Between June 1999 and August 2007, the company operated at various times under the names Iceberg Corporation of America, Royal Alliance Entertainment, Inc., and Infinity. Infinity purports to be a specialty healthcare company and initially listed its principal place of business as Ontario, Canada. During the relevant period, Infinity did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act of 1933 ("Securities Act"). During the relevant period, Infinity's shares were quoted on the Pink Sheets operated by Pink OTC Markets Inc. ("Pink Sheets").

3. Cannon was incorporated in Delaware in 1983 as Citisource, Inc. ("Citisource"). In June 2006, the company changed its name from Citisource to China Shuangji Cement Corporation, but changed it back to Citisource in October 2007. In April 2008, the company changed its name to Cannon. Cannon purports to be a mining and exploration company and listed its principal place of business as Ontario, Canada. During the relevant period, Cannon did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, Cannon's shares were quoted on the Pink Sheets.

4. China Jiangsu was incorporated in Nevada in 1999 as Puppettown.com, Inc. The company changed its name to Business Translation Services, Inc. in December 2001, to Muller Media, Inc. in February 2002, and to China Jiangsu in October 2007. Since late 2008, the company has operated as Santana Mining, Inc. During the relevant period, the company's principal place of business was China, and it purported to be a manufacturer and supplier of ball bearings. During the relevant period, China Jiangsu did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, China Jiangsu's shares were quoted on the Pink Sheets.

C. GLOBAL SENTRY'S FAILURE TO COMPLY WITH EXCHANGE ACT PROVISIONS CONCERNING TRANSFER AGENTS

1. In at least 2008, Infinity, Cannon, and China Jiangsu issued a total of approximately 3.5 million purportedly unrestricted shares to Wheeler. Global Sentry, acting in its capacity as transfer agent, issued stock certificates in Wheeler's name, which Wheeler's brokerage firm credited to Wheeler's account and from which Wheeler subsequently sold the shares. Specifically, Global Sentry failed to comply with the Exchange Act and related rule provisions as follows:

a. Section 17(a)(1) of the Exchange Act requires, in relevant part, that “[e]very . . . registered transfer agent . . . shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this [Act].” Section 17A(d)(1) of the Exchange Act provides, in relevant part, that “[n]o . . . registered transfer agent shall, directly or indirectly, engage in any activity as . . . [a] transfer agent in contravention of such rules and regulations [] as the Commission may prescribe as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Act]. . . .” Pursuant to this authority, the Commission adopted Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19 and 17Ac2-2.

b. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-6(c) thereunder require that, “every registered transfer agent which, under the terms of its agency, maintains securityholder records for an issue shall, with respect to such issue, retain each cancelled registered bond, debenture, share, warrant or right, other registered evidence of indebtedness, or other certificate of ownership and all accompanying documentation, except legal papers returned to the presenter.” Under these provisions, Global Sentry was required to maintain cancelled stock certificates. Global Sentry admitted that it is “not in possession of any documentation concerning Wheeler” Global Sentry failed to maintain cancelled stock certificates relating to the sale of Infinity, Cannon, and China Jiangsu shares issued to Wheeler as required under Rule 17Ad-6.

c. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-7(d) thereunder require “the records required under Rule 17Ad-6(c) shall be maintained for a period of not less than six years” Under this Rule, to the extent that Global Sentry failed to maintain documents as required under 17Ad-6(c) identified in paragraph b. above, Global Sentry was required to maintain cancelled Infinity, Cannon, and China Jiangsu stock certificates that it issued to Wheeler for not less than six years. Global Sentry admitted that it is “not in possession of any documentation concerning Wheeler” Global Sentry failed to maintain cancelled stock certificates relating to the sale of Infinity, Cannon, and China Jiangsu shares issued to Wheeler as required under Rule 17Ad-7.

d. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-10(a)(1) thereunder require that “[e]very recordkeeping transfer agent shall promptly and accurately post to the master securityholder file debits and credits containing minimum and appropriate certificate detail representing every security transferred, purchased, redeemed or issued; *Provided, however,* That if a security transferred or redeemed contains certificate detail different from that currently posted to the master securityholder file, the credit shall be posted to the master securityholder file and the debit and related certificate detail shall be maintained in a subsidiary file until resolved.” Rule 17Ad-10(b) requires that “every recordkeeping transfer agent shall maintain and keep current an accurate master securityholder file. . . .” Global Sentry admitted that it is “not in possession of any documentation concerning Wheeler” Global Sentry failed to maintain accurate “master securityholder files” as required under Rule 17Ad-10.

e. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-19(b) thereunder require registered transfer agents "involved in the handling, processing, or storage of securities certificates [to] establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates." Rule 17Ad-19(d) provides that a transfer agent "shall maintain records that demonstrate compliance with the requirements set forth" under Rule 17Ad-19. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler" Global Sentry failed to maintain records as required under Rule 17Ad-19, in particular the stock certificates relating to the transfer of Infinity, Cannon, and China Jiangsu shares issued to Wheeler.

f. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Exchange Act Rule 17Ac2-2(a) require every transfer agent registered on December 31 to file a report covering the reporting period on Form TA-2 by March 31 following the end of the reporting period. Global Sentry has failed to make timely filings for the years ended December 31, 2008, and December 31, 2009, as required.

D. VIOLATIONS

1. As a result of the conduct described above, Global Sentry willfully violated Sections 17(a)(1) and 17A(d)(1) of the Exchange Act and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Global Sentry pursuant to Section 17A(c)(3) of the Exchange Act including, but not limited to, disgorgement, if any, and civil penalties pursuant to Section 21B of the Exchange Act;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of, and any future violations of, Sections 17(a)(1) and 17A(d)(1) of the Exchange Act and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an

Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

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

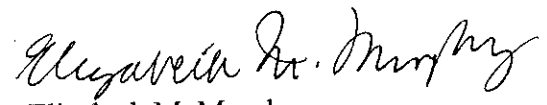
If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules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

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

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

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

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63911 / February 15, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14257

In the Matter of

**Carrier1 International S.A., and
China Expert Technology, 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 Carrier1 International S.A. and China Expert Technology, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Carrier1 International S.A. (CIK No. 1081824) is a Luxembourg corporation located in Strassen, Luxembourg with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Carrier1 is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2001, which reported a net loss of \$495 million for the prior three months. As of February 2, 2011, the company's common stock (symbol "CONEQ") was traded on the over-the-counter markets.

2. China Expert Technology, Inc. (CIK No. 1039726) is a revoked Nevada corporation located in Shenzhen, Peoples Republic of China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Expert is delinquent in its periodic filings with the Commission, having not filed any periodic

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reports since it filed a Form 10-Q for the period ended March 31, 2007. As of February 2, 2011, the company's common stock (symbol "CXTI") was traded on the over-the-counter markets, but had no market makers, and was not eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

3. 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.

4. 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.

5. 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 the 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 Answer, 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 the Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

ETATS UNIS D'AMERIQUE
Devant la
COMMISSION DES OPERATIONS DE BOURSE

LOI SUR LES TRANSACTIONS BOURSIERES DE 1934
Sortie No. 63911 / February 15, 2011

PROCEDURE ADMINISTRATIVE
Dossier No. 3-14257

Dans l'Affaire

**Carrier1 International S.A. et
China Expert Technology, Inc.,**

Défendeurs.

**ORDONNANCE INSTITUANT
LES PROCEDURES
ADMINISTRATIVES ET D'AUDITION
CONFORMEMENT AUX
DISPOSITIONS DE LA SECTION 12(j)
DE LA LOI SUR LES TRANSACTIONS
BOURSIERES DE 1934**

I.

La Commission des Opérations de Bourse (« Commission ») considère nécessaire et approprié en vue de la protection des investisseurs qu'une procédure administrative publique soit conduite, conformément aux dispositions de la Section 12(j) de la Loi sur les Transactions Boursières de 1934 (« Loi Boursière ») à l'encontre des Défendeurs Carrier1 International S.A. et China Expert Technology, Inc.

II.

Après examen, le Département du Contentieux allègue que :

A. DEFENDEURS

1. Carrier1 International S.A. (CIK No. 1081824) est une société luxembourgeoise située à Strassen, au Luxembourg, avec une classe de titres enregistrée par la Commission conformément aux dispositions de la Section 12(g) de la Loi Boursière. Carrier1 est défaillante dans la transmission à la Commission de ses rapports périodiques et ce depuis la production du Formulaire 10-Q couvrant la période finissant le 30 septembre 2001, qui indiquait une perte nette de 495 millions de dollars pour la période de trois mois précédant cette date. A la date du 2 février 2011, l'action de la société (symbole "CONEQ") était négociée sur les marchés libres (over-the-counter markets).

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2. China Expert Technology, Inc. (CIK No. 1039726) est une société radiée de l'état du Nevada, située à Shenzhen, en République Populaire de Chine, avec une classe de titres enregistrée par la Commission conformément aux dispositions de la Section 12(g) de la Loi Boursière. China Expert est défaillante dans la transmission à la Commission de ses rapports périodiques et ce depuis la production du Formulaire 10-Q couvrant la période finissant le 31 mars 2007. A la date du 2 février 2011, l'action de la société (symbole "CXTP") était négociée sur les marchés libres, mais n'avait pas d'animateur de marché (market makers) et ne bénéficiait pas de l'exception de feroutage ("piggyback") prévue à l'article 15c2-11(f)(3) de la Loi Boursière.

B. RAPPORTS PERIODIQUES DEFAILLANTS

3. Ainsi que décrit plus en détail ci-dessus, les Défendeurs sont défaillants dans la transmission à la Commission de leurs rapports périodiques, ont manqué à maintes reprises de faire face à leurs obligations de transmission des rapports périodiques en temps et heure et ont négligé de prendre en compte les lettres de relance adressées à eux par la Division des Finances des Entreprises, leur réclamant de remplir leurs obligations de transmission des rapports périodiques ou, du fait de leur défaillance à garder une adresse à jour dans les dossiers ouverts à leur nom à la Commission, ainsi qu'il est réclamé par la Commission, n'ont pas reçu lesdites lettres.

4. La Section 13(a) de la Loi Boursière, ainsi que les règlements promulgués en application, font obligation aux émetteurs de titres inscrits, en application de la Section 12 de la Loi Boursière, de transmettre à la Commission des informations courantes et à jour au sein de rapports périodiques, même en cas d'inscription volontaire aux termes de la Section 12(g). En particulier, l'article 13a-1 fait obligation aux émetteurs de transmettre des rapports annuels et l'article 13a-13 fait obligation aux émetteurs de transmettre des rapports trimestriels.

5. En conséquence, les Défendeurs ont manqué à leur obligation de se conformer aux dispositions de la Section 13(a) de la Loi Boursière et des articles 13a-1 et 13a-13 subséquents.

III.

Dans le cadre des allégations faites par le Département du Contentieux, la Commission estime nécessaire et approprié, en vue de la protection des investisseurs, qu'une procédure administrative soit ouverte afin de déterminer :

A. Si les allégations contenues dans la Section II ci-dessus sont exactes et, en conséquence, de permettre au Défendeur d'établir toute défense en réponse auxdites allégations ; et,

B. S'il est nécessaire et approprié, en vue de la protection des investisseurs, de suspendre pour une période maximum de douze mois, ou de radier l'inscription de chaque classe de titres, inscrite conformément aux dispositions de la Section 12 de la Loi Boursière,

au nom du Défendeur identifié à la Section 12 ci-dessus, de tout successeur aux termes des articles 12b-2 ou 12g-3 de la Loi Boursière et de toute nouvelle dénomination sociale du Défendeur.

IV.

IL EST EN CONSEQUENCE ORDONNE qu'une audience publique en vue de rassembler les preuves relatives aux points soulevés à la Section III ci-dessus devra être tenue à une date et en un lieu à déterminer et devant un Juge Administratif à désigner par ordonnance à venir, conformément aux dispositions de l'article 110 du Règlement Intérieur de la Commission [17 C.F.R. § 201.110].

IL EST EN OUTRE ORDONNE que le Défendeur devra déposer une Réponse aux allégations contenues dans la présente Ordonnance dans un délai de dix (10) jours à compter de la signification de la présente Ordonnance, conformément aux dispositions de l'article 220(b) du Règlement Intérieur de la Commission [17 C.F.R. § 201.220(b)].

Pour le cas où le Défendeur manquerait à l'obligation de déposer sa Réponse, ou de se présenter à l'audience après avoir été dûment notifié, le Défendeur, tout successeur aux termes des articles 12b-2 ou 12g-3 de la Loi Boursière et toute nouvelle dénomination sociale du Défendeur seront considérés défaillants et une décision sera prononcée contre eux sur la base de l'Ordonnance, dont les allégations seront considérées exactes, conformément aux dispositions des articles 155(a), 220(f), 221(f) et 310 du Règlement Intérieur de la Commission [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) et 201.310].

Cette Ordonnance sera signifiée sur-le-champ personnellement par remise en main propre au Défendeur ou par courrier express, recommandé simple ou avec avis de réception, ou par tout autre moyen permis par le Règlement Intérieur de la Commission.

IL EST EN OUTRE ORDONNE que le Juge Administratif devra rendre une décision préliminaire dans un délai maximum de 120 jours à compter de la date de signification de la présente Ordonnance, conformément aux dispositions de l'article 360(a)(2) du Règlement Intérieur de la Commission [17 C.F.R. § 201.360(a)(2)].

En l'absence d'autorisation adéquate, aucun responsable ou employé de la Commission, ayant des fonctions d'investigation ou de poursuites dans cette affaire ou toute affaire rattachée, ne sera autorisé à participer ou à prodiguer des conseils dans le cadre de la procédure, en suite de la signification. Du fait que cette procédure ne crée pas de règle au sens de la Section 551 de la Loi sur la Procédure Administrative, elle n'est pas sujette aux dispositions de la Section 553 retardant la date d'effet de toute action définitive de la Commission.

Pour la Commission.

Elizabeth M. Murphy
Secrétaire

15/jmp

By: Jill M. Peterson
Assistant Secretary

Liste des Personnes à Signifier

L'article 141 du Règlement Intérieur de la Commission dispose que le Secrétaire, ou tout autre représentant dûment habilité de la Commission, devra signifier une expédition de l'Ordonnance Relative aux Procédures Administratives et d'Audition, conformément aux dispositions de la Section 12(j) de la Loi sur les Transactions Boursières de 1934 (« l'Ordonnance »), aux Défendeurs et leurs représentants légaux.

L'Ordonnance jointe a été adressée aux parties suivantes, ainsi qu'aux personnes sensées être signifiées :

La Distinguée Brenda P. Murray
Juge Administrative en Chef
Commission des Opérations de Bourse
100 F St., N.E.
Washington, DC 20549-2557

Me Neil J. Welch, Jr.
Département du Contentieux
Commission des Opérations de Bourse
100 F St., N.E.
Washington, DC 20549-6010

Par remise de courrier UPS, conformément à la Convention de La Haye sur la Signification à l'Etranger de Documents Judiciaires et Extra-Judiciaires en Matière Civile ou Commerciale (envoyés par le Bureau de la Commission des Affaires Internationales) :

Carrier1 International S.A.
Route D'Arlon 3
L-8009 Strassen, Luxembourg
Luxembourg

Carrier1 International S.A.
c/o Messr. Alain Rukavina
Représentant Officiel
Wagener, Rukavina & Kettenmeyer
10 A Boulevard de la Foire
L-1528 Luxembourg
Luxembourg

Par courrier express :
China Expert Technology, Inc.
c/o Incorp Services, Inc.
Représentant Officiel
2360 Corporate Circle, Suite 400
Henderson, NV 89074-7722

[Le Département du Contentieux fera également délivrer toute signification à tout Défendeur situé sur le territoire des Etats-Unis.]

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63912 / February 15, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14258

In the Matter of

**Emporia Systems,
Eneftech Corp.,
Entrée Corp.,
eSAT, Inc.,
Estream, Inc., and
Everex Systems, Inc. (n/k/a CFLC, 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 Emporia Systems, Eneftech Corp., Entrée Corp., eSAT, Inc., Estream, Inc., and Everex Systems, Inc. (n/k/a CFLC, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Emporia Systems (CIK No.1083413) is a permanently revoked Nevada corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Emporia is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2001, which reported a net loss of \$70,229 for the prior twelve months.

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2. Eneftech Corp. (CIK No. 1138654) is an inactive Texas corporation located in Burbank, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Eneftech 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, 2005, which reported a net loss of \$26,073 since the company's April 2, 2001 inception.

3. Entrée Corp. (CIK No. 814579) is an inactive Delaware corporation located in Calabasas, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Entrée 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 January 4, 1997, which reported a net loss of \$1,876 for the prior twelve weeks.

4. eSAT, Inc. (CIK No. 1081798) is a permanently revoked Nevada corporation located in Orange, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). eSat is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2001, which reported a net loss of over \$1.2 million for the prior three months. As of February 7, 2011, the company's stock (symbol "ASAT") was traded on the over-the-counter market.

5. Estream, Inc. (CIK No. 1058260) is a California corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Estream is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2002 which reported a net loss of \$10,017 for the prior three months.

6. Everex Systems, Inc. (n/k/a CFLC, Inc.) (CIK No. 816762) is an inactive Delaware corporation located in Fremont, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CFLC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 3, 1992. On January 4, 1993, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, which was converted to Chapter 11, and the case was terminated on June 14, 2005.

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. 63913 / February 15, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3159 / February 15, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14259

In the Matter of

ROBERT F. MCCULLOUGH,
JR., CPA

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Robert F. McCullough, Jr., CPA ("McCullough" or "Respondent").

II.

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

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of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. McCullough has served as Chief Financial Officer of CytoCore, Inc. ("CytoCore" or the "Company") since September 2005, the Company's Chief Executive Officer of the Company since October 2007, a Company director since 2005, and Chairman of the Company's Board of Directors since April 2009. McCullough has also served as President and Portfolio Manager of Summitcrest Capital, Inc., a California-registered investment adviser, since October 2003. McCullough is a licensed Certified Public Accountant in the State of California, with inactive status. McCullough, 56 years old, is a resident of Kentfield, California.

2. On January 26, 2011, a final judgment was entered by consent against McCullough, permanently enjoining him from future violations of Sections 14(a) and 16(a) of the Exchange Act and Rules 14a-9 and 16a-3 thereunder, and from aiding and abetting future violations of Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. CytoCore, Inc., et al., Civil Action Number 1:11-cv-00246, in the United States District Court for the Northern District of Illinois.

3. The Commission's complaint alleged that, among other things, during his tenure as an officer of CytoCore, McCullough directed CytoCore to pay Daniel Burns, a CytoCore consultant that was not affiliated with a registered broker-dealer, commissions in connection with Burns' fundraising efforts for the Company. The complaint alleged that McCullough made these payments despite knowing that commissions for fundraising from investors could be paid only to registered broker-dealers. The complaint further alleged that McCullough failed to disclose numerous personal transactions in CytoCore stock on Forms 4 and in CytoCore's proxy statements, and that when McCullough did report his CytoCore holdings, he reported inaccurately. The complaint alleged that from July 2007 through February 2010, McCullough purchased 520,812 shares of CytoCore stock in his personal accounts over 76 separate trading days, yet he reported purchases on only 14 trading days totaling 219,000 shares during this period. Moreover, the complaint alleged that from August 2006 through January 2010, Summitcrest Capital Partners, an investment partnership managed by McCullough in which McCullough has a 10% ownership interest, purchased CytoCore stock on 128 separate trading days and sold CytoCore stock on 5 trading days for a net accumulation of 1,786,000 shares, yet McCullough reported purchases on only 32 trading days for a total accumulation of 839,700 shares during this period, and did not report any of the sales.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent McCullough be, and hereby is suspended from association with any broker, dealer, or investment adviser for a period of twelve months.

The twelve-month suspension shall begin to run from the second Monday following the entry of the Order. Respondent McCullough shall provide to the Commission, within thirty (30) days after the end of the twelve-month suspension period described above, an affidavit that he has complied fully with the sanction described in Section IV of the 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 ACT OF 1933
Release No. 9187 / February 16, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3160 / February 16, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14260

In the Matter of

ENVISION CAPITAL
MANAGEMENT, LTD. AND
MICHAEL M. DRUCKMAN

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS, PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, AND SECTIONS 203(e), 203(f),
and 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-
DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Envision Capital Management, Ltd. and Michael M. Druckman (collectively "Respondents").

II.

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

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III.

On the basis of this Order and Respondents' Offers, the Commission finds¹ that

Summary

This matter involves inaccurate and incomplete disclosures made by Envision Capital Management, Ltd. ("Envision Capital"), a registered investment adviser, and Michael M. Druckman ("Druckman"), Envision Capital's owner and officer, regarding three affiliated hedge funds Envision Capital manages. Druckman formed Equity Income Partners, L.P. ("Equity Income"), Galileo Capital Partners LLC ("Galileo LLC"), and Galileo Capital Partners, Ltd. ("Galileo Ltd.") (collectively, the "Funds") to invest in short-term asset-backed real estate loans. Beginning in at least January 2007, Envision Capital and Druckman did not provide complete and accurate disclosure of material facts to the Funds' investors regarding the Funds' redemption practices and loan-to-value ratios on real estate loans made by the Funds. They also overcharged performance and management fees for Galileo LLC, and at times, used cash from one Fund to pay another Fund's property expenses without disclosing the practice to investors. Envision Capital also failed to follow the custody rules of the Advisers Act, did not implement Envision Capital's policies and procedures regarding the custody rule, and failed to appoint an appropriate chief compliance officer to oversee the firm's activities. Druckman willfully aided and abetted and caused Envision Capital's custody rule and policies and procedures violations.

Respondents

1. Envision Capital Management, Ltd., formerly known as Physicians Financial Services, Ltd., is a Scottsdale-based Arizona corporation formed in 1982. Envision Capital has been registered as an investment adviser with the Commission since 1985. Michael and Patricia Druckman indirectly own 100% of Envision Capital through the Druckman Family Trust.
2. Michael M. Druckman, age 58, is a resident of Fountain Hills, Arizona. Druckman is the founder, president, and indirect owner of Envision Capital.

Other Relevant Entities

3. Equity Income Partners, L.P. is an Arizona based limited partnership formed in March 1989. Equity Income's general partner is Envision Capital. From January 2007 to August 2009, Equity Income raised approximately \$950,000 from 16 investors in an unregistered offering.
4. Galileo Capital Partners, LLC is an Arizona limited liability company formed in September 2004. Envision Capital is the manager of Galileo LLC. From January 2007 to August 2009, Galileo LLC raised \$4.1 million from 27 investors in an unregistered offering.

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

5. Galileo Capital Partners, Ltd. is a Cayman Islands exempted company incorporated in February 2006. Envision Capital is the manager of Galileo. From January 2007 to August 2009, Galileo Ltd. raised \$13.8 million from 9 investors in an unregistered offering.

Background

6. Envision Capital has a portfolio management business in which the firm is the adviser for over 300 separately managed accounts, including three affiliated hedge Funds Druckman created, Equity Income, Galileo LLC, and Galileo Ltd. Two of the Funds, Equity Income and Galileo LLC, invest in, and directly provide, short term asset-backed loans to commercial borrowers. The third Fund, Galileo Ltd., purchases participation interests in loans. From January 2007 through at least August 2009, about 52 investors, including institutions, individuals, and fund of funds, invested almost \$19 million in the Funds.

7. Envision Capital, the general partner or manager of the Funds, has discretionary authority over and access to the Funds' investments, and Druckman manages and controls all of the Funds' operations and real estate loan decisions. In addition to the loans, all three Funds also held shares in money market funds.

8. From January 2007 through at least August 2009, a total of about 140 investors located in multiple states were invested in the Funds. At least 26 investors in Equity Income were unaccredited, and a number of subscription documents for both Galileo LLC and Equity Income did not contain supporting accreditation documentation. About 65 of the Funds' investors are advisory clients of Envision Capital.

9. Prior to investing, investors typically receive a copy of the respective Funds' Private Offering Memorandum ("POM") and subscription documents. The POMs for Equity Income and Galileo LLC state that redemptions are only available to investors "first come, first served" based on the respective Fund's liquidity. The POMs also include provisions that give full discretion to Envision Capital and Druckman to determine if any redemption can occur. On several occasions between February 2006 and April 2009, contrary to the "first come, first served" language in the POMs, Envision Capital and Druckman satisfied requests for partial redemptions or those requests involving smaller amounts of monies, without disclosing this practice to investors.

10. Envision Capital charges monthly fees to the Funds. Per Galileo LLC's POM, Envision Capital charges Galileo LLC management fees of 1% and performance fees of 20%, which are computed on the basis of actual cash receipts. Equity Income and Galileo Ltd. require performance and management fees, if any, to be computed on an accrual basis. From January 2007 to December 2008, Envision Capital and Druckman overcharged the performance and management fees that Galileo LLC paid to Envision Capital by erroneously using an accrual basis method. Specifically, Envision Capital and Druckman overcharged Envision Capital's fees by \$305,244 by taking into account \$1.5 million of unpaid accrued interest income, which Galileo LLC had not, at that time, received from the borrowers on the loans. Therefore, Envision Capital was not entitled to any fees on that income. Envision Capital has now credited this amount back.

11. At times, and undisclosed to Fund investors, Envision Capital and Druckman used monies from one Fund to pay the expenses of another Fund. When a loan financed by the Funds defaulted and the property securing the loan was foreclosed upon, one or more of the Funds typically acquired the underlying property and became responsible for the resulting property expenses (such as taxes, maintenance, and repairs). The Funds jointly owned some of the properties, while other properties were acquired by only one Fund. If a property was jointly owned, each Fund was obligated to pay for the property expenses only to the extent of its relative ownership percentage of the underlying property. In some instances, however, Envision Capital and Druckman used cash from one Fund to make property expense payments, regardless of the paying Funds' ownership interest in the property at issue. The POMs do not authorize Envision Capital and Druckman to use one Fund's monies to pay another Fund's property expenses, and Envision Capital and Druckman did not disclose this practice to investors.

12. Envision Capital represented in its marketing materials and on its website that loans made by the Funds would not exceed a loan-to-value ratio of 65% for Equity Income and 67.5% for Galileo LLC and Galileo Ltd. In some instances during the relevant period, Envision Capital and Druckman used Druckman's own valuation of the property in calculating the loan-to-value ratio instead of third-party property appraisals Envision Capital had received. At times, even when using Druckman's own valuation to determine the property's value, Envision Capital and Druckman exceeded the advertised loan-to-value ratios. Envision Capital and Druckman did not adequately disclose its valuation practices to investors, and the marketing materials did not contain any disclosures stating the methods used to value the properties and calculate loan-to-value ratios.

13. Envision Capital maintains custody of the Funds' assets and securities. During the relevant time period, Envision Capital and Druckman failed to comply with the custody rule under the Advisers Act because they sent account statements directly to the Funds' investors without either subjecting the Funds to an annual surprise exam by an independent public accountant or sending annual GAAP-compliant audited financial statements to investors within 120 days of the end of the fiscal year end.

14. The Advisers Act requires that an investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, and requires that investment advisers appoint a chief compliance officer responsible for administering the adviser's policies and procedures. Although Envision Capital's policies and procedures manual contained custody rule policies and procedures, Envision Capital and Druckman did not implement them. Additionally, from June 2006 to April 2009, Envision Capital and Druckman appointed as Envision Capital's chief compliance officer an individual who had no compliance training, management responsibilities or authority, or prior compliance oversight experience.

Violations

15. As a result of the conduct described above, Envision Capital and Druckman willfully² violated Sections 17(a)(2) and (3) of the Securities Act, which proscribes fraudulent practices in the offer and sale of a security. Proof of scienter is not required to establish a violation of Sections 17(a)(2) and (3) of the Securities Act. *Aaron v. SEC*, 446 U.S. 680, 697 (1980).

16. Envision Capital and Druckman were each investment advisers because they, in return for compensation, engaged in the business of advising others as to the advisability of investing in, purchasing, or selling securities. As a result of the conduct described above, Envision Capital and Druckman willfully violated Section 206(2) of the Advisers Act, which makes it unlawful for any adviser to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

17. As a result of the conduct described above, Envision Capital willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, which required an investment adviser to a pooled investment vehicle with custody of the pool's funds or securities to have the qualified custodian maintaining such funds or securities provide account statements to the investors in the pool at least quarterly, or alternately, if the adviser elects to send statements to investors, either arrange for the pool to undergo an annual surprise examination by an independent public accountant or have the pool audited by an independent public accountant and distribute the audited financial statements to the investors within 120 days of the end of the pool's fiscal year. Druckman willfully aided and abetted and caused Envision Capital's violations.

18. As a result of the conduct described above, Envision Capital willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules promulgated thereunder. Druckman willfully aided and abetted and caused Envision Capital's violations.

19. As a result of the conduct described above, Druckman willfully violated Sections 5(a) and (c) of the Securities Act, which prohibit the sale of, and offers to buy or sell, a security in interstate commerce unless a registration statement is in effect as to the security or an exemption from registration applies.

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

Undertakings

Envision Capital has undertaken to:

20. Retain, not later than 45 days after the date of this Order, at its expense, an independent consultant not unacceptable to the Commission's staff (the "Independent Consultant"). Envision Capital shall require the Independent Consultant to:

- a. Conduct a comprehensive review of Envision Capital's policies, procedures, practices, and internal controls with respect to compliance with the Advisers Act. Such review shall include, but not be limited to, custody rule compliance, computation of fees, books and records, internal accounting, property loan-to-value ratios, and redemptions, and the accuracy of disclosures to the Funds' current and prospective investors concerning these items (collectively, the "Policies/Controls"). Such review shall also include Envision Capital's policies, procedures, and practices with respect to the chief compliance officer ("CCO") and whether the CCO can effectively implement the compliance functions and responsibilities (collectively, the "Compliance Function Policies");
- b. Make recommendations concerning the Policies/Controls and the Compliance Function Policies with a view to assuring compliance with the federal securities obligations and the Funds' disclosures to current and prospective investors;
- c. Conduct an annual review, for each of the following two years from the date of the issuance of the Independent Consultant's initial report, to assess whether Envision Capital is complying with its revised Policies/Controls and whether the revised Policies/Controls are effective in achieving their stated purposes; and
- d. Conduct a quarterly review, for each of the first three quarters of the two years from the date of the issuance of the Independent Consultant's initial report, to assess whether Envision Capital is complying with its revised Compliance Function Policies and whether the revised Compliance Function Policies are effective in achieving their stated purposes.

21. No later than 10 days following the date of the Independent Consultant's engagement, provide to the Commission staff a copy of an engagement letter detailing the Independent Consultant's responsibilities pursuant to paragraph 20 above. To ensure independence, Envision Capital shall not have the authority to terminate the Independent Consultant without prior written approval of the Commission's staff.

22. Arrange for the Independent Consultant to issue its first report within 90 days after the date of the engagement and the following two reports within 60 days following each subsequent quarterly period from the date of the Independent Consultant's first report. Within 10 days after the issuance of the reports, Envision Capital shall require the Independent Consultant to submit to Diana Tani of the Commission's Los Angeles Regional Office a copy of

the Independent Consultant's reports. The Independent Consultant's reports shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary to make the Compliance Policies/Controls adequate and address the deficiencies set forth in Section III of the Order.

23. Within thirty days of receipt of the Independent Consultant's reports, adopt all recommendations contained in the reports and remedy any deficiencies in its written policies, procedures, practices, and internal controls; provided, however, that as to any recommendation that Envision Capital believes is unnecessary or inappropriate, Envision Capital may, within fifteen days of receipt of the reports, advise the Independent Consultant in writing of any recommendations that it considers to be unnecessary or inappropriate and propose in writing an alternative policy or procedure designed to achieve the same objective or purpose.

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

25. Within thirty days after the date of the Independent Consultant's second annual report, submit an affidavit to the Commission's staff stating that it has implemented any and all recommendations of the Independent Consultant, or explaining the circumstances under which it has not implemented such recommendations.

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

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

28. Within thirty days after the date of the entry of this Order, Envision Capital shall disseminate, at its own expense, a copy of the Order to all existing clients and all current investors of the Funds and, for a period of two calendar years starting from the date of the entry of this Order, to all prospective clients and prospective investors of the Funds, including posting

a link to a copy of the Order on the home page, in a readily viewed area, of any and all of Envision Capital's website(s) for a period of six months.

29. Certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondents agree to provide such evidence. The certification and supporting material shall be submitted to Diana Tani, Assistant Regional Director, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty days from the date of the completion of the undertakings.

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

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, and Sections 203(e), 203(f), and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Sections 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-2 and 206(4)-7 promulgated thereunder, and additionally as to Druckman, violations of Sections 5(a) and 5(c) of the Securities Act.

B. Respondents are censured.

C. Respondents shall, jointly and severally, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 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 wire transfer, 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 Envision Capital and Druckman as Respondents in these proceedings, the file number of these proceedings, a copy of which

cover letter and money order or check shall be sent to Michele Wein Layne, Los Angeles Regional Office, 5670 Wilshire Blvd., 11th Floor, Los Angeles, California 90036.

D. Respondents shall comply with the undertakings enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63924 / February 17, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14264

In the Matter of

SHAUN SARNICOLA,

Respondent.

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

I.

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

II.

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

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III.

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

1. Sarnicola, age 32, resides in Brooklyn, New York. From 1998 to 2006, he was a securities lending representative associated with Kellner Dileo & Company ("Kellner"), a broker-dealer registered with the Commission.

2. On August 16, 2007, Sarnicola pled guilty to one count of conspiracy to commit wire fraud in violation of Title 18 United States Code, Section 1349 before the United States District Court for the Eastern District of New York, in United States v. Shaun Sarnicola, Crim. Information No. 07-CR-639.

3. The count of the criminal information to which Sarnicola pled guilty alleged, inter alia, that Sarnicola, together with others, did knowingly and intentionally conspire to execute a scheme and artifice to defraud Kellner of money and property and to obtain money and property from Kellner by means of materially false and fraudulent pretenses, representations and promises and in executing such scheme and artifice to defraud did so by means of wire communication in interstate and foreign commerce.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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By: 
Jill M. Peterson
Assistant Secretary

*Chairman Shapiro
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3162 / February 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14265

In the Matter of

JACQUES R. GENDREAU,

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 Jacques R. Gendreau ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

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

1. From its inception in 2007, Gendreau was the president and chief compliance officer of Gendreau & Associates, Inc. ("G&A"), an investment adviser registered with the Commission. Gendreau 69 years old, is a resident of Aliso Viejo, California.

2. On February 9, 2011, a judgment was entered by consent against Gendreau, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act, and from aiding and abetting violations of Section 204 of the Advisers Act and Rule 204-2 thereunder, in the civil action entitled Securities and Exchange Commission v. Gendreau & Associates, Inc., et al., Civil Action Number CV09-3697- JST (FMOx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, from at least July 2007 through September 2008, Gendreau employed successive high-risk investment strategies for G&A clients without adequately disclosing the increasingly high-risk nature of his strategies. The complaint alleged that Gendreau used these high-risk strategies even though he knew that the investments were not suitable because of the clients' risk tolerance, including the clients' age, retirement status, or need for funds in the short-term. In August and September 2008, according to the complaint, Gendreau implemented his riskiest strategy by investing client assets – regardless of the client's risk tolerance – solely in the preferred shares of two banks using substantial margin. The complaint further alleged that in implementing this strategy, Gendreau disregarded the instructions from several clients who had instructed him to invest solely in cash. The complaint further alleged that although Gendreau knew that this was a very risky investment strategy, Gendreau misrepresented to clients that the investments were "guaranteed" and/or involved "practically no risk." The complaint also alleged that Gendreau aided and abetted G&A's failure to maintain its written communications with its clients, including emails containing investment recommendations or advice.

IV.

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

Accordingly, it is hereby ORDERED:

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

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of

factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9188 / February 17, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 63926 / February 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14266

In the Matter of

JOHNNY CLIFTON,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE AND
CEASE-AND-DESIST PROCEEDINGS PURSUANT
TO SECTION 8A OF THE SECURITIES ACT OF
1933 AND SECTION 15(b) OF THE SECURITIES
EXCHANGE ACT OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. Respondent

1. **Johnny Clifton**, age 43, was the president and principal of MPG Financial, LLC from April 2009 until April 2010. He is currently a registered principal with another Commission-registered broker-dealer.

B. Relevant Entities

2. **MPG Financial, LLC** is a Texas limited liability company, wholly owned by Managed Petroleum Group, Inc., with its principal place of business in Richardson, Texas. It

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was a broker-dealer registered with the Commission (#8-67838) from August 5, 2008 until December 31, 2010.

3. **Managed Petroleum Group, Inc.** is a Texas corporation with its principal place of business in Richardson, Texas. Managed Petroleum Group is in the oil and gas exploration business. It is not registered with the Commission in any capacity and has no securities registered with the Commission.

C. MPG Financial's 2009-1 Osage LP Offering

4. In April 2009, MPG Financial, on behalf of Managed Petroleum Group, began offering limited partnership interests in a six-well oil and gas drilling project in Oklahoma, the 2009-1 Osage L.P. ("the Osage project"). MPG Financial offered 15 units of the Osage project at \$71,250 each, for a total offering of \$1,068,750. Ultimately, MPG Financial raised about \$500,000 from 22 investors by the time the offering closed at year-end 2009.¹

D. Development of the Osage Project

5. Managed Petroleum Group began drilling on the Osage project in April 2009 with seed money provided by its industry partners. The first well, the Osage 1-5, was completed in early April. Well test data showed an initial production rate of 20-30 barrels of oil per day (BOPD), but after completion actual production was only about 5 BOPD because of excess water in the well. As a result, the Osage 1-5 was not commercially viable as long as the excess water had to be trucked away. Managed Petroleum Group timely informed Clifton of these developments.

6. In June 2009, Managed Petroleum Group drilled the second Osage project well, the Osage 1-1. Well testing on the Osage 1-1 initially showed some potential to produce gas, but after completion it produced excessive amounts of water. Managed Petroleum Group decided to convert Osage 1-1 into a salt water disposal well (SWDW) to eliminate much of the water transportation cost for the Osage 1-5 and its nearby wells. Obtaining the permit to convert the Osage 1-1 to a SWDW, however, required several months. In August 2009, Managed Petroleum Group decided to shut down the Osage 1-5 well until it secured the SWDW permit for the Osage 1-1. Managed Petroleum Group timely informed Clifton of these developments.

7. Managed Petroleum Group did not drill another Osage well until December 2009. On December 28, 2009, Managed Petroleum Group learned that the next well, the Osage 1-4, was a dry hole. In January 2010, the company drilled two more wells, which were also dry holes. Managed Petroleum Group decided not to complete those three wells and not to drill the last of the six wells. Ultimately, Managed Petroleum Group shut down the entire field. In February 2010, Managed Petroleum Group notified investors that it was shutting down the Osage field and returned 25% of the investors' principal. Managed Petroleum Group timely informed Clifton of these developments.

¹ Managed Petroleum Group raised another \$1.4 million from its "industry partners," who were not limited partners in the 2009-1 Osage L.P.

E. MPG Financial's Sales of the Osage Project

8. Clifton, who became MPG Financial's principal before any Osage project sales, supervised MPG Financial's sales representatives and sales practices. Clifton held meetings at least weekly with the MPG Financial sales representatives to provide any updates or additional information about the Osage project. At these meetings, Clifton instructed the sales representatives to use the PPM and information he provided orally to pitch the Osage project, but gave them no additional written materials. Clifton was the only MPG Financial representative who received Osage project updates from the issuer.

F. Material Misrepresentations and Omissions by MPG Financial

9. As discussed above, early on in the Osage project the Osage 1-5 and 1-1 wells became non-commercial, leading Managed Petroleum Group to convert the Osage 1-1 into a SWDW. Although Managed Petroleum Group provided Clifton with all of the material information about the Osage project in a timely manner, Clifton failed to ensure that all MPG Financial sales representatives were informed of these developments. As a result, investors were not adequately informed about the project by MPG Financial before investing. In addition, Clifton made false and misleading statements or omitted material information in at least one sales presentation call he made that was attended by several prospective investors.

Material misrepresentations and omissions that the Osage project had not started yet

10. In some cases, MPG Financial sales representatives failed to disclose that drilling on the Osage project had yet to begin. Clifton, in a December 23, 2009 conference call with prospective investors, led them to believe that no drilling on the Osage project had occurred. By leading them to believe that the project was still prospective, Clifton and other MPG Financial sales representatives omitted disclosing negative information about the first two wells.

Material misrepresentations and omissions about the Osage 1-5 well

11. MPG Financial sales representatives also misled some prospective investors about the Osage 1-5 well's production. For example, MPG Financial sales representatives failed to disclose to certain investors who sent checks in after August 2009 that Managed Petroleum Group had shut down the Osage 1-5 well, and/or that it was converting the Osage 1-1 to a SWDW. Moreover, in e-mails sent to prospective clients as late as December 2009, MPG Financial sales representatives touted the Osage 1-5 well's initial production rate of as much as 35 BOPD, without disclosing the well's actual post-completion production rate of 5 BOPD and its shut-in status.

Material misrepresentations and omissions about the Osage 1-1 well

12. MPG Financial sales representatives also failed to inform certain prospective investors that the company was converting the Osage 1-1 well to a SWDW. In the same December 2009 e-mails, sales representatives disclosed potential production (and related returns on investment) of the six Osage wells. This, of course, was not true, since converting the Osage 1-1 well to a SWDW left only five potentially producing wells.

Material misrepresentations and omissions about the Osage 1-4

13. On December 28, 2009, Clifton learned that the Osage 1-4 was a dry hole. After that date, MPG Financial accepted funds from four investors who previously had submitted subscription paperwork, without disclosing the dry hole to those investors.

G. Clifton Failed Reasonably to Supervise MPG Financial Sales Representatives

14. In addition to making or causing material misrepresentations and omitting material information in the offer and sale of the Osage project, Clifton failed reasonably to supervise MPG Financial's sales representatives, who violated Section 17(a) of the Securities Act.

15. Clifton was responsible for drafting and approving MPG Financial's written supervisory procedures (WSPs). Such WSPs were inadequate in two significant areas: outgoing correspondence and providing material information to investors regarding recommended investments. While MPG Financial's WSPs provide a list of do's and don'ts for its sales representatives regarding outgoing correspondence, including e-mail, they contain no instructions as to supervisory review of the outgoing correspondence. Clifton failed to establish a formal correspondence review system and failed to record whether any outgoing correspondence was reviewed. Had Clifton established an effective correspondence review process, he could have prevented and detected materially misleading statements in the sales representatives' outgoing correspondence to investors in connection with recommending the limited partnership interests offered by MPG Financial.

16. MPG Financial's WSPs also include a section on due diligence that requires MPG Financial and associated persons to "have reasonable grounds to believe, based on the information provided by the issuer, that all material facts are adequately and accurately disclosed." Further, the WSPs require the "[m]aintenance of records indicating steps taken in order to verify the adequacy of the disclosures made to investors." The WSPs, however, do not include procedures to ensure that MPG Financial provides material information it learns after completion of the initial offering memorandum to sales representatives and, consequently, to prospective investors. For example, Clifton knew that the Osage project would be drilled concurrently with the sales of Osage project interests. Yet, because Clifton failed to keep any record of the project updates he provided to sales representatives, there is no evidence that such updated information was provided timely to sales representatives. Moreover, MPG Financial had no procedures to follow up with investors after the sale to confirm that the investors had received adequate, updated information about the project at the time of their investment. If MPG Financial had maintained such records or followed up with investors, it could have learned that

its procedures were inadequate to ensure that investors received all material information about the project when they invested.

17. In addition to failing reasonably to supervise the registered representatives who solicited investors to purchase the limited partnerships offered by MPG Financial by failing to develop reasonable supervisory procedures, Clifton failed to implement day-to-day supervision over the registered representatives. He was solely responsible for providing information to sales representatives about the Osage project status, and he was responsible for supervising their sales activities. At a minimum, Clifton failed to ensure that all sales representatives were informed about the status of the projects. Instead, he only provided oral updates, which were not effective in disseminating the necessary information. He also failed to take reasonable steps, such as a systematic review of electronic correspondence, to ensure that the representatives were providing up-to-date material information to prospective investors. As a result, MPG Financial sales representatives failed to inform some prospective investors, among other things, that the Osage 1-1 was drilled or that it was to be converted to a SWDW and that the Osage 1-5 had been shut in. Further, as late as December 2009, MPG Financial sales representatives provided some investors with misleading production projections that were based on stale information. Clifton, as supervisor, failed to ensure that MPG Financial's sales representatives were providing all material information to prospective investors.

II. Violations

18. As a result of the conduct described above, Clifton willfully violated Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act which prohibits fraudulent conduct in the offer and sale of securities.

19. As a result of the conduct described above, Clifton failed reasonably to supervise MPG Financial sales representatives within the meaning of Section 15(b)(6)(A) of the Exchange Act, which incorporates by reference Section 15(b)(4)(E) of the Exchange Act, with a view to preventing and detecting violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act by MPG Financial's sales representatives.

III.

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

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

B. Whether, pursuant to Section 8A of the Securities Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of the provisions set forth Section II.H above; and

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3163 / February 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14267

In the Matter of

William J. Reid,

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 William J. Reid ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

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

1. Reid is the founder, managing member and sole employee of Algorithmic Trading Advisors, LLC ("ATA"), an unregistered investment adviser which provided investment advisory services to World Stock Fund, L.P. ("WSF"), an unregistered investment fund.

2. On February 3, 2011, a final judgment was entered by consent against Reid, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Algorithmic Trading Advisors, LLC, et al., Civil Action Number 4:11CV0016, in the United States District Court for the Southern District of Georgia.

3. The Commission's complaint alleged that, among other misrepresentations, Reid falsely represented the performance returns and assets under management of WSF. One of the means Reid used to disseminate WSF's false performance returns and assets under management was by providing such false information to various hedge fund reporting services, including Morningstar, Inc., BarclayHedge, and Hedge Fund Research, Inc. Upon receiving such false information, Morningstar, Inc., BarclayHedge, and Hedge Fund Research, Inc., and other services to which Reid provided information, included the false WSF information on their websites which evaluate and rate hedge funds.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Reid be, and hereby is, barred from association with any investment adviser.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63928 / February 18, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3244 / February 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14268

In the Matter of
JOANNE KLINE,
Respondent.

:
:
:
: ORDER INSTITUTING ADMINISTRATIVE
: PROCEEDINGS PURSUANT TO RULE
: 102(e) OF THE COMMISSION'S RULES OF
: PRACTICE, MAKING FINDINGS, AND
: IMPOSING REMEDIAL SANCTIONS
:
:
:
:

I.

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

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

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

II.

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

III.

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

1. Kline, age 48, has been a certified public accountant licensed to practice in the State of Arizona since April 1993, but her license was suspended in November 2010. She served as the controller of NutraCea, Inc. ("NutraCea") from March 2007 to June 2009.
2. NutraCea is a California corporation with its principal executive offices located in Phoenix, Arizona and is engaged in the business of manufacturing health food products. NutraCea's common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and trades on the OTC:BB under the symbol "NTRZ".
3. On January 13, 2011, the Commission filed a complaint against Kline in SEC v. NutraCea, et al. (Civil Action No. CV 11-0092-PHX-SRB). On February 14, 2011, the court entered an order permanently enjoining Kline, by consent, from future violations of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. Kline was also ordered to pay a \$25,000 civil money penalty.
4. The Commission's complaint alleged, among other things, that NutraCea, through the misconduct of Kline and others, overstated its sales revenues for the second and third quarters of fiscal year 2007 and its fiscal year 2007 by booking false sales and engaging in improper revenue recognition practices. The complaint alleged that Kline violated the books and records and internal controls provisions of the federal securities laws because she knew that NutraCea improperly accounted for a \$2.6 million sale in the second quarter of 2007 and a \$1.9 million sale in the fourth quarter of 2007. The complaint further alleged that Kline also signed false management representation letters to NutraCea's auditors.

IV.

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

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

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

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

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

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

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

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

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

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

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

By the Commission.

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. 63932 / February 18, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3164 / February 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14269

In the Matter of

NEAL R. GREENBERG,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Neal R. Greenberg ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

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

1. Respondent was at all relevant times the chief executive officer and majority owner of registered investment adviser Tactical Allocation Services, LLC ("TAS") and the head portfolio manager for a registered investment adviser wholly-owned by TAS, Agile Group, LLC ("Agile Group"). At all relevant times, Respondent held Series 1, 4, 7, 24, 63, and 65 licenses. He was the principal of an affiliated registered broker-dealer, Agile Securities, Inc., starting in 1996 until that firm withdrew its registration with the Commission in November 2008. Respondent ended his association with Agile Group and TAS when they withdrew their registrations with the Commission in October 2009. Respondent, 55 years old, is a resident of Boulder, Colorado.

2. On February 10, 2011, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 206(4)-8 promulgated thereunder, in the civil action entitled *Securities and Exchange Commission v. Neal R. Greenberg*, Civil Action Number 1:11-cv-00313-JLK, in the United States District Court for the District of Colorado.

3. The Commission's complaint alleged that extensive losses were suffered by affiliated hedge funds managed and recommended by Respondent, including the Agile Safety Fund ("Safety Fund"), the Agile Safety Fund International ("International Fund"), and the Agile Safety Variable Fund ("Variable Fund") (collectively "Agile hedge funds"). The Agile hedge funds were marketed and managed by affiliated investment advisers Agile Group and TAS. The Commission's complaint also alleged that Respondent negligently misrepresented the safety, suitability, and diversification of the Agile hedge funds to TAS clients, in many cases conservative investors in or near retirement.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Greenberg be, and hereby is barred from association with any broker, dealer, or investment adviser. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63939 / February 22, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14270

In the Matter of

**eMobile Data Corp.,
Encore Group, Inc.,
Ener-Grid, Inc.,
Environmental Technologies International,
Inc. (n/k/a Eco Technologies
International, Inc.)
Evergreen Network.com, Inc., and
Eye Catching Marketing 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 eMobile Data Corp., Encore Group Inc., Ener-Grid, Inc., Environmental Technologies International, Inc. (n/k/a Eco Technologies International, Inc.), Evergreen Network.com, Inc., and Eye Catching Marketing Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. eMobile Data Corp. (CIK No. 1142464) is a Yukon Territory corporation located in Richmond, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). eMobile is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a

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Form 20-F for the period ended December 31, 2001, which reported a net loss of over \$3.2 million (Canadian) for the prior twelve months.

2. Encore Group, Inc. (CIK No. 276259) is an inactive Oregon corporation located in Tigard, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Encore Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the fiscal year ended December 31, 1997, which reported a net loss of \$50,000 for the prior twelve months.

3. Ener-Grid, Inc. (CIK No. 805228) is a Colorado corporation located in Buckeye, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ener-Grid is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1997, which reported a loss of \$72,617 for the prior three months. On March 23, 1998, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Arizona, which was terminated on May 5, 2003.

4. Environmental Technologies International, Inc. (n/k/a Eco Technologies International, Inc.) (CIK No. 894229) is an Ontario corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Eco Technologies International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1997, which reported a net loss of over \$1 million for the prior year.

5. Evergreen Network.com, Inc. (CIK No. 1112921) is a dissolved Colorado corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Evergreen Network.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Registration Statement on Form 10-SB/A on February 1, 2001, which reported a net loss of \$550,847 for the nine-month period ended September 30, 2000.

6. Eye Catching Marketing Corp. (CIK No. 1088210) is a dissolved Nevada corporation located in Kelowna, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Eye Catching Marketing is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ending March 31, 2006, which reported a net loss of \$4,227 for the prior three 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 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.

9. 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


By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63940 / February 22, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3245 / February 22, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-11377

In the Matter of :
Benedict P. Rybicki, CPA : ORDER GRANTING APPLICATION FOR
: REINSTATEMENT TO APPEAR AND PRACTICE
: BEFORE THE COMMISSION AS AN ACCOUNTANT

On August 5, 2004, Benedict P. Rybicki, CPA ("Rybicki") 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 Rybicki pursuant to Rule 102(e) of the Commission's Rules of Practice.¹ Rybicki consented to the entry of the order without admitting or denying the findings therein. This order is issued in response to Rybicki's application for reinstatement to practice before the Commission as an accountant.

In his role as the sole engagement manager for Doeren Mayhew & Co., P.C.'s joint audit, with Grant Thornton LLP, of MCA Financial Corporation's ("MCA") 1998 annual financial statements, Rybicki was alleged to have engaged in improper professional conduct. The Commission alleged that Rybicki recklessly engaged in conduct that resulted in violations of professional standards and recklessly failed to follow applicable auditing standards in the areas of mortgages and land contracts held for resale and related party transactions. Rybicki's conduct also caused and willfully aided and abetted MCA's violations of Section 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 12b-20 and 15d-1 thereunder. Finally, Rybicki willfully aided and abetted violations of Section 10A of the Exchange Act by failing to assure that MCA's audit committee or board of directors were adequately informed of suspected illegal acts that were detected in the course of the audit.

¹ See Accounting and Auditing Enforcement Release No. 2076 dated August 5, 2004. Rybicki was permitted, pursuant to the order, to apply for reinstatement after one year upon making certain showings.

Rybicki 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 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, Rybicki 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 Rybicki, it appears that he has complied with the terms of the August 5, 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 Rybicki, 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 Rybicki, 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 Benedict P. Rybicki, 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 (c)(1) or (c)(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

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63941 / February 22, 2011

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3165 / February 22, 2011

INVESTMENT COMPANY ACT OF 1940
Rel. No. 29578 / February 22, 2011

Admin. Proc. File No. 3-13887

In the Matter of
DAVID W. BALDT

ORDER GRANTING
EXTENSION

The Chief Administrative Law Judge has moved, pursuant to Commission Rule of Practice 360(a)(3),¹ for an extension of time to issue an initial decision in this proceeding. For the reasons set forth below, we have determined to grant the motion.

On May 11, 2010, we issued an Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 against David W. Baldt, who served as portfolio manager for two municipal bond funds sponsored by Schroder Investment Management North America, Inc.

The OIP alleged that Baldt, while in possession of material non-public information, advised his family members to sell their shares in one of the funds that he managed, in willful violation of Securities Act Section 17(a), Exchange Act Section 10(b) and Exchange Act Rule 10b-5, and Investment Advisers Act Sections 206(1) and 206(2). The OIP directed the presiding law judge, in this case, Judge Mahoney, to hold a public hearing to take evidence regarding the allegations and the appropriate sanctions. The OIP specified that, pursuant to Commission Rule

¹ 17 C.F.R. § 201.360(a)(3).

of Practice 360(a)(2),² the presiding law judge should issue an initial decision in this proceeding no later than 300 days from the date of service of the OIP.

The initial decision in this case is due on March 8, 2011. On February 4, 2011, the Chief Administrative Law Judge filed a motion, pursuant to Commission Rule of Practice 360(a)(3),³ requesting an extension of time of forty-five days to issue an initial decision.

II.

We adopted Rules of Practice 360(a)(2) and 360(a)(3) as part of an effort to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings.⁴ At that time, we determined that adoption of mandatory deadlines for completion of administrative hearings would enhance timely completion of the adjudication process. However, we also recognized that a "one size fits all" approach to timely disposition is not feasible.⁵ We therefore established three different deadlines – 120, 210, or 300 days – depending on "the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors."⁶

We further provided for the granting of extensions to those deadlines under certain circumstances. If, during the proceeding, the presiding law judge decides that the proceeding cannot be concluded in the time specified in the OIP, Rule 360(a)(3) provides that the law judge may request an extension of the stated deadline. To obtain an extension, the law judge should consult with the Chief Administrative Law Judge. "Following such consultation, the Chief Administrative Law Judge may determine, in his or her discretion, to submit a motion to the Commission requesting an extension."⁷ The motion should explain why circumstances require an extension and should specify the extension's length.⁸ We may authorize an extension based on

² 17 C.F.R. § 201.360(a)(2).

³ 17 C.F.R. § 201.360(a)(3).

⁴ See *Adopting Release*, Securities Act Rel. No. 8240 (June 11, 2003), 80 SEC Docket 1463.

⁵ *Id.*

⁶ 17 C.F.R. § 201.360(a)(2).

⁷ 17 C.F.R. § 201.360(a)(3).

⁸ See *Adopting Release*, 80 SEC Docket at 1463.

the Chief Administrative Law Judge's motion if we determine that "additional time is necessary or appropriate in the public interest."⁹

The Chief Administrative Law Judge supports her extension request by stating that the initial decision cannot be issued within the specified time because of the size of the record (four days of transcript and approximately 150 exhibits), office workload, and staffing issues (fewer judges and law clerks than normal). In light of the reasonableness of the request, we believe that it is appropriate in the public interest to extend the deadline for filing the initial decision by forty-five days.

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this matter be, and it hereby is, extended until April 22, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary


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

*Chairman Schapiro
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63964 / February 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14273

In the Matter of

ELIZABETH PAGLIARINI,

Respondent.

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

I.

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

II.

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

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

These proceedings arise out of Pagliarini's failure to supervise Tony Ahn, a registered representative who, between September 2005 and September 2007 (the "relevant period"), helped manipulate the prices of several microcap issuers' stocks. During this time, Ahn was associated with Hunter World Markets, Inc. ("HWM"), a registered broker-dealer for which Pagliarini was the designated compliance officer, as well as Ahn's direct supervisor. Ahn directly violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aided and abetted and caused HWM's violations of Section 15(c)(1) of the Exchange Act, by executing a number of trades, including wash trades, the apparent purposes of which were to manipulate the prices of microcap companies stocks and to generate over \$600,000 in sales credits to HWM, which the firm considered to be the equivalent of commissions. Pagliarini failed reasonably to supervise Ahn because she failed to follow HWM's procedures that required her to follow up on suspicious transactions, such as the wash trades, that lacked business sense or exhibited a lack of concern regarding risks, commissions, or other transaction costs.

Pagliarini also willfully aided and abetted and caused HWM's violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Rule 17a-8 requires brokers and dealers to comply with the recordkeeping, retention, and reporting obligations imposed by the Currency and Financial Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act ("BSA")), 12 U.S.C. § 1829b, 12 U.S.C. §§ 1951-1959, and 31 U.S.C. §§ 5311-5330. HWM violated that rule when it failed to file any suspicious activity reports ("SARs") with respect to several large money transfers into and out of the brokerage account of Florian Homm ("Homm"), one of HWM's co-owners at the time, a large transfer of funds to a third party account at a Canadian bank by Colin Heatherington ("Heatherington"), as well as with respect to the wash trades described above. As HWM's compliance officer and the firm's anti-money laundering ("AML") compliance officer, Pagliarini was directly responsible for causing the firm to file SARs, yet she failed to do so with respect to any of Homm's suspect money transfers, the Heatherington transfer, or the wash trades.

Respondent

1. Pagliarini was the chief compliance officer and AML compliance officer of HWM from October 2004 through May 2008 and Ahn's supervisor during the relevant period. Ahn was a

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.

registered representative with HWM, a now defunct broker-dealer that had been registered with the Commission during the relevant period. Pagliarini, 39 years old, is a resident of Mission Viejo, California.

Other Relevant Individuals and Entities

2. Hunter World Markets, Inc. is a California corporation formerly based in Beverly Hills, California. During the relevant period, HWM conducted both a brokerage and investment banking business. HWM was registered as a broker-dealer with the Commission from March 1996 through November 30, 2009, when HWM's Form BDW, withdrawing its registration from the Commission as a broker-dealer, became effective.

3. Tony Ahn was associated with HWM as a registered representative and was its primary trader during the relevant period.

4. Florian Wilhelm Jurgen Homm was a co-owner and director of HWM during the relevant period. Homm was also the co-founder, the original chief investment officer and later the co-chief investment officer of Absolute Capital Management Holdings Limited ("ACMH"), a London-based hedge fund management company.

5. ACMH was organized under the laws of the Cayman Islands. It was quoted on the London Alternative Investment Market and was registered with the Commission as an investment adviser until September 10, 2007. During the relevant period, ACMH managed eight Cayman Islands-domiciled hedge funds (the "Absolute funds") that have subsequently either been liquidated or are now managed by a different fund management company. ACMH has no securities registered under the Exchange Act.

Background

6. During the relevant period, HWM and several individuals associated with the firm, including Ahn, manipulated upward the prices of several thinly traded microcap issuer stocks or maintained the prices of those stocks at artificially high levels. A variety of techniques were employed to manipulate the issuers' stock prices, including matched orders, marking the close, wash trades and purchases at artificially increasing prices. As a result of the manipulation, HWM's co-owners, as well as other individuals, reaped over \$65.5 million. During the course of the manipulation, Pagliarini served as HWM's chief compliance officer, with the responsibility to file SARs on HWM's behalf.

Pagliarini Failed Reasonably to Supervise Ahn

7. Pagliarini was directly responsible for supervising Ahn, HWM's primary trader. As part of her supervisory duties, Pagliarini reviewed and approved all order tickets generated from Ahn's trading activity. The firm's procedures required Pagliarini to follow up on suspicious

transactions, such as those where the customer engages in transactions that lack business sense, or exhibits a lack of concern regarding risks, commissions, or other transaction costs.

8. Pagliarini failed to follow up on the red flags presented by the wash transactions Ahn executed while at HWM. Specifically, Pagliarini never followed up on the wash transactions by obtaining any information on why they were being placed. The wash transactions, which effectively moved issuer stock between accounts held by the same Absolute fund, had no ostensible business purpose other than to either manipulate the price of the stock or to generate sales credits to HWM. By failing to follow-up on these suspect wash transactions, Pagliarini failed to prevent Ahn's securities law violations. Accordingly, Pagliarini failed reasonably to supervise Ahn.

HWM's Failure to File Suspicious Activity Reports

9. In April 2002, Congress passed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001. The Patriot Act amended provisions of the BSA and substantially expanded a broker-dealer's obligations to detect and prevent money laundering. The regulations implementing the BSA mandate that, effective December 31, 2002, broker-dealers report suspicious transactions by filing a SAR with the Financial Crimes Enforcement Network ("FinCEN") to report any transaction (or a pattern of transactions of which the transaction is a part) involving or aggregating to at least \$5,000 that it "knows, suspects, or has reason to suspect": (1) involves funds derived from illegal activity or is conducted to disguise funds derived from illegal activities; (2) is designed to evade any requirements of the BSA; (3) has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 103.19(a)(2).

10. Rule 17a-8 of the Exchange Act requires broker-dealers to comply with the recordkeeping, retention, and reporting obligations of the regulation under the BSA. The failure to file a SAR as required by the SAR Rule is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Pagliarini was responsible for filing SARs on behalf of HWM.

11. The information available to HWM and Pagliarini should have indicated that the wash transactions executed by Ahn were suspicious and involved the type of conduct that should have caused Pagliarini to file SARs on behalf of HWM. However, HWM did not, and Pagliarini did not cause HWM to, file a SAR with respect to any of these wash transactions.

12. HWM also failed to file SARs with respect to certain suspicious cash transfers made into and out of Homm's brokerage account. Although Homm conducted only minimal securities trading in the account, large amounts of cash were routinely transferred into this account from HWM's operations account, and soon thereafter transferred to various bank accounts in Switzerland and overseas. In fact, HWM's clearing agent became concerned over certain transfers,

and sent HWM an anti-money laundering inquiry in May 2006 regarding the source of the funds in Homm's account. The clearing agent also inquired about the nature and purpose of the account. Pagliarini responded that HWM was comfortable with the source of the funds and business purpose of the account, even though the account conducted few actual trades.

13. HWM also failed to file a SAR with respect to a \$4 million wire transfer by Ficeto from Heatherington's CIC Global Capital, Ltd. account at HWM to a Canadian bank account in the name of a different company. This transfer was against HWM's policy to disallow wires from customer accounts to third parties. Although Pagliarini's concerns over the transfer were evidenced when she did not sign off on this transaction and required that the funds be returned, she did not file a SAR.

14. In light of these red flags, and given the potential that Homm was, in fact, laundering money through his account, these cash transfers were suspicious and Pagliarini should have caused HWM to have filed a SAR with respect to these transfers. Pagliarini knew of her obligation to assist HWM in fulfilling its requirements to file SARs, and knew, or was reckless in not knowing, that significant suspicious activity was not being reported by HWM as a result of her actions.

Violations

15. As a result of the conduct described above, Pagliarini failed reasonably to supervise Ahn with a view to preventing Ahn's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aiding and abetting violations of Section 15(c)(1) of the Exchange Act through the execution of the wash transactions.

16. As a result of the conduct described above, Pagliarini willfully aided and abetted and caused HWM's violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder through the failure to file SARs.

IV.

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

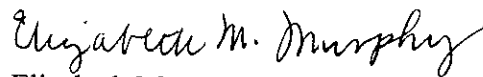
Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Pagliarini shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder;

B. Respondent Pagliarini be, and hereby is suspended from acting in a supervisory capacity with any broker or dealer for a period of twelve months, effective on the second Monday following the entry of the Order.

C. Respondent shall pay a civil money penalty in the amount of Twenty Thousand Dollars (\$20,000) to the United States Treasury. Payment shall be made in the following four installments: (a) Five Thousand Dollars (\$5,000) to be paid within twenty-one days of the entry of this Order; (b) Five Thousand Dollars (\$5,000) to be paid within six (6) months of the entry of this Order; (c) Five Thousand Dollars (\$5,000) to be paid within nine (9) months of the entry of this Order; and (d) a final payment of Five Thousand Dollars (\$5,000) to be paid within one year of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments shall be: (A) made by wire transfer, 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 Elizabeth Pagliarini 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 Michele Layne, Associate Regional Director, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63952 / February 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14271

In the Matter of

Bio-Life Labs, Inc.,
BSI2000, Inc.,
Calais Resources, Inc.,
EGX Funds Transfer, Inc.,
Fischer Imaging Corp.,
Great Western Land Recreation, Inc.
(a/k/a Great Western Land and Recreation, Inc.), and
Id-CONFIRM, 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 Bio-Life Labs, Inc., BSI2000, Inc., Calais Resources, Inc., EGX Funds Transfer, Inc., Fischer Imaging Corp., Great Western Land Recreation, Inc. (a/k/a Great Western Land and Recreation, Inc.), and Id-CONFIRM, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Bio-Life Labs, Inc.¹ ("BLFE") (CIK No. 899049) is a Nevada corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BLFE 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 \$377,724 for the prior nine months. As of February 16,

¹The short form of each issuer's name is also its stock symbol.

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2011, the common stock of BLFE was quoted on OTC Link, had six market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

2. BSI2000, Inc. ("BSIO") (CIK No. 1099780) is a void Delaware corporation located in Evergreen, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BSIO 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 \$3,798,795 for the prior year. As of February 16, 2011, the common stock of BSIO was quoted on OTC Link, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

3. Calais Resources, Inc. ("CAAUF") (CIK No. 1044650) is a British Columbia corporation located in Nederland, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CAAUF 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, 2004, which reported a net loss of \$1,712,821 Canadian for the prior three months. As of February 16, 2011, the common shares of CAAUF were quoted on OTC Link, had eleven market makers, and were eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

4. EGX Funds Transfer, Inc. ("EGXF") (CIK No. 1081227) is a void Delaware corporation located in Boulder, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EGXF is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2002, which reported a net loss of \$2,262,116 for the prior nine months. As of February 16, 2011, the common stock of EGXF was quoted on OTC Link, had six market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

5. Fischer Imaging Corp. ("FIMG") (CIK No. 750901) is a forfeited Delaware corporation located in Broomfield, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FIMG 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, 2006, which reported a net loss of \$2,950,000 for the prior nine months. On August 22, 2006, FIMG filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Colorado, which was terminated on August 16, 2010. On November 15, 2004, FIMG consented to the entry of a cease and desist order against committing or causing any violations of Securities Act of 1933 Section 17(a) and Exchange Act Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder. *Fischer Imaging Corp.*, Admin. Proc. No. 3-11736 (Nov. 15, 2004). As of February 16, 2011, the common stock of FIMG was traded on the over-the-counter markets.

6. Great Western Land Recreation, Inc. (a/k/a Great Western Land and Recreation, Inc.) ("GWES") (CIK No. 854882) is a Nevada corporation located in Scottsdale, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GWES 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 \$1,723,042 for the prior nine months. As of February 16, 2011, the common stock of GWES was quoted on OTC Link, had five market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

7. Id-CONFIRM, Inc. ("IDCO") (CIK No. 1111696) is a revoked Nevada corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IDCO 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, 2007, which reported a net loss of \$4,423,707 for the prior nine months. As of February 16, 2011, the common stock of IDCO was quoted on OTC Link, had eight market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

8. 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.

9. 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.

10. 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


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 24, 2011

In the Matter of

**Bio-Life Labs, Inc.,
BSI2000, Inc.,
Calais Resources, Inc.,
EGX Funds Transfer, Inc.,
Great Western Land Recreation, Inc.
(a/k/a Great Western Land and Recreation, Inc.), and
Id-CONFIRM, 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 Bio-Life Labs, 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 BSI2000, Inc. 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 Calais Resources, Inc. because it has not filed any periodic reports since the period ended August 31, 2004.

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Great Western Land Recreation, Inc. (a/k/a

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Great Western Land and Recreation, Inc.) because it has not filed any periodic reports since the period ended June 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Id-CONFIRM, Inc. because it has not filed any periodic reports since the period ended March 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. EST on February 24, 2011, through 11:59 p.m. EST on March 9, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Chairman Schapiro
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63953 / February 24, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3166 / February 24, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29588 / February 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13934

In the Matter of

SAM P. DOUGLASS and
ANTHONY R. MOORE,

Respondents.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER PURSUANT
TO SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934, SECTIONS 203(f)
AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940, AND SECTION
9(b) OF THE INVESTMENT COMPANY ACT
OF 1940 AS TO SAM P. DOUGLASS**

I.

On June 10, 2010, the Securities and Exchange Commission ("Commission") instituted administrative and cease-and-desist proceedings pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Sam P. Douglass ("Douglass" or "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-And-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act Of 1940 as to Sam P. Douglass ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that

Summary

Douglass served as chairman of Equus Total Return, Inc. ("Equus" or "the Fund"), a business development company ("BDC"), from September 1991 through June 2005. From May 1997 through June 2005, Douglass controlled the investment adviser that provided investment advice to the Fund. During a June 2005 proxy solicitation to approve a change in Fund investment advisers, an Equus press release included a statement by Douglass that officers and directors would not receive above-market prices for their stock options in contemplated private transactions relating to the proposed adviser change. Two weeks before the press release, however, Douglass participated in negotiations with attorneys for the new adviser concerning a senior vice president's compensation package, which provided for a 26% stock-option premium. As a result, Douglass violated or caused violations of antifraud and other provisions of the federal securities laws.

Respondent

1. Douglass, age 78, resides in Houston, Texas and was chairman and CEO of Equus, a business development company, from September 1991 to December 2007. Douglass is an attorney licensed in Texas.

Other Relevant Person and Entities

2. Anthony R. Moore, age 63, resides in London, England and is the co-founder and CEO of Moore, Clayton & Co., Inc., an international private equity investment and advisory firm. He served as Equus's co-chairman and president from June 2005 to December 2007, and as its CEO from June 2005 to August 2007. Moore is also a respondent in these proceedings.

3. Equus, a Delaware corporation based in Houston, Texas, became a BDC on September 6, 1991. Equus trades as a closed-end fund on the New York Stock Exchange, under the symbol "EQS." Its securities are registered under Section 12(b) of the Exchange Act.

4. Moore, Clayton & Co., Inc. ("MCC"), is an international private equity investment and advisory firm headquartered in London with operations in many countries including the United States. Moore is one of MCC's principal shareholders.

5. Moore Clayton Capital Advisors, Inc. ("MCCA"), a Delaware corporation based in Houston, Texas, is wholly owned by MCC. MCCA was a Commission-registered investment

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.

adviser from July 5, 2005 to July 6, 2009, when its contract with Equus was not renewed. MCCA became Equus's investment adviser, via proxy vote, on June 30, 2005.

6. Equus Capital Administration Company ("ECAC"), a Utah corporation based in Houston, Texas and controlled by Moore, acted as Equus's administrator from June 30, 2005 to July 1, 2009.

7. Equus Capital Management Corporation ("ECMC"), a Delaware corporation based in Houston, Texas and controlled by Douglass, was a Commission-registered investment adviser from June 8, 1984 to September 29, 2005. ECMC was Equus's investment adviser and administrator from May 9, 1997 to June 30, 2005.

Facts

Proposed Change in Equus's Investment Adviser

8. In late 2004, several large Equus shareholders pressed Equus management to consider liquidating the Fund. Consequently, on January 21, 2005, Equus's board created a special committee of three independent directors to review alternatives, including hiring a new adviser.

9. About the same time, Douglass learned that Moore wanted to purchase a U.S.-based investment management company. He proposed that Moore purchase Douglass's interest in ECMC and take over as Equus's adviser. Accordingly, in January 2005, Moore and his firm, MCC, agreed to purchase Douglass's ECMC shares. Douglass then asked the special committee to consider hiring MCCA as Equus's new investment adviser.

10. On March 31, 2005, the special committee recommended that the board engage MCCA as adviser. The special committee further recommended that ECAC (MCCA's sister company) become the Fund administrator.

11. On May 5, 2005, MCC agreed to purchase Douglass's interests in ECMC for more than \$4 million. The purchase agreement was contingent on Equus shareholder and Board approval of MCCA's appointment as adviser and ECAC's appointment as administrator. As part of the agreement, MCCA agreed to purchase 27.5% of the Fund's outstanding shares.

12. Because several large Equus shareholders still favored liquidating the Fund rather than merely changing advisers, MCC agreed, as part of its purchase of Equus shares, to acquire these shareholders' stock at a negotiated price of \$9.49 per share (about \$1 per share above the market price).

MCCA's Proposed Advisory Agreement

13. MCCA's proposed advisory agreement with Equus provided that MCCA would receive an annual asset based fee of 2% and a performance fee equal to 20% of the Fund's realized capital gain, net of all realized capital loss and unrealized capital depreciation. This differed from Equus's agreement with ECMC, under which ECMC and its officers received stock options to incentivize their performance. Section 205 of the Advisers Act generally prohibits investment

advisers from receiving performance fees. Section 205(b)(3) provides an exception for advisory contracts with BDCs if, among other things, the BDC doesn't have "outstanding any option, warrant, or right issued" pursuant to Section 61(a)(3)(B) of the ICA, which permits BDCs to issue certain options. Therefore, to enter an advisory agreement with Equus that included a performance fee, MCCA had to purchase or cancel the outstanding options issued to ECMC and Equus employees who continued to work for the Fund after the change in advisers.

The Proxy Statement

14. On April 6, 2005, Equus's board approved the special committee's recommendations and authorized the filing of proxy materials recommending that shareholders approve MCCA's advisory agreement and ECAC's administration agreement. Equus filed its preliminary proxy statement on May 10, 2005, and filed its definitive proxy statement on May 27, 2005. Both proxy filings proposed to discontinue the stock option plan and to require MCCA to purchase all outstanding stock options from the Fund's officers and directors. The proposed administration agreement stated that, while MCCA was responsible for all investment professionals' expenses including salaries, ECAC may provide "significant managerial assistance to the Fund's portfolio companies." Payments to ECAC were capped at \$450,000 per year.

Retention of Certain Employees

15. After the special committee recommended MCCA as the new adviser, Moore told Douglass that MCCA needed to retain certain ECMC employees, especially its senior vice president ("the senior vice president"), an Equus senior vice president who located and evaluated the companies in which Equus invested. Thereafter, Douglass participated in negotiations with the senior vice president concerning his new compensation package.

16. On June 10, 2005, Douglass, through his assistant, sent the senior vice president an e-mail that included a summary of negotiations with MCC and its attorneys concerning the senior vice president's compensation package. That summary called for payment for the senior vice president's stock options at a price of \$10.49 per share, a 26% premium over the current market price of \$8.30. The premium would be paid out in a retention bonus of \$60,000, with the remainder structured as a consulting agreement with ECAC that would compensate the senior vice president an additional \$373,620.

Douglass's Materially Misleading Statements in a June 22, 2005 Press Release

17. On June 17, 2005, in the midst of the proxy solicitation, Dow Jones Newswire ran a story about Equus, highlighting the Fund's performance issues and discussing ongoing disagreements between the Fund's management and certain large shareholders about the Fund's fate. The story specifically quoted one shareholder who said that the Fund "should be shut down." The Dow Jones story also noted the proxy statement's commitment that MCCA would purchase 27.5% of Equus's outstanding shares on the public market or through "privately-arranged transactions with individual shareholders." According to the story, this raised concerns among some shareholders that not all shareholders would be given the chance to sell at a favorable price.

18. In response to the Dow Jones Newswire story, Equus issued a press release on June 22, 2005, regarding the proposed change in advisers. Douglass approved the issuance of the press release, which addressed, among other things, the change in the adviser's incentive-compensation structure and MCCA's commitment to purchase shares. The press release attributed the following statement to Douglass:

"In order to adopt the new incentive compensation structure, the Fund may not have any outstanding stock options in accordance with legal requirements. To facilitate the exercise of the existing stock options held by officers and directors, Moore Clayton may buy the shares issued upon exercise of such options. *The purchase price paid for any such shares will not exceed the current market price for the shares.*" [Emphasis added.]

19. The market price for Equus shares at the time was approximately \$8.30 per share. Given the agreement negotiated earlier, pursuant to which the senior vice president was to be paid a significant premium above market price for his options, the June 22, 2005 press release was materially misleading. Equus filed the press release with the Commission on June 22, 2005, under cover of Form 8-K and also filed it on June 24, 2005, as definitive additional proxy materials on Schedule 14A.

Approval of MCCA and ECAC's appointment

20. Equus's shareholders approved MCCA as the new adviser and ECAC as the new administrator on June 30, 2005. Equus's board, at a meeting later that day, approved the contracts to appoint MCCA as Equus's new adviser and ECAC as the Fund's new administrator. In addition, that day the senior vice president and Moore signed the senior vice president's consulting agreement with MCCA and his consulting agreement with ECAC.

Special Administrative Fee

21. During the June 30, 2005 board meeting, Moore disclosed that ECAC had encountered \$800,000 in "unforeseen administrative expenses" relating to the adviser change and asked Equus to cover those expenses. Although not disclosed at the board meeting, a significant portion of the "unforeseen administrative expenses" was the senior vice president's compensation.

22. In response, Equus's board formed a special committee, consisting of three independent board directors, to examine the unforeseen administrative expenses and to determine whether the Fund should reimburse ECAC. During the special committee's review, an independent director discussed with Moore the components of the special administrative fee. Moore admitted that some of the expenses included retention bonuses for the senior vice president and others, but did not enumerate the specific amounts.

23. On August 9, 2005, upon the special committee's recommendation, Equus's board agreed to pay MCCA a one-time supplemental fee of \$535,000 (approximately 1% of the Fund's assets at the time) to reimburse "extraordinary costs that were incurred by the Management Company above what had been anticipated" with respect to the change in administrators. In effect,

the Fund paid for the stock option premium paid to the senior vice president without any disclosure to the shareholders or the public.

24. Equus's CFO thereafter prepared (or assigned someone to prepare) a spreadsheet outlining the components of the fee: \$400,000 for the senior vice president's consulting agreement with ECAC; \$60,000 for the senior vice president's retention bonus; and \$75,000 of retention bonuses for other personnel.

Equus's Subsequent Commission Filings

25. Equus filed its second quarter 2005 Form 10-Q on August 15, 2005, disclosing that the Fund had reimbursed ECAC \$535,000 for unexpected costs and expenses associated with the change in administrators. The Form 10-Q failed to disclose the true purposes of the special administrative fee or that the majority of the funds compensated the senior vice president.

26. On March 31, 2006, Equus filed its 2005 Form 10-K. This filing also disclosed that the special administrative fee was associated with the change in administrators, but failed to disclose that the special administrative fee primarily compensated a Fund officer.

27. On April 24, 2006, Equus filed its annual proxy statement providing information about officer and director compensation in 2005. The proxy statement represented that the senior vice president received compensation of \$136,620 in 2005, consisting of realized earnings from the company's acquisition of his 198,000 stock options. This figure was materially understated because the senior vice president, in fact, received more than \$460,000 from the transaction. This misleading compensation disclosure was incorporated by reference in Equus's 2005 Form 10-K.

28. Douglass failed to inform Equus's CFO and Equus's auditor of the premium paid to the senior vice president for his stock options. He signed management-representation letters to the auditor for the third quarter of 2005 and for fiscal year 2005 that confirmed that Equus's financial information was fairly presented and that all material transactions were properly recorded. These representations were materially misleading in light of the senior vice president's undisclosed stock-option premium.

Legal Discussion

Standards to Establish Violations

29. Section 13(a) of the Exchange Act requires issuers to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rules 13a-1, 13a-11, and 13a-13 require the filing of annual, current, and quarterly reports, respectively. In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading. "The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports." *SEC v. Savoy Industries*, 587 F.2d 1149, 1165 (D.C. Cir. 1978)

(citing *SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex. 1974)). A violation of the reporting provisions is established if a report is shown to contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975). No showing of *scienter* is necessary to establish an issuer's violation of Section 13(a). *SEC v. Wills*, 472 F. Supp. 1250, 1268 (D.D.C. 1978). In the securities context, *scienter* refers to a mental state embracing intent to deceive, manipulate, or defraud. *Aaron v. SEC*, 446 U.S. 680, 686 n. 5 (1980).

30. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal-accounting controls sufficient to provide reasonable assurances that transactions are recorded to permit the preparation of financial statements in conformity with generally accepted accounting principles. No showing of *scienter* is necessary to establish violations of Sections 13(b)(2)(A) and 13(b)(2)(B). *SEC v. World-Wide Coin Investments*, 567 F. Supp. 724, 749-51 (N.D. Ga. 1983).

31. Exchange Act Rule 13b2-1 prohibits a person from, directly or indirectly, falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act. Exchange Act Rule 13b2-2(a) provides that no director or officer of an issuer shall, directly or indirectly, make or cause to be made a materially false or misleading statement to an accountant or omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with financial-statement audits, reviews, or examinations or the preparation or filing of any document or report required to be filed with the Commission. No showing of *scienter* is required to establish a violation of Rules 13b2-1 or 13b2-2. *World-Wide Coin*, 567 F. Supp. at 749; Promotion of the Reliability of Financial Information and Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices, Exch. Act Rel. No. 15570, 16 SEC Docket 1143 (Feb. 15, 1979).

32. Exchange Act Rule 14a-9 provides that no proxy solicitation shall be made which is materially false or misleading. A violation of this rule results in a violation of Section 14(a) of the Exchange Act. No showing of *scienter* is required. See *Wilson v. Great American Industries, Inc.*, 855 F.2d 987, 995 (2d Cir. 1988).

33. Section 206(2) of the Advisers Act prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. Proof of *scienter* is not required to establish a violation of Section 206(2). *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

Standards for Cease-and-Desist Order, Remedial Sanctions, and Penalty

34. Under Section 21C(a) of the Exchange Act and Section 203(k) of the Advisers Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of those acts and upon any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation. In this context, "cause" is based upon negligence, which is

“sufficient to establish liability for causing a primary violation that does not require *scienter*.” *Matter of Warwick Cap. Mgmt., Inc., et al.*, Admin. Proc. File No. 3-12357, 2007 WL 505772, at *10 (Feb. 15, 2007) (quoting *KPMG Marwick LLP*, 54 S.E.C. 1135, 1175 (2001)).

35. Under Section 203(f) of the Advisers Act, the Commission may censure, impose activities limits, suspend, or bar from association any person associated with an investment adviser who, among other things, has willfully violated any provision of the Exchange Act or Advisers Act.²

36. In any proceeding instituted pursuant to Section 9(b) of the Investment Company Act against any person, the Commission may impose a civil penalty if it finds that such person has willfully violated any provision of the Exchange Act.

Violations

37. As a result of the conduct described above, Douglass willfully violated Section 14(a) of the Exchange Act and Rules 13b2-1, 13b2-2, and 14a-9 thereunder and caused violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder and Section 206(2) of the Advisers Act.

IV.

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

Accordingly, pursuant Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Douglass shall cease and desist from committing or causing any violations and any future violations of Section 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, 13b2-1, 13b2-2, and 14a-9 thereunder and Section 206(2) of the Advisers Act.

B. Respondent Douglass is censured.

C. Respondent Douglass shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$25,000 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 wire transfer, 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

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

under cover letter that identifies Respondent Douglass 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 Stephen J. Korotash, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Burnett Plaza, Suite 1900, 801 Cherry Street, Unit 18, Fort Worth, Texas 76102.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Chairman Shapiro
not participating*

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934
Release No. 63963 / February 24, 2011**

**ADMINISTRATIVE PROCEEDING
File No. 3-14272**

In the Matter of

TONY AHN,

Respondent.

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

I.

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

II.

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

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III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

These proceedings arise out of the manipulation of the prices of a number of microcap issuer stocks between September 2005 and September 2007 (the "relevant period") by Hunter World Markets, Inc. ("HWM"), Todd Ficeto ("Ficeto"), Florian Wilhelm Jurgen Homm ("Homm"), Colin Heatherington ("Heatherington"), and Ahn, in service of a larger fraud perpetrated on the investors in several now defunct hedge funds managed by Absolute Capital Management Holdings, Ltd. ("ACMH"). Homm co-founded and was the co-chief investment officer for ACMH, a London-based hedge fund management company that purported to have \$2.1 billion in assets under management as of August 31, 2007. Homm abruptly resigned from ACMH on September 18, 2007. The next day, ACMH announced that eight hedge funds it managed (the "Absolute funds") held between \$440 to \$530 million in "illiquid positions." Most of these "illiquid positions" were, in fact, U.S.-microcap stocks purchased and traded by the Absolute funds primarily through HWM.

As HWM's primary trader, Ahn, executed numerous trades that manipulated upwards the price of the microcap stocks. Ahn received the Absolute funds' trade orders from Heatherington, who received his instructions from Homm. Ahn would often communicate with Heatherington via an online instant messaging system in which they openly discussed trade orders. The instant messages also reveal Ficeto's knowledge and oversight of the scheme. Some of the methods Heatherington, Homm, Ficeto and Ahn used to accomplish the price manipulation included matched orders between the various Absolute funds, marking the close in shares of several of the microcap companies, and wash trades between accounts held in the names of the same individual funds. Many of these transactions were executed at the end of the day, and very often the end of the month, for the apparent purpose of marking the close to positively impact the Absolute funds' net asset values ("NAVs"), thereby engaging in "portfolio pumping," or materially overstating the hedge funds' performance and NAVs before the end of the month. At times, trades were back-dated to the previous month-end, also with the apparent purpose of portfolio pumping. Homm, Ficeto, and Heatherington made millions of dollars through these manipulative trades as well as transaction fees paid to HWM.

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.

Respondent

1. Ahn was a registered representative from August 2005 to May 2008 associated with HWM, a now defunct broker-dealer that had been registered with the Commission during the relevant period. Ahn was HWM's primary trader during the relevant period. Ahn, 36 years old, is a resident of Fullerton, California.

Other Relevant Individuals and Entities

2. HWM is a California corporation formerly based in Beverly Hills, California. During the relevant period, HWM conducted both a brokerage and investment banking business. HWM was registered as a broker-dealer with the Commission from March 1996 through November 30, 2009, when HWM's Form BDW, withdrawing its registration with the Commission as a broker-dealer, became effective.

3. Ficeto was the co-owner of HWM during the relevant period, during which time Ficeto was also a director of the firm as well as a registered representative, trader, branch manager and general securities principal.

4. Homm was the co-owner and a director of HWM during the relevant period. Homm was also the co-founder, the original chief investment officer and later the co-chief investment officer of ACMH.

5. Heatherington was an ACMH trader and the employee in charge of back office operations during most of the relevant period.

6. ACMH was organized under the laws of the Cayman Islands. It was quoted on the London Alternative Investment Market and was registered with the Commission as an investment adviser until September 10, 2007. During the relevant period, ACMH managed the Absolute funds, which were formerly domiciled in the Cayman Islands but have subsequently either been liquidated or are now managed by a different fund management company. ACMH has no securities registered under the Exchange Act.

Background

7. During the relevant period, HWM, Homm, Ficeto, Heatherington and Ahn manipulated upward the prices of a number of thinly-traded microcap stocks or artificially maintained their prices, including some of those which HWM helped bring public, in return for placement fees and warrants and shares of stock.

8. Generally, after the Absolute funds invested in a company through a private placement, HWM orchestrated a reverse merger to bring the companies public by merging the entity with a publicly traded shell company. Following the reverse merger, the

companies prepared a Form SB-2 registration statement to register for re-sale the shares held by HWM in its name, by Heatherington's company, and, in some cases, by the Absolute funds. Following the registration statement going effective, the Absolute funds began selling their shares, mostly through matched orders placed between their HWM accounts, in order to walk the stock price upwards or to maintain an artificially high price. Many of the matched orders also set the closing prices for the stocks. Additionally, HWM made purchases on behalf of the Absolute funds in the market to mark the close in the stock of a number of the issuers. For some of the companies' stock, nearly all of the trading volume during the relevant period resulted from trades executed through HWM. Typically, the manipulative trading began with the Absolute funds trading among each other at low prices. After the stock price had been artificially inflated, Ficeto, Homm and Heatherington would then sell their shares to the Absolute funds, reaping millions of dollars of profit as a result.

9. Homm, Ficeto, Heatherington and Ahn used a number of different manipulative techniques to artificially inflate the microcap issuers' stock price, including the use of matched orders, marking the close, wash sales and purchases at increasing prices. As HWM's primary trader, Ahn, following the instructions of Ficeto and Heatherington, executed nearly all of these manipulative trades. Ahn also communicated with the Absolute funds' point of contact, Heatherington, using an instant messaging system the text of which HWM failed to retain. The instant messages reveal multiple examples of Heatherington stating the price at which he wanted a stock to close the day, discussions regarding the best way to achieve those prices, and back-dating trades so that the trades would fall on the last day of the month, and thus be included for a particular fund's quarter-end performance. One discussion between Ahn and Heatherington concerned selecting the best day to back-date a certain trade, so as to make it less suspicious because the trade's predetermined price was significantly away from the market on the actual day it was executed.

Manipulation of the Prices of Numerous Microcap Stocks

10. The most frequent methods by which the issuers' stock prices were manipulated were through purchases of the stocks at increasing, artificial prices and numerous matched orders, mostly executed between Absolute funds' accounts held at HWM, as well as trades between the Absolute funds and accounts held in HWM's name and accounts owned or controlled by Ficeto and Heatherington.

11. An example of the price manipulation accomplished through matched orders occurred in shares of ProElite, Inc. ("ProElite"), a microcap issuer that HWM and Ficeto helped to bring public in May 2007. HWM (in its own name), Ficeto, Heatherington, and the Absolute funds owned considerable stakes in ProElite, which HWM itself, Ficeto, and Heatherington had obtained at discounted prices or as part of HWM's underwriting compensation.

12. On at least twenty-one days during the period September 2006 through September 2007, HWM marked the close in ProElite stock through matched orders either between accounts held at HWM or between accounts held at HWM and another broker, including at least three wash sales. On most of these days, there were no other reported trades in ProElite stock other than matched orders in which HWM executed both sides of the trade or matched orders in which HWM was involved as a broker on one side of the trade.

13. In January 2007, ProElite filed a Form SB-2 resale registration statement, effective May 14, 2007, for the sale of almost all of the shares held by HWM in its name, by Ficeto as custodian for his two minor children, over half of the shares held by Heatherington's company and some of the shares held by the Absolute funds.

14. On May 15, 2007, following the effective date of the Form SB-2, HWM, through Ahn, executed a series of cross trades (a) in three separate trades between different Absolute funds at \$3.25 a share, (b) among an Absolute fund and HWM and Heatherington's company at \$8.00 a share, and (c) among an Absolute fund and the custodial accounts of Ficeto's children at \$12.00 a share. Ahn, at the instruction of Ficeto and/or Heatherington, entered the cross trades within minutes of each other, all after the close of the market. There were no significant announcements by the company that day or any other reason that would explain the increase in price. Further, there were no other reported trades in ProElite stock that day other than those executed by HWM.

15. As a result of the manipulation of ProElite's stock price, HWM made significant profits. Specifically, HWM sold \$14.2 million worth of ProElite shares to the Absolute funds, as well as an additional \$2.8 million to the Hunter Fund, an investment fund managed by Ficeto whose sole investors were three of the Absolute funds. Ficeto individually and on behalf of his children sold \$2.4 million to the Absolute funds, and Heatherington sold \$8.7 million to the Absolute funds. Additionally, HWM made \$1.1 million in sales credits, which HWM considered to be the equivalent of commissions.

16. During the relevant period, HWM, Ficeto, Heatherington and Ahn manipulated the price of at least five other microcap issuers through matched orders. As a result of that manipulative activity, HWM sold nearly \$15.4 million worth of stock to the Absolute funds at artificially high prices, and made nearly \$4 million in sales credits. Ficeto individually and on behalf of his children sold an additional \$1.7 million worth of stock to the Absolute funds, and Heatherington sold \$2.9 million in stock to the Absolute funds as well.

17. HWM, Ficeto, Heatherington, and Ahn also marked the close in a number of the same microcap issuers' stock. Marking the close is the practice of executing purchase or sale orders at or near the close of the market with the intent to affect its closing price. For example, at the end of 14 of the 15 months between January 2006 and March 2007, HWM, Ficeto, Heatherington, and Ahn successfully marked the close in MicroMed

Cardiovascular. Similar marking the close trades were executed through HWM in the stock of at least five other microcap issuers on over fifty occasions.

18. Ahn, at the instruction of Ficeto and/or Heatherington, executed nearly all of the manipulative trades. Most of the matched orders and desired closing prices were placed by Heatherington, either by telephone or through e-mail and instant messages, including through HWM's archived e-mail system, as well as an alternate instant messaging system that HWM or Ficeto purposely did not retain. While Ahn did not properly retain either the originals or copies of all of the instant messages, he did retain copies of a number of them in his personal files.

19. HWM, Ficeto, Heatherington and Ahn also executed a number of trades between two accounts held by the same fund, thus effecting at least four wash sales. As with the other matched orders, the apparent purpose of those transactions was to manipulate the price of the issuers' stock and/or to generate massive sales credits to HWM. Specifically, on June 18, 2007, the Absolute East West Fund Limited sold 500,001 shares of ProElite from one of its HWM accounts to another. On June 26, 2007, the Absolute Activist Value Fund sold 250,000 shares of ProElite from one of its HWM accounts to another. On September 13, 2007, the Absolute Octane Fund Limited sold 4.5 million shares of Quest Group to another of its HWM accounts, and sold 2.5 million shares of ProElite to another of its HWM accounts. As a result of these trades, the firm made \$615,000 in sales credits. Two of the wash sales in ProElite constituted all of the trades on those days, and therefore effectively set the stock's price. Similarly, the wash trade in Quest Group stock artificially inflated its stock price as well.

20. HWM, Ficeto, Heatherington and Ahn also back-dated a number of trades. As detailed in certain instant messages, Heatherington asked Ahn to revise the trade date of certain transactions to reflect a date that was prior to month's end. For example, on September 4, 2007, Heatherington asked Ahn if a matched trade for 400,000 shares of ProElite traded among three of the ACMH funds could be back-dated to the previous Friday, the last trading day of the month. Ahn responded that he would need to call Ficeto to obtain approval. Ficeto approved the trade which was entered with an "as of" date of August 31, 2007.

21. In a July 30, 2007 instant message exchange between Heatherington and Ahn, Heatherington proposed a matched trade at such a high price for the day that Ahn responded that it would "be a red flag to print [*i.e.*, be reported] a lot above the high of the day." Apparently to avoid raising the red flag triggered by Heatherington's proposed price, Ahn suggested back-dating the trade to the prior week, but noted that he would need to obtain Ficeto's approval before so doing. With Ficeto's approval, Ahn entered the trade as of July 23, 2007, when the stock was trading closer to Heatherington's initial proposed price.

Ahn Aided and Abetted HWM's Failure to Preserve Instant Messaging Transcripts

22. HWM is required to maintain originals or copies of all communications that relate to its business, including instant-messaging transcripts, for a period of three years. As detailed above, HWM failed to maintain originals or copies of the instant messages sent via the alternate instant message system. By knowingly failing to maintain originals or copies of the instant messages in accordance with the requirements of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4), Ahn willfully aided and abetted and caused HWM's failure to maintain a record of those instant messages.

Violations

23. As a result of the conduct described above, Ahn willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

24. As a result of the conduct described above, Ahn willfully aided and abetted and caused HWM's violations of Section 15(c)(1) of the Exchange Act, which prohibits brokers and dealers from using manipulative, deceptive, or other fraudulent devices or contrivances in connection with securities transactions.

25. As a result of the conduct described above, Ahn willfully aided and abetted and caused HWM's violations of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder, which requires brokers and dealers to retain originals of all communications received and copies of all communications sent relating to its business as such.

Undertakings

Respondent undertakes to:

26. In connection with this public administrative proceeding and any related judicial or administrative proceedings or investigation commenced by the Commission or to which the Commission is a party, Ahn: (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) with respect to such notices and subpoenas, waive the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (iv) consent to personal jurisdiction over him in any United States District Court or administrative court for the purposes of enforcing any such subpoena.

In determining whether to accept Ahn's Offer, the Commission has considered Ahn's undertaking to cooperate as enumerated in Section III.26 above.

IV.

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

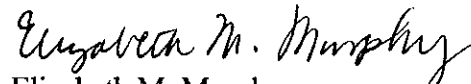
Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent Ahn cease and desist from committing or causing any violations and any future violations of Sections 10(b), 15(c)(1) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-4(b)(4) thereunder.
- B. Respondent Ahn be, and hereby is barred from association with any broker and dealer with the right to reapply for association after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.
- C. 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.
- D. Respondent shall pay a civil money penalty in the amount of Forty Thousand Dollars (\$40,000) to the United States Treasury. Payment shall be made in the following four installments: (a) Ten Thousand Dollars (\$10,000) to be paid within twenty-one days of the entry of this Order; (b) Ten Thousand Dollars (\$10,000) to be paid within six (6) months of the entry of this Order; (c) Ten Thousand Dollars (\$10,000) to be paid within nine (9) months of the entry of this Order; and (d) a final payment of Ten Thousand Dollars (\$10,000) to be paid within one year of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments shall be: (A) made by wire transfer, 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 Tony Ahn 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 Michele Layne, Associate Regional Director, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

E. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of Forty Thousand Dollars (\$40,000) based upon his agreement to cooperate in a Commission investigation and/or related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may not, by way of defense to any resulting administrative proceeding: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
Securities and Exchange Commission

Securities Exchange Act of 1934
Release No. 63954 / February 24, 2011

File No. SR-ISE-2009-35

In the Matter of)
Chicago Board Options)
Exchange, Incorporated)
400 South LaSalle Street)
Chicago, IL 60605)
_____)

**Order Setting Aside the Order
by Delegated Authority Approving
SR-ISE-2009-35 and Dismissing CBOE's
Petition for Review**

On June 15, 2009, the International Securities Exchange, LLC ("ISE") filed a proposed rule change with the Commission seeking to establish a Qualified Contingent Cross ("QCC") Order. The proposed rule change was published for comment on June 26, 2009.¹ On August 28, 2009, the Commission approved, by authority delegated to the Division of Trading and Markets, the proposed rule change ("Approval Order").² On September 4, 2009, the Chicago Board Options Exchange ("CBOE") filed a notice of intention to file a petition for review of the Approval Order and, on September 14, 2009, CBOE filed a petition for review with the Commission ("Petition for Review"). Under the Commission's Rules of Practice, the filing of CBOE's Petition for Review automatically stayed the Approval Order.³ On September 11, 2009, ISE filed a motion to lift the automatic stay. On November 12, 2009, the Commission granted CBOE's Petition for Review and denied a motion filed by ISE to lift the automatic stay.⁴

On March 17, 2010, the Commission approved the placement in the public file of a memorandum by its Division of Risk, Strategy, and Financial Innovation ("RiskFin") analyzing certain data relating to ISE's proposed rule change ("RiskFin Memo"). At the same time that the Commission approved placement of the RiskFin Memo in the public file, the Commission also issued an order extending the time to file statements in support of or in opposition to the

¹ See Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009).

² See Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009).

³ 17 C.F.R. § 201.431(e).

⁴ See Securities Exchange Act Release Nos. 60988 and 60989.

Approval Order to give the public an opportunity to review the data and analysis in the RiskFin Memo.⁵

On July 14, 2010, ISE filed a new proposed rule change to modify the requirements for QCC Orders (file number SR-ISE-2010-73). The Commission published for public comment the modified proposal.⁶ Also on July 14, 2010, ISE submitted a letter requesting that the Commission vacate the Approval Order concurrently with the approval of the new proposed rule, SR-ISE-2010-73.⁷

We have determined to construe ISE's request as a petition to vacate the Approval Order pursuant to Commission Rule of Practice 431(a), which permits us to "affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, any action made pursuant to" delegated authority.⁸ We find that, in light of the filing of ISE's modified proposal regarding the QCC Orders,⁹ it is appropriate to grant ISE's request and set aside the Approval Order. We also find that, given this disposition of the Approval Order, CBOE's petition for review of that order has become moot.

Accordingly, IT IS ORDERED that the August 28, 2009 order approving by delegated authority ISE's proposed rule change number SR-ISE-2009-35, be, and it hereby is, set aside; and

It is further ORDERED that the petition for review, filed by the Chicago Board Options Exchange on September 14, 2009, of the August 28, 2009 order approving by delegated authority ISE's proposed rule change number SR-ISE-2009-35 be, and it hereby is, DISMISSED.

By the Commission.



Elizabeth M. Murphy
Secretary

⁵ See Securities Exchange Act Release No. 61722.

⁶ See Securities Exchange Act Release No. 62523 (July 16, 2010), 75 FR 43211 (July 23, 2010).

⁷ See letter from Michael J. Simon, Secretary and General Counsel, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated July 14, 2010.

⁸ 17 C.F.R. § 201.431(a).

⁹ The Commission has this day issued a separate order approving SR-ISE-2010-73.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63955; File No. SR-ISE-2010-73)

February 24, 2011

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Granting Approval of a Proposed Rule Change to Modify Qualified Contingent Cross Order Rules

I. Introduction

On July 14, 2010, the International Securities Exchange, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to modify rules for Qualified Contingent Cross (“QCC”) Orders. The proposed rule change was published for comment in the Federal Register on July 23, 2010.³ The Commission received eight comment letters on the proposed rule change⁴ and a response letter from ISE.⁵

This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 62523 (July 16, 2010), 75 FR 43211 (“Notice”).

⁴ See Letters from Anthony J. Saliba, Chief Executive Officer, LiquidPoint, LLC, to Elizabeth M. Murphy, Secretary, Commission dated, July 30, 2010 (“LiquidPoint Letter 2”); William J. Brodsky, Chairman and Chief Executive Officer, Chicago Board Options Exchange, Incorporated (“CBOE”), to Elizabeth M. Murphy, Secretary, Commission, dated August 9, 2010 (“CBOE Letter 1”); Ben Londergan and John Gilmartin, Co-Chief Executive Officers, Group One Trading, LP, to Elizabeth M. Murphy, Secretary, Commission, dated August 9, 2010 (“Group One Letter 2”); Janet M. Kissane, Senior Vice President – Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated August 9, 2010 (“NYSE Letter 2”); Thomas Wittman, President, NASDAQ OMX PHLX, Inc. (“Phlx”), to Elizabeth M. Murphy, Secretary, Commission, dated August 13, 2010 (“Phlx Letter 2”); J. Micah Glick, Chief Compliance Officer, Cutler Group LP to Elizabeth M. Murphy, Secretary, Commission, dated September 3, 2010 (“Cutler Letter”); Janet L. McGinness, Senior Vice President – Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated October 21, 2010 (“NYSE Letter 3”); and Gerald D. O’Connell,

II. Background

A. Regulation NMS and Qualified Contingent Trades

The Commission adopted Regulation NMS in June 2005.⁶ Among other things, Regulation NMS addressed intermarket trade-throughs of quotations in NMS stocks.⁷ In 2006, pursuant to Rule 611(d) of Regulation NMS,⁸ the Commission provided an exemption⁹ for each NMS stock component of certain qualified contingent trades (as defined below) from Rule 611(a) of Regulation NMS for any trade-throughs caused by the execution of an order involving one or more NMS stocks (each an “Exempted NMS Stock Transaction”) that are components of a qualified contingent trade.

The Original QCT Exemption defined a “qualified contingent trade” to be a transaction consisting of two or more component orders, executed as agent or principal, where: (1) at least one component is in an NMS stock; (2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the

Chief Compliance Officer, Susquehanna International Group, LLP, to Elizabeth M. Murphy, Secretary, Commission, dated October 22, 2010 (“Susquehanna Letter 2”).

⁵ See Letter from Michael J. Simon, Secretary and General Counsel, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated, August 25, 2010 (“ISE Response”).

⁶ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

⁷ See 17 CFR 242.611. An “NMS stock” means any security or class of securities, other than an option, for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan. See 17 CFR 242.600(b)(46) and (47).

⁸ 17 CFR 242.611(d). See also 15 U.S.C. 78mm(a)(1) (providing general authority for the Commission to grant exemptions from provisions of the Act and the rules thereunder).

⁹ See Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) (“Original QCT Exemption”). The Securities Industry Association (“SIA,” n/k/a Securities Industry and Financial Markets Association) requested the exemption. See Letter to Nancy M. Morris, Secretary, Commission, from Andrew Madoff, SIA Trading Committee, SIA, dated June 21, 2006.

execution of all other components at or near the same time; (4) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since cancelled;¹⁰ (6) the Exempted NMS Stock Transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade;¹¹ and (7) the Exempted NMS Stock Transaction that is part of a contingent trade involves at least 10,000 shares or has a market value of at least \$200,000.¹²

In 2008, in response to a request from the CBOE, the Commission modified the Original QCT Exemption to remove the “block size” requirement of the exemption (i.e., that the Exempted NMS Stock Transaction be part of a contingent trade involving at least 10,000 shares or having a market value of at least \$200,000).¹³

¹⁰ Transactions involving securities of participants in mergers or with intentions to merge that have been announced would meet this aspect of the requested exemption. Transactions involving cancelled mergers, however, would constitute qualified contingent trades only to the extent they involve the unwinding of a pre-existing position in the merger participants’ shares. Statistical arbitrage transactions, absent some other derivative or merger arbitrage relationship between component orders, would not satisfy this element of the definition of a qualified contingent trade. See Original QCT Exemption, *supra*, note 9.

¹¹ A trading center may demonstrate that an Exempted NMS Stock Transaction is fully hedged under the circumstances based on the use of reasonable risk-valuation methodologies. *Id.*

¹² See 17 CFR 242.600(b)(9) (defining “block size” with respect to an order as at least 10,000 shares or \$200,000 in market value).

¹³ See Securities Exchange Act Release No. 57620 (April 4, 2008) 73 FR 19271 (April 9, 2008) (“CBOE QCT Exemption”). The current QCT Exemption (i.e., as modified by the CBOE QCT Exemption) is referred to herein as the “NMS QCT Exemption.”

B. Background of ISE's Proposal

In August 2009, the Commission approved the Order Protection and Locked/Crossed Market Plan¹⁴ which, among other things, required the options exchanges to adopt written policies and procedures reasonably designed to prevent trade-throughs.¹⁵ Unlike its predecessor plan,¹⁶ the New Linkage Plan does not include a trade-through exemption for "Block Trades," defined to be trades of 500 or more contracts with a premium value of at least \$150,000.¹⁷ However, because the New Linkage Plan does not provide a Block Trade exemption, the Exchange was concerned that the loss of the Block Trade exemption would adversely affect the ability of its members to effect large trades that are tied to stock. Accordingly, the Exchange proposed the Original QCC Order (defined below) as a limited substitute for the Block Trade exemption to facilitate the execution of large stock/option combination orders, to be implemented contemporaneously with the New Linkage Rules.

C. SR-ISE-2009-35

1. ISE's Original Qualified Contingent Cross Order Proposal

¹⁴ See Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (File No. 4-546) ("New Linkage Plan"). ISE also proposed revisions to its rules to implement the New Linkage Plan ("New Linkage Rules"). See Securities Exchange Act Release No. 60559 (August 21, 2009), 74 FR 44425 (August 28, 2009) (SR-ISE-2009-27).

¹⁵ A trade-through is a transaction in a given option series at a price that is inferior to the best price available in the market.

¹⁶ The former options linkage plan, the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Former Linkage Plan"), was approved by the Commission in 2000 and was operative until August 31, 2009, when the New Linkage Plan took effect. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (File No. 4-429).

¹⁷ See Sections 2(3) and 8(c)(i)(C) of the Former Linkage Plan and old ISE Rule 1902(d)(2).

In SR-ISE-2009-35,¹⁸ ISE proposed a new order type, the QCC Order. The QCC Order as proposed in SR-ISE-2009-35 (“Original QCC Order”) permitted an ISE member to cross the options leg of a Qualified Contingent Trade (“QCT”) (as defined below) on ISE immediately upon entry, without exposure, if the order: (i) was for at least 500 contracts; (ii) met the six requirements of the NMS QCT Exemption; and (iii) was executed at a price at or between the national best bid or offer (“NBBO”). Proposed Supplementary Material .01 to ISE Rule 715 defined a QCT as a transaction composed of two or more orders, executed as agent or principal, where: (i) at least one component is in an NMS stock; (ii) all components are effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent; (iii) the execution of one component is contingent upon the execution of all other components at or near the same time; (iv) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined by the time the contingent order is placed; (v) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and (vi) the transaction is fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade.¹⁹

On August 28, 2009, the Commission approved, by authority delegated to the Division of Trading and Markets, ISE’s Original QCC Order proposal.²⁰ On September 4, 2009, CBOE filed

¹⁸ See Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009) (SR-ISE-2009-35 Notice).

¹⁹ The six requirements are substantively identical to the six elements of a QCT under the NMS QCT Exemption. See *supra* notes 9 and 13.

²⁰ See Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009) (“Original Approval Order”).

with the Commission a notice of intention to file a petition for review of the Commission's approval by delegated authority²¹ and, on September 14, 2009, CBOE filed a petition for review, which automatically stayed the delegated approval of the Original QCC Order.²² On September 11, 2009, ISE filed a motion to lift the automatic stay.²³ On September 17, 2009, CBOE filed a response to ISE's Motion.²⁴ On September 22, 2009, ISE filed a reply in support of its motion to lift the automatic stay.²⁵ In addition to the submissions from CBOE and ISE, the Commission received eight comment letters requesting that the Commission grant CBOE's Petition for Review.²⁶

²¹ See Letter from Paul E. Dengel, Counsel for CBOE, Schiff Hardin LLP, to Elizabeth M. Murphy, Secretary, Commission, dated September 4, 2009.

²² See Letter from Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated September 14, 2009 ("Petition for Review").

²³ See Brief in Support of ISE's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by CBOE's Notice of Intention to Petition for Review, dated September 11, 2009 ("ISE's Motion").

²⁴ See Response of CBOE to Motion of ISE to Lift Automatic Stay, dated September 17, 2009 ("Response to Motion").

²⁵ See Reply in Support of ISE's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by CBOE's Notice of Intention to Petition for Review, dated September 22, 2009 ("ISE Reply").

²⁶ See Letters from Jeffrey S. Davis, Vice President and Deputy General Counsel, NASDAQ OMX PHLX, Inc., to Elizabeth M. Murphy, Secretary, Commission, dated September 22, 2009 ("Phlx Letter"); Gerald D. O'Connell, Chief Compliance Officer, Susquehanna International Group, LLP, to Elizabeth M. Murphy, Secretary, Commission, dated September 30, 2009 ("Susquehanna Letter"); Megan A. Flaherty, Chief Legal Counsel, Wolverine Trading, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated October 2, 2009 ("Wolverine Letter"); Janet M. Kissane, Senior Vice President-Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated October 5, 2009 ("NYSE Letter"); Ben Londergan, Co-CEO, Group One Trading, L.P., to Elizabeth M. Murphy, Secretary, Commission, dated October 5, 2009 ("Group One Letter"); Anthony J. Saliba, Chief Executive Officer, LiquidPoint, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated October 7, 2009 ("LiquidPoint Letter"); Kimberly Unger, Executive Director, The Security Traders Association of New York, Inc., to Elizabeth M. Murphy, Secretary, Commission, dated

On November 12, 2009, the Commission granted CBOE's Petition for Review and denied ISE's motion to lift the automatic stay.²⁷ In connection with the Order Granting Petition, the Commission received three statements in support of the Original Approval Order (two of which were submitted by ISE)²⁸ and five statements in opposition to the Original Approval Order (two of which were submitted by CBOE).²⁹

2. Commenter's to ISE's Original OCC Order Proposal

October 29, 2009 ("STA Letter"); and Peter Schwarz, Integral Derivatives, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated November 25, 2009 ("Integral Derivatives Letter"). In addition, ISE submitted certain market volume and share statistics. See E-mail from Michael J. Simon, ISE, to Elizabeth King, Associate Director, Division of Trading and Markets, Commission, dated September 30, 2009.

²⁷ See Commission Order Granting Petition for Review and Scheduling Filing of Statements, dated November 12, 2009 and Commission Order Denying ISE's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegate Action Triggered by CBOE's Notice of Intention to Petition for Review, dated November 12, 2009 ("Order Granting Petition").

²⁸ See Letters from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated December 3, 2009 ("ISE Statement 1"); from Leonard Ellis, Head of Capital Markets, Capstone Global Markets, LLC, to Elizabeth Murphy, Secretary, Commission, dated December 3, 2009 ("Capstone Statement"); and Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated December 16, 2009 ("ISE Statement 2").

²⁹ See Letters from Joanne Moffic-Silver, Executive Vice President, General Counsel & Corporate Secretary, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated December 3, 2009 ("CBOE Statement 1"); Michael Goodwin, Senior Managing Member, Bluefin Trading, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated December 2, 2009 ("Bluefin Statement"); John C. Nagel, Managing Director and Deputy General Counsel, Citadel, to Elizabeth M. Murphy, Commission, dated December 3, 2009 ("Citadel Statement"); Janet M. Kissane, Senior Vice President-Legal & Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated December 3, 2009 ("NYSE Statement 1"); and Angelo Evangelou, Assistant General Counsel, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated January 20, 2010 ("CBOE Statement 2"). The Commission also received a statement from ISE responding to the CBOE Statement 2 regarding its statistical claim and number of trade-throughs. See Letter from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated March 1, 2010.

In its Petition for Review and statements in support thereof, CBOE argued that ISE's Original QCC Order proposal was inconsistent with the Act³⁰ and raised important policy concerns that the Commission should address, including whether crossing straight or complex option orders without exposure is appropriate and whether permitting a "clean" cross in front of public customer orders is appropriate. CBOE believed that ISE's proposal was inconsistent with the Act because "it effectively establishes ISE as a print facility for large options orders rather than an exchange where orders are able to interact in an auction setting."³¹ CBOE and certain commenters objected to the Original QCC Order proposal because, for crosses that satisfy the QCC's requirements, a member of ISE could execute a clean cross without exposing the cross to other ISE participants, which CBOE stated would represent a significant change from historical and current market practices in the options markets.³² CBOE contended that the Commission's policy and practice had been to limit the percentage of the crossing entitlement to an amount below 50% of the order being executed, and then only after ensuring that all crossing entitlements are exposed and yield to public customer orders.³³ CBOE stated that the policies requiring exposure and yielding to public customer interest balance "the desire to permit internalization/solicitations to some degree while at the same time ensuring competition and

³⁰ See e.g., Petition for Review, supra note 22, at 11. See also CBOE Statement 1, supra note 29, at 5-6, 15-16.

³¹ See Petition for Review, supra note 22, at 13. See also Bluefin Statement, supra note 29; Citadel Statement, supra note 29, at 2; and LiquidPoint Letter, supra note 26, at 4. See also Wolverine Letter, supra note 26 and CBOE Statement 1, supra note 29, at 8.

³² See Petition for Review, supra note 22, at 5, 9, 13-15. See also Bluefin Statement, supra note 29; Citadel Statement, supra note 29, at 2; NYSE Statement 1, supra note 29, at 2; Wolverine Letter, supra note 26; and LiquidPoint Letter, supra note 26, at 2.

³³ See Petition for Review, supra note 22, at 5, 17. CBOE also noted ISE's investment in an entity that CBOE asserted is "geared towards the non-transparent execution of block size stock-option transactions," which CBOE contended would benefit from the ISE's proposal. Id. at 11. See also CBOE Statement 1, supra note 29, at 13-14.

price discovery and, to some degree, protecting public customers (including retail investors).³⁴

Without an exposure requirement, CBOE contended that the proposal would have a major adverse impact on options market structure, and result in a trading environment that is “sluggish, nontransparent, and noncompetitive.”³⁵

CBOE and many of the commenters to the Original QCC Order proposal believed that the lack of any exposure requirement in ISE’s Original QCC Order would have a detrimental effect on the options market as it would provide a disincentive to ISE’s market makers to quote competitively, undercut their market making function and could result in market makers migrating off other exchanges that do not offer a QCC Order type to ISE, to take advantage of potentially wider spreads and where greater margins might be available with less competitive quoting.³⁶ One commenter stated that the Original QCC Order, by preventing market makers from participating in trades occurring at their quoted prices, would cause market makers to spread their quotes wider to increase their profit margins in compensation for the lower volume of trading in which they participate.³⁷ This commenter further stated that, eventually, such market makers might very well question the wisdom of committing capital to make firm markets in the thousands of options series in which they have continuous quoting obligations.³⁸ Another commenter noted that, ultimately, this would “increase the costs and decrease the availability of

³⁴ See Petition for Review, supra note 22, at 15.

³⁵ Id. at 10, 14. CBOE and some commenters also noted their belief that the lack of exposure also degrades market transparency, which they believe is related to the Commission’s concerns relating to dark pools. Id. at 16. See also, e.g., NYSE Statement 1, supra note 29, at 1, 4.

³⁶ See CBOE Statement 1, supra note 29, at 8; NYSE Statement 1, supra note 29 at 2, 3; and LiquidPoint Letter, supra note 26, at 3, 5. See also Petition for Review, supra note 22, at 13.

³⁷ See NYSE Statement 1, supra note 29 at 3.

³⁸ Id.

proven, effective risk management through derivatives” and harm options market participants, as their ability “to execute their myriad strategies would disappear.”³⁹ Thus, some commenters believed that permitting the implementation of the QCC Order would harm the growth prospects of the overall options industry.⁴⁰

However, ISE argued that the QCC Order type would not impact the options markets, and that large-size contingency orders are executed on floor-based exchanges in a manner very similar to the new order type proposed by ISE. In addition, ISE noted that there is no meaningful transparency on floors because there is no requirement that information on orders presented to the floor be announced electronically to all exchange members or the public.⁴¹ ISE also noted that some floor-based options exchanges have eliminated the requirement that market makers have a physical presence on the floor, which it believes undermines the claim that price discovery and transparency occur on the trading floor.⁴² One commenter to the Original QCC Order proposal agreed and stated that the exposure-related concerns of other commenters “do not adequately recognize the reality of how this business is conducted today and seem to simply endorse a manual trading environment that prevents competition from electronic exchanges.”⁴³

In addition to CBOE’s opposition to the Original QCC Order because of its lack of an exposure requirement, CBOE also argued that public customers that have previously placed limit orders at the execution price of a QCC Order would be harmed because those customers would

³⁹ See LiquidPoint Letter, supra note 26, at 3, 5.

⁴⁰ See NYSE Statement 1, supra note 29, at 2 and LiquidPoint Letter, supra note 26, at 3-5. See also CBOE Statement 1, supra note 29, at 8.

⁴¹ See ISE Statement 1, supra note 28, at 2, 6.

⁴² Id.

⁴³ See Capstone Statement, supra note 28, at 2.

lose priority and would not receive executions of their resting orders.⁴⁴ CBOE expressed concern that, because certain customer orders would not receive priority, the proposal would create a disincentive to placing limit orders.⁴⁵ CBOE maintained that, with respect to intra-market priority in the exchange-listed options markets, the long-standing industry policy and practice has been to require public customer priority for simple option orders.⁴⁶ Two commenters also expressed concern that the Original QCC Order would cause public customers with existing orders to be disadvantaged in the executions that they receive and would be a direct disincentive to market makers and would likely encourage wider quoted markets.⁴⁷

ISE disagreed with the commenters' claims that public customers with resting limit orders would be harmed by its QCC proposal. ISE stated that large-size contingency trades that would qualify as QCC Orders are currently almost exclusively executed on floor-based exchanges, thus "the occasional customer limit order resting on ISE's book...has no opportunity to interact with [such orders]."⁴⁸

In addition, CBOE stated that no execution entitlements have been permitted thus far, unless there is first yielding to public customer interest.⁴⁹ CBOE contrasted the Original QCC Order with the rules of all options exchanges relating to net-priced complex orders, which require that each options leg(s) of the complex order trade at or inside the NBBO and, at a minimum, price improve public customer orders in at least one component options leg.⁵⁰ CBOE

⁴⁴ See Response to Motion, supra note 24, at 4.

⁴⁵ See Petition for Review, supra note 22, at 13.

⁴⁶ Id. at 17. See also CBOE Statement 1, supra note 29, at 5, 9.

⁴⁷ See Bluefin Statement, supra note 29 and NYSE Statement 1, supra note 29 at 2.

⁴⁸ See ISE Statement 1, supra note 28, at 2, 5.

⁴⁹ See Petition for Review, supra note 22, at 15.

⁵⁰ Id. at 18.

also noted that, in a stock-option order net-priced package, it has been the Commission policy to require that the option leg of the stock-option order either yield to the same priced public customer order represented in the individual options series or trade at a better price.⁵¹ CBOE argued that the Original QCC Order, in contrast, would be given special priority that goes beyond the priority afforded to packaged stock-option orders by permitting it to be crossed without giving priority to public customers.⁵²

In response, ISE noted that there are many examples of exception to rules to accommodate specific trading strategies.⁵³ ISE further argued that there is no basis under the Act to prevent exchanges from adopting market structures and priority rules that are tailored for large-size contingent orders and that customer priority is not required in all circumstances.⁵⁴

Commenters to the Original QCC Order also questioned whether the customer involved in the QCC Order would be able to receive the best price for its order because, without a requirement for the order to be exposed, the submitting member's customer would not have the opportunity to receive price improvement for the options leg of the order.⁵⁵ Specifically, CBOE expressed concern that, because the QCC Order would eliminate the requirement of market exposure, the customer whose order is submitted through the QCC Order mechanism might

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Id.

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Id. at 19.

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See ISE Statement 1, supra note 28, at 2, 5. For example, ISE pointed to the existing rules of the options exchanges that permit the execution of one leg of a complex trade at the same price as a public customer order on the limit order book if another leg of the order is executed at an improved price. See CBOE Rule 6.45A.

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Id.

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See CBOE Statement 1, supra note 29, at 7-8 and Petition for Review, supra note 22, at 13. See also Bluefin Statement, supra note 29; Group One Letter, supra note 26, at 1-2; and Integral Derivatives Letter, supra note 26.

receive a fill at a price that is inferior to the price the customer would have received if the full package or even the options component had been represented to the market.⁵⁶

ISE responded to these concerns by explaining that, when negotiating a stock-option order, market participants agree to a "net price," i.e., a price that reflects the total price of both the options and stock legs of the transaction which are executed separately in the options and equity markets.⁵⁷ Accordingly, ISE believed that, for such trades, the actual execution price of each component is not as material to the parties to the trade as is the net price of the transaction.⁵⁸

3. RiskFin Analysis of Large-Size Contingency Orders

In support of the Original QCC Order, ISE stated that its proposed QCC Order provided an all-electronic alternative to the open-outcry execution of large stock-option trades on floor-based exchanges. While both all-electronic exchanges and floor-based exchanges have rules that require exposure of an order before a member is permitted to trade with such order, ISE believes that the requirement under ISE's rules is significantly more onerous than the similar requirement of floor-based exchanges, where such exchanges are only required to expose such orders to their members on the floor and not electronically to all members. Accordingly, ISE asserted, among other things, that it needed the QCC Order to remain competitive with other exchanges, particularly floor-based exchanges, because although these orders are exposed on the floor-based exchanges, they are rarely broken up.⁵⁹

⁵⁶ See CBOE Statement 1, supra note 29, at 7.

⁵⁷ See ISE Statement 1, supra note 28, at 2, 6.

⁵⁸ See id.

⁵⁹ See ISE Reply, supra note 25, at 5.

In order to examine ISE's contention with respect to activity on floor-based exchanges regarding large-sized contingent trades, in October 2009, the Commission's Division of Risk, Strategy and Financial Innovation ("RiskFin") requested Consolidated Options Audit Trail System ("COATS") data from certain options exchanges for each Tuesday in August and September of 2009. On March 17, 2010, RiskFin placed in the public file a memorandum analyzing the COATS data, in which it presented the findings of its analysis of ISE's contention that large-size contingency orders on floor-based exchanges were never or nearly never broken up.⁶⁰ The RiskFin Analysis provided some support for ISE's contention that large orders are broken up less frequently on floor-based exchanges than on an electronic exchange, though it did not definitively confirm ISE's contention. Specifically, in examining the percentage of trades that are either fully or near-fully executed against a single contra-party, the RiskFin Analysis showed that, for trades with a size of 2,000 contracts or more, only 12% were completely executed with only one execution on ISE, compared to 26% and 29% of trades that were filled with only one execution on two floor-based exchanges. Similarly, the data also showed that for orders of 2,000 contracts or more, only 16% of orders on ISE were 90% filled against a single contra-party, while the comparable figures for two floor-based exchanges were 35% and 37%.

While the RiskFin Analysis provided the percentage of orders on each exchange that were filled in a single execution versus multiple executions, the COATS data used for the analysis was not limited to facilitation orders.⁶¹ Thus, the RiskFin Analysis was not dispositive

⁶⁰ See Memorandum Regarding ISE Qualified Contingent Cross Proposal from Division of Risk, Strategy and Financial Innovation, dated March 1, 2010 ("RiskFin Analysis") (available at <http://www.sec.gov/rules/other/2010/sr-ise-2009-35/riskfinmemo030110.pdf>). The RiskFin Analysis reviewed COATS data from ISE, CBOE and Phlx.

⁶¹ For example, ISE notes that the inclusion of index options trading in the data distorts the extent to which there is "break-up" of large crosses on the floor-based exchanges and

with respect to ISE's contention because it contained orders unrelated to ISE's proposed order type. Concurrently with the placement of the RiskFin Analysis in the public file, the Commission issued an order extending the time to file a statement in support of or in opposition to the Original Approval Order.⁶² Subsequently, the Commission received three statements relating to the RiskFin Analysis.⁶³

Both CBOE and ISE focused on the RiskFin Analysis and noted that the "analysis did not confirm ISE's contention that large orders are broken-up less frequently on floor-based exchanges, though certain data did provide support for ISE's position." Although CBOE believed that the conclusion was favorable to its opposing position on ISE's QCC Order type, it clarified that it did not believe the study was necessary and that the policy question of exposure and whether it would benefit investors or not was the critical concern.⁶⁴

Alternatively, ISE believed that the RiskFin Analysis conclusion strongly supported ISE's position that the QCC Order type is an appropriate and necessary competitive tool for the ISE.⁶⁵ In support of its belief, ISE noted that the most critical statistic in determining whether exchange members can affect a trade without being broken up is to look at how often large trades are executed in a single execution. ISE points to the RiskFin Analysis data that demonstrates

believes that excluding index options from the RiskFin Analysis would significantly increase the number of floor-based exchanges' large orders that were executed without break-up. See ISE Statement 3, infra note 63, at 2-3.

⁶² See Commission Order Extending Time to File Statements, dated March 17, 2010.

⁶³ See Letters from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated April 7, 2010 ("CBOE Statement 3"); Pia K. Bennett, Associate Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated April 7, 2010 ("NYSE Statement 2"); and Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated April 7, 2010 ("ISE Statement 3").

⁶⁴ See CBOE Statement 3, supra note 63, at 1 and 4.

⁶⁵ See ISE Statement 3, supra note 63, at 2.

that for the largest trades (2,000 or more contracts) only 12% of such trades were executed without a break-up on the ISE, while the percentages for the two floor-based exchanges were more than twice as high.⁶⁶

Another commenter reiterated its concern that the proposed QCC Order type creates a disincentive to competitively quote by limiting price discovery opportunities and dampens transparency in the options markets.⁶⁷ In response to the RiskFin Analysis data, the commenter stated that the crossing of two orders on or within the best bid or offer of the options markets, with no interference from other participants despite exposure to the market, indicated that the cross was fairly priced as part of the off-exchange negotiation and that without exposure, there is no such comfort that the best possible price was obtained.⁶⁸

4. Request to Vacate SR-ISE-2009-35 Original Approval Order

On July 14, 2010, concurrently with the filing of the current proposal to modify the rules for QCC Orders (i.e., SR-ISE-2010-73), the Commission received a letter from ISE requesting the Commission to vacate the Original Approval Order concurrently with an approval of SR-ISE-2010-73.⁶⁹ Specifically, the Vacate Letter stated that ISE submitted its current proposal to address the most significant issues that commenters raised regarding the Original QCC Order.

D. Description of Current Proposal to Modify QCC Order Rules

As noted above, among their objections to ISE's Original QCC Order, CBOE and some commenters argued that public customers with limit orders resting on ISE's book at the execution price of a QCC Order would be harmed because the QCC Order would execute ahead

⁶⁶ Id. at 2.

⁶⁷ See NYSE Statement 2, supra note 63, at 1.

⁶⁸ Id. at 3.

⁶⁹ See Letter from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated July 14, 2010 ("Vacate Letter").

of their resting orders and that, because certain customer orders would not receive priority, the proposal would create a disincentive to placing limit orders.⁷⁰ CBOE and some commenters also questioned whether the customer involved in the QCC Order would be able to receive the best price for its order because, without a requirement for the order to be exposed, the submitting member's customer would not have the opportunity to receive price improvement for the options leg of the order.⁷¹

Though ISE believes that there is nothing novel about granting or not granting customer priority, that the Commission had approved exchange rules that do not provide customer priority, and that there is no statutory requirement that customer orders receive priority,⁷² in SR-ISE-2010-73 the Exchange proposes to modify the Original QCC Order rules to require that a QCC Order be automatically cancelled if there are any Priority Customer⁷³ orders on the Exchange's limit order book at the same price. This modification thus prohibits QCC Orders from trading ahead of Priority Customer orders. In addition, in SR-ISE-2010-73, ISE proposes to increase the minimum size requirement for a QCC Order from 500 contracts to 1,000 contracts. ISE

⁷⁰ See, e.g., Petition for Review, supra note 22, at 13, 15, 17. See also Bluefin Statement, supra note 29; Phlx Letter, supra note 26; Wolverine Letter, supra note 26; Group One Letter, supra note 26, at 1; and Integral Derivatives Letter, supra note 26.

⁷¹ See, e.g., CBOE Statement 1, supra note 29, at 7-8 and Petition for Review, supra note 22, at 13. See also Bluefin Statement, supra note 29; Group One Letter, supra note 26, at 1-2; and Integral Derivatives Letter, supra note 26.

⁷² See ISE Statement 1, supra note 28, at 4. See also Capstone Statement, supra note 28, at 2.

⁷³ Under ISE Rule 100(37A), a priority customer is a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Pursuant to ISE Rule 713, priority customer orders are executed before other trading interest at the same price.

contends that such an increase supports the Exchange's intention to permit the crossing of only large-sized institutional stock-option orders.⁷⁴

Thus, as modified, an ISE member effecting a trade pursuant to the NMS QCT Exemption could cross the options leg of the trade on ISE as a QCC Order immediately upon entry, without exposure, only if there are no Priority Customer orders on the Exchange's limit order book at the same price and if the order: (i) is for at least 1,000 contracts; (ii) meets the six requirements of the NMS QCT Exemption;⁷⁵ and (iii) is executed at a price at or between the NBBO ("Modified QCC Order").⁷⁶ In the Notice, ISE stated that the modifications to the Original QCC Order (i.e., to prevent the execution of a QCC if there is a Priority Customer on its book and to increase the minimum size of a QCC Order) remove the appearance that such orders are trading ahead of Priority Customer orders or that the QCC Order could be used to disadvantage retail customers.⁷⁷

E. Commenters to ISE's Modified QCC Order Proposal

The Commission received eight comment letters opposing ISE's Modified QCC Order proposal and a response letter from ISE.⁷⁸ While some commenters noted that ISE had addressed their prior objections relating to customer priority,⁷⁹ commenters objected to ISE's modified proposal because it remained unchanged from the original proposal with respect to

⁷⁴ See Vacate Letter, supra note 69, at 1.

⁷⁵ See supra notes 9 and 13 and accompanying text.

⁷⁶ If there are Priority Customer orders on ISE's limit order book at the same price, the QCC Order would be automatically canceled. See proposed ISE Rule 721(b)(1).

⁷⁷ See Notice, supra note 3.

⁷⁸ See supra notes 4 and 5.

⁷⁹ See CBOE Letter 1, supra note 4, at 1, NYSE Letter 2, supra note 4, at 7, and Susquehanna Letter 2, supra note 4, at 1. See also supra notes 44-54 and accompanying text.

exposure, in that QCC Orders would still be crossed without exposure.⁸⁰ Commenters noted that exposure is especially critical in the options market, which is quote-driven and relies on market makers to ensure that two-sided quotations are available for hundreds of thousands of different options series.⁸¹ Commenters argued that exposure, in addition to allowing for the possibility of price improvement, provides market makers an opportunity to participate in trades, which in turn provides them incentives to quote aggressively, thus benefiting the market as a whole.⁸²

Relatedly, several commenters warned against removing incentives for liquidity providers in light of the market events of May 6, 2010.⁸³ One commenter noted that any tightening of market maker obligations could only succeed if market maker benefits were correspondingly aligned, and argued that ISE's proposal would withdraw significant options order flow and, thus, the opportunity for market makers to interact with that order flow via exposure.⁸⁴

⁸⁰ See CBOE Letter 1, supra note 4, at 1; Phlx Letter 2, supra note 4, at 1; LiquidPoint Letter 2, supra note 4, at 1-2; Group One Letter 2, supra note 4, at 1; NYSE Letter 2, supra note 4, at 1-2, 7-8; and Susquehanna Letter 2, supra note 4, at 1.

⁸¹ See CBOE Letter 1, supra note 4, at 1-2; Phlx Letter 2, supra note 4, at 1; LiquidPoint Letter 2, supra note 4, at 1, 2; Group One Letter 2, supra note 4, at 2; NYSE Letter 2, supra note 4, at 3, 7-8; NYSE Letter 3, supra note 4, at 2; and Susquehanna Letter 2, supra note 4, at 3.

⁸² See CBOE Letter 1, supra note 4, at 2-3 and Phlx Letter 2, supra note 4, at 1. See also Cutler Letter, supra note 4 (stating that without exposure, there is no incentive for market makers to display liquidity, provide liquidity or offer price improvement) and LiquidPoint Letter 2, supra note 4, at 2 (stating that if market makers are not able to participate in all price discovery opportunities, they would be left to participate in only price discovery opportunities that are less-desirable and that the result of this negative selection would be "increased risk, a higher probability of unprofitable trades and a reticence to post their best markets. See also Group One Letter 2, supra note 4, at 2; NYSE Letter 2, supra note 4, at 2, 3; and Susquehanna Letter 2, supra note 4, at 3.

⁸³ See CBOE Letter 1, supra note 4, at 1, 3-4; Group One Letter 2, supra note 4, at 2; and NYSE Letter 2, supra note 4, at 2.

⁸⁴ See CBOE Letter 1, supra note 4, at 3.

In addition, CBOE stated that order exposure and the opportunity for market participant interaction was integrally related to what constitutes an exchange and stressed that the Commission should not abandon such long-held standards to permit "print" mechanisms on options exchanges, which it believed the ISE proposal to be.⁸⁵ CBOE and NYSE also noted that the Commission has generally not permitted 100% participation guarantees, as the QCC Order would provide for.⁸⁶

CBOE also noted that the component legs of stock-option orders are exposed on options exchanges as a package (e.g., through complex order mechanisms) with all terms of the complete order being transparent to the marketplace.⁸⁷ This commenter noted that such stock-option orders, while still requiring exposure, are granted intermarket trade-through relief. In contrast, this commenter saw no reason why QCC Orders should receive any special treatment (i.e., not be required to be exposed) and noted that they are not represented as a package and thus do not provide the same transparency as stock-option orders, with only upstairs parties to these trades aware of the complete terms of the total transaction.⁸⁸ In response, ISE reiterated its belief that the crossing of large-size contingency orders on a floor today is not transparent because "there are very few traders (if any) on the floor to hear an order 'announced'" and are executed with little, if any, interruption.⁸⁹ ISE stated that commenters opposed to its proposal were arguing about the theoretical benefits of exposure and ignoring the realities of what is occurring in the

⁸⁵ See CBOE Letter 1, supra note 4, at 3, 5.

⁸⁶ See NYSE Letter 2, supra note 4, at 3; NYSE Letter 3, supra note 4, at 1-2; and CBOE Letter 1, supra note 4, at 2.

⁸⁷ See CBOE Letter 1, supra note 4, at 4-5. See also NYSE Letter 2, supra note 4, at 4.

⁸⁸ See CBOE Letter 1, supra note 4, at 4-5. See also Cutler Letter, supra note 4; and NYSE Letter 2, supra note 4, at 4.

⁸⁹ See ISE Statement 1, supra note 28, at 3.

markets.⁹⁰ Further, ISE stated that, currently, members arrange large stock-option trades upstairs and then bring them to an exchange for execution. Floor exchanges, ISE argued, accommodate these trades by providing a market structure where there is little or no chance that members will break up the pre-arranged trade.⁹¹ Another commenter believed that splitting a stock-option order into separate executions for the individual stock and options legs, rather than representing the stock-option order as a package, was generally not in the best interest of the customer from a best execution point of view.⁹²

Another commenter reiterated its belief that the benefits of price discovery and transparency afforded by exposure were especially crucial for broker facilitated crosses such as QCC Orders because of the inherent conflict of interest for such orders since a broker is “betting against the customer” in such trades.⁹³ Commenters also contended that ISE’s claim that it needed the QCC Order to compete with trading on floor-based exchanges is erroneous and disingenuous, and that it ignored the broader ramification of QCC Orders that, whereas trading floors require exposure of orders before any executions can occur, the QCC Order would ensure that exposure was eliminated altogether.⁹⁴

With respect to the increase in contract size for QCC Orders from 500 contracts (as originally proposed in SR-ISE-2009-35) to 1,000 contracts, NYSE questioned whether the change was meaningful in limiting the scope of the proposed QCC Order type, as it believed that

⁹⁰ See ISE Response, supra note 5, at 2.

⁹¹ Id.

⁹² See Susquehanna Letter 2, supra note 4, at 4-5.

⁹³ See Group One Letter 2, supra note 4, at 1-2. See also supra note 55 and accompanying text.

⁹⁴ See CBOE Letter 1, supra note 4, at 4-5. See also NYSE Letter 2, supra note 4, at 3-4 and NYSE Letter 3, supra note 4, at 2.

market participants could game the rule to meet this requirement,⁹⁵ while another commenter believed that the 1,000 contract requirement was a relatively low threshold that would permit large broker-dealers to shut out other market participants on relatively small trades.⁹⁶

In its response letter, ISE reiterated its argument that its QCC Order proposals were simply a way for ISE to compete against floor-based options exchanges for the execution of large stock-option orders.⁹⁷ ISE countered commenters' arguments regarding the lack of exposure of QCC Orders by stating that the required exposure of orders on floor-based exchanges was nominal and theoretical, and ignores the realities of what is occurring on those markets.⁹⁸ One commenter agreed with ISE's assertion that floor-based options exchanges enjoy an unfair competitive advantage over all-electronic options exchanges for executing clean blocks, noting that, in its own experience, "institutional brokers are much more apt to use a trading floor when the primary intention is to execute as clean a cross as possible."⁹⁹ ISE stated its belief that floor-based options markets accommodate such trades by "providing a market structure in which there is little or no chance that members will break up the pre-arranged trade" by structuring their markets to provide such trades with the least amount of "friction."¹⁰⁰ ISE contended that, if floor-based exchanges were serious about exposure, they would expose such orders to their entire marketplace, rather than limiting exposure to "those few (if any) members physically present in the floor-based trading crowd."¹⁰¹ One commenter echoed ISE's

⁹⁵ See NYSE Letter 2, supra note 4, at 5-7 and NYSE Letter 3, supra note 4, at 3.

⁹⁶ See Cutler Letter, supra note 4.

⁹⁷ See ISE Response, supra note 5, at 1-2.

⁹⁸ Id. at 2.

⁹⁹ See Susquehanna Letter 2, supra note 4, at 2.

¹⁰⁰ Id.

¹⁰¹ Id.

contention and suggested that a common rule for all block crosses on all options exchanges should be adopted to require all pre-negotiated option block crosses, including floor crosses, to be entered into an electronic crossing mechanism. This commenter believed that such a requirement would ensure that market makers could compete for such orders and thus provide the orders a greater chance at price improvement, as well as act as a check to ensure that the brokers facilitating these orders priced them competitively.¹⁰²

ISE also countered commenters' arguments that the QCC Order proposal, because it does not provide for exposure, would not allow for price improvement by reiterating its prior explanation that those parties involved in a stock-option order negotiate such transactions on a "net price" basis, reflecting the total price of both the stock and options legs of the trade. Thus, ISE argued, the actual execution price of each individual component is not as material to the parties involved as is the net price of the entire transaction, which ISE believes means that price improvement of the individual legs of the trade is not a critical issue in the execution of a QCC Order.¹⁰³

In addition, ISE argued that its QCC Order proposal has no relevance to the market events of May 6, 2010, despite commenters' attempts to link the two. ISE again noted that large stock-options trades are currently arranged upstairs and then shopped among exchanges to achieve a clean cross.¹⁰⁴ ISE argued that, accordingly, large stock-option trades today "rely on the liquidity that firms can provide in arranging these trades and do not now include exchange-

¹⁰² See Susquehanna Letter 2, supra note 4, at 2.

¹⁰³ See ISE Response, supra note 5, at 3-4.

¹⁰⁴ See ISE Response, supra note 5, at 4.

provided liquidity.”¹⁰⁵ ISE believed that the QCC Order type would simply provide a competitive electronic vehicle for such trades and will have no effect on available liquidity.¹⁰⁶

In response to NYSE’s contention that the QCC Order’s contract size requirement could be gamed, ISE noted that any member creating “fake customer orders” would be misrepresenting its order in violation of ISE’s rules and expressed confidence that its surveillance program would be able to catch any such attempt.¹⁰⁷ In addition, ISE clarified the calculation of the 1,000 contract minimum size for a QCC Order noting that, in order to meet this requirement, an order must be for at least 1,000 contracts and could not be, for example, two 500 contract orders or two 500 contract legs.¹⁰⁸

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.¹⁰⁹ Specifically, the Commission finds that the proposal is consistent with Sections 6(b)(5)¹¹⁰ and 6(b)(8),¹¹¹ which require, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect

¹⁰⁵ Id.

¹⁰⁶ Id.

¹⁰⁷ Id. at 5-6.

¹⁰⁸ Id. at 6.

¹⁰⁹ 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹¹⁰ 15 U.S.C. 78f(b)(5).

¹¹¹ 15 U.S.C. 78f(b)(8).

investors and the public interest and that the rules of an exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In addition, the Commission finds that the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act,¹¹² in which Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other things, the economically efficient execution of securities transactions.

A. Consistency with the NMS QCT Exemption

In approving the Original QCT Exemption, the Commission recognized that contingent trades can be “useful trading tools for investors and other market participants, particularly those who trade the securities of issuers involved in mergers, different classes of shares of the same issuer, convertible securities, and equity derivatives such as options [italics added].”¹¹³ The Commission stated that “[t]hose who engage in contingent trades can benefit the market as a whole by studying the relationships between the prices of such securities and executing contingent trades when they believe such relationships are out of line with what they believe to be fair value.”¹¹⁴ As such, the Commission stated that transactions that meet the specified requirements of the NMS QCT Exemption could be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process.¹¹⁵

The parties to a contingent trade are focused on the spread or ratio between the transaction prices for each of the component instruments (i.e., the net price of the entire

¹¹² 15 U.S.C. 78k-1(a)(1)(C).

¹¹³ See Original QCT Exemption, supra note 9, at 52830.

¹¹⁴ Id. at 52831.

¹¹⁵ See CBOE QCT Exemption, supra note 13.

contingent trade), rather than on the absolute price of any single component.¹¹⁶ Pursuant to the requirements of the NMS QCT Exemption, the spread or ratio between the relevant instruments must be determined at the time the order is placed, and this spread or ratio stands regardless of the market prices of the individual orders at their time of execution. As the Commission noted in the Original QCT Exemption, “the difficulty of maintaining a hedge, and the risk of falling out of hedge, could dissuade participants from engaging in contingent trades, or at least raise the cost of such trades.”¹¹⁷ Thus, the Commission found that, if each stock leg of a qualified contingent trade were required to meet the trade-through provisions of Rule 611 of Regulation NMS, such trades could become too risky and costly to be employed successfully and noted that the elimination or reduction of this trading strategy potentially could remove liquidity from the market.¹¹⁸

The Commission believes that ISE’s proposal, which would permit a clean cross of the options leg of a subset of qualified contingent trades (i.e., a stock-option qualified contingent trade that meets the requirements of the NMS QCT Exemption), is appropriate and consistent with the Act in that it would facilitate the execution of qualified contingent trades, for which the Commission found in the Original QCT Exemption to be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process.¹¹⁹ The QCC Order would provide assurance to parties to stock-option qualified contingent trades that their hedge would be maintained by allowing the options component to be executed as a clean cross.

¹¹⁶ See Original QCT Exemption, supra note 9, at 52829 (explaining SIA’s position on the need for the Original QCT Exemption).

¹¹⁷ Id. at 52831.

¹¹⁸ Id.

¹¹⁹ Id.

B. Exposure and Qualified Contingent Trades

Commenters believed that ISE's modifications to the Original QCC Order did not adequately address their main objection regarding the QCC Order, particularly in that it would continue to permit option crosses to occur without prior exposure to the marketplace.

Commenters generally reiterated their prior comments that exposing options orders promotes price competition, increases order interaction, and leads to better quality executions for investors by providing opportunities for price improvement.¹²⁰ These commenters continued to argue that, without exposure, the Modified QCC Order would cause significant harm to the options market because it would eliminate valuable incentive for dedicated liquidity provider participation.¹²¹

In response to commenters' concerns that the Modified QCC Order would have a detrimental effect on the options markets because of the lack of any exposure requirement, ISE stated that exchange members arrange large stock-option trades upstairs and then bring them to an exchange for execution, and that exchange floors accommodate the trades by providing a market structure in which there is little or no chance that members will break up the pre-arranged trade.¹²² ISE believed that, rather than harming the options markets, the QCC proposal would permit fair competition to occur between floor-based and all-electronic options exchanges by providing an all-electronic execution alternative to floor-based executions.¹²³

The Commission recognizes that significant liquidity on options exchanges is derived from quotations submitted by members of an exchange that are registered as market makers.¹²⁴

¹²⁰ See supra notes 70 and 85-94 and accompanying text.

¹²¹ See supra notes 81-84 and accompanying text.

¹²² See supra notes 97-100 and accompanying text.

¹²³ See ISE Response, supra note 5, at 3.

¹²⁴ See, e.g., Susquehanna Letter 2, supra note 4, at 3 (noting that, in the options market, market makers provide over 90% of the liquidity).

Pursuant to the options exchanges' rules, market makers generally are required to maintain continuous two-sided quotations in their registered options for a specified percentage of the time, or in a specified number of series or classes. One of the perceived benefits for market makers with such obligations is the opportunity to participate in transactions through the exposure requirement. As noted above, some commenters argue that the lack of exposure for QCC Orders would act as a disincentive for market maker participation.¹²⁵

While the Commission believes that order exposure is generally beneficial to options markets in that it provides an incentive to options market makers to provide liquidity and therefore plays an important role in ensuring competition and price discovery in the options markets, it also has recognized that contingent trades can be "useful trading tools for investors and other market participants, particularly those who trade the securities of issuers involved in mergers, different classes of shares of the same issuer, convertible securities, and equity derivatives such as options [italics added]." ¹²⁶ and that "[t]hose who engage in contingent trades can benefit the market as a whole by studying the relationships between the prices of such securities and executing contingent trades when they believe such relationships are out of line with what they believe to be fair value."¹²⁷ As such, the Commission stated that transactions that meet the specified requirements of the NMS QCT Exemption could be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process.¹²⁸

¹²⁵ See supra notes 81-82 and accompanying text.

¹²⁶ See Original QCT Exemption, supra note 9, at 52830-52831.

¹²⁷ Id.

¹²⁸ See CBOE QCT Exemption, supra note 13, at 19273.

Thus, in light of the benefits provided by both the requirement for exposure as well as by qualified contingent trades such as QCC Orders, the Commission must weigh the relative merits of both for the options markets.¹²⁹ The Commission believes that the proposal, in requiring a QCC Order to be: (1) part of a qualified contingent trade under Regulation NMS; (2) for at least 1,000 contracts; (3) executed at a price at or between the national best bid or offer; and (4) cancelled if there is a Priority Customer Order on ISE's limit order book, strikes an appropriate balance for the options market in that it is narrowly drawn¹³⁰ and establishes a limited exception to the general principle of exposure and retains the general principle of customer priority in the options markets. Furthermore, not only must a QCC Order be part of a qualified contingent trade by satisfying each of the six underlying requirements of the NMS QCT Exemption, the requirement that a QCC Order be for a minimum size of 1,000 contracts provides another limit to its use by ensuring only transactions of significant size may avail themselves of this order type.¹³¹

As noted above, some commenters argue that the concerns regarding the impact of the QCC Order on the incentives for liquidity providers are heightened by the events of May 6,

¹²⁹ The Commission notes that it has previously permitted the crossing of two public customer orders, for which no exposure is required on ISE and CBOE. See CBOE Rule 6.74A.09 and ISE Rules 715(i) and 721.

¹³⁰ The Commission notes that, in its request to remove the block-size requirement of the Original QCT Exemption, CBOE stated that the NMS QCT Exemption's other requirements would ensure that the exemption was narrowly drawn and limited to a small number of transactions. See Letter, dated November 28, 2007, from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Nancy M. Morris, Secretary, Commission, at 1, 4.

¹³¹ The Commission notes that the requirement that clean crosses be of a certain minimum size is not unique to the QCC Order. See, e.g., NSX Rule 11.12(d), which requires, among other things, that a Clean Cross be for at least 5,000 shares and have an aggregate value of at least \$100,000.

2010.¹³² Specifically, commenters argued that in light of the events of May 6, 2010, the Commission should not improve measures that would create disincentives for market makers to provide liquidity to the markets.¹³³ The Commission recognizes the important role liquidity providers play, particularly in the options markets, which tend to be more quote driven than the cash equities markets. In addition, the Commission is cognizant of the concerns raised by some commenters with regard to the events of May 6, 2010. However, as discussed above, the Commission has weighed the relative merits of the QCC Order and of the exposure of such orders and believes that ISE's proposal is consistent with the Act.

C. Customer Protection

In response to concerns that the Original QCC Order did not provide adequate customer protection because the QCC Order would have priority over resting customer orders on ISE's books,¹³⁴ ISE proposes to modify the QCC Order to provide for automatic cancellation of a QCC Order if there is a Priority Customer order on the Exchange's limit order book at the same price. The Commission believes that this modification to yield to a Priority Customer order on the book would ensure that QCC Orders do not trade ahead of Priority Customer orders at the same price, and thus should alleviate commenters' concerns regarding the Original QCC Order that customers would not receive executions of their resting orders, which could also create a disincentive to placing limit orders.

Some commenters objected to the Modified QCC Order because they believed that a customer order submitted as a QCC Order risks receiving a fill at an inferior price to the price it

¹³² See supra notes 83-84 and accompanying text.

¹³³ Id.

¹³⁴ See Petition for Review, supra note 22, at 15, 17. See also Bluefin Statement, supra note 29; Phlx Letter, supra note 26; Wolverine Letter, supra note 26; Group One Letter, supra note 26, at 1; and Integral Derivatives Letter, supra note 26.

could have received if it has been exposed to the market.¹³⁵ Another commenter was concerned that, while the option trade would be within the NBBO, the stock trade may be priced outside of the market and that “[t]he effect is a valuation for the stock/option package . . . unrestricted by competition”¹³⁶ In response to commenters concerns regarding price improvement, ISE argued that the actual execution price of each component is not as material to the parties as is the net price of the transaction and accordingly, price improvement of the individual legs of the trade is not a critical issue in executing the QCC Order.¹³⁷

As discussed above, QCC Orders must be for 1,000 or more contracts, in addition to meeting all of the requirements of the NMS QCT Exemption. The Commission believes that those customers participating in QCC Orders will likely be sophisticated investors who should understand that, without a requirement of exposure for QCC Orders, their order would not be given an opportunity for price improvement on the Exchange. These customers should be able to assess whether the net prices they are receiving for their QCC Order are competitive, and who will have the ability to choose among broker-dealers if they believe the net price one broker-dealer provides is not competitive. Further, broker-dealers are subject to a duty of best execution for their customers’ orders, and that duty does not change for QCC Orders.

IV. Conclusion

In sum, the Commission believes that ISE’s Modified QCC Order is consistent with the NMS QCT Exemption, which found that qualified contingent trades are of benefit to the market as a whole and a contribution to the efficient functioning of the securities markets and the price

¹³⁵ See Group One Letter 2, supra note 4, at 1; and CBOE Letter 1, supra note 4, at 2.

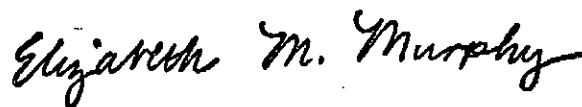
¹³⁶ See LiquidPoint Letter 2, supra note 4, at 2.

¹³⁷ See supra note 103 and accompanying text.

discovery process.¹³⁸ In addition, the Exchange's Modified QCC Order is narrowly drawn to provide a limited exception to the general principle of exposure, and retains the general principle of customer priority. Accordingly, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.¹³⁹ Specifically, the Commission finds that the proposal is consistent with Sections 6(b)(5)¹⁴⁰ and 6(b)(8) of the Act.¹⁴¹ Further, the Commission finds that the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act.¹⁴²

IT IS THEREFORE ORDERED, the proposed rule change (SR-ISE-2010-73) is approved pursuant to Section 19(b)(2) of the Act.¹⁴³

By the Commission.



Elizabeth M. Murphy
Secretary

¹³⁸ See supra note 13.

¹³⁹ 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁴⁰ 15 U.S.C. 78f(b)(5).

¹⁴¹ 15 U.S.C. 78f(b)(8).

¹⁴² 15 U.S.C. 78k-1(a)(1)(C).

¹⁴³ 15 U.S.C. 78s(b)(2).

**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

**Securities Act of 1933
Release No. 9191 / February 24, 2011**

**Securities Exchange Act of 1934
Release No. 63956 / February 24, 2011**

**ORDER REGARDING REVIEW OF FASB ACCOUNTING SUPPORT FEE FOR
2011 UNDER SECTION 109 OF THE SARBANES-OXLEY ACT OF 2002**

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

On April 25, 2003, the Commission issued a policy statement concluding that the Financial Accounting Standards Board ("FASB") and its parent organization, the Financial Accounting Foundation ("FAF"), satisfied the criteria for an accounting

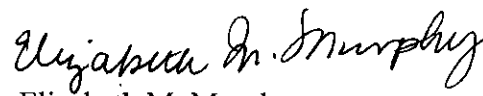
standard-setting body under the Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" under Section 108 of the Act.¹ As a consequence of that recognition, the Commission undertook a review of the FASB's accounting support fee for calendar year 2011. In connection with its review, the Commission also reviewed the budget for the FAF and the FASB for calendar year 2011.

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

After its review, the Commission determined that the 2011 annual accounting support fee for the FASB is consistent with Section 109 of the Act. Accordingly,

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

By the Commission.


Elizabeth M. Murphy
Secretary

¹ Financial Reporting Release No. 70.

Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933

Release No 9190 / February 24, 2011

In the Matter of

Wave2Wave Communications, Inc.

Registration No. 333-171199

**ORDER DENYING
WITHDRAWAL OF
REGISTRATION STATEMENT
UNDER THE SECURITIES ACT
OF 1933**

1. Wave2Wave Communications, Inc. ("Wave2Wave") filed a Form S-1 registration statement with the Commission on December 16, 2010 and filed two amendments thereto on January 12, 2011 and January 26, 2011 (collectively, the "Registration Statement"). The Registration Statement is still pending. The Registration Statement was filed with respect to 3,300,000 units, with each unit consisting of one share of common stock and one warrant to purchase one share of common stock of Wave2Wave.

2. On February 10, 2011, Wave2Wave filed an application to withdraw its Registration Statement under Rule 477 of Regulation C of the Commission's General Rules and Regulations under the Securities Act of 1933 ("Securities Act"), 17 C.F.R. § 230.477.

3. After considering Wave2Wave's application, the Commission has determined that the granting of the withdrawal request is not consistent with the public interest and the protection of investors. Accordingly, it is hereby:

ORDERED that Wave2Wave's application to withdraw its registration statement on Form S-1 filed on December 16, 2010 and the two amendments thereto filed on January 12, 2011 and January 26, 2011 is denied in accordance with Rule 477.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63980 / February 25, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14274

In the Matter of

DIVINE CAPITAL MARKETS,
LLC, DANIELLE HUGHES AND
MICHAEL BUONOMO

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-
AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF
THE SECURITIES ACT OF 1933,
AND SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF
1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), against Divine Capital Markets, LLC ("Divine"), Danielle Bionda Hughes ("Hughes"), and Michael Buonomo ("Buonomo") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

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A. RESPONDENTS

1. Divine Capital Markets, LLC is a broker-dealer registered with the Commission with its principal office located in New York. During the relevant period Divine conducted a general securities business through its registered representatives and traders; and participated in the offering of shares of Advanced Optics Electronics Inc.

2. Danielle Hughes, age 41, is a New Jersey resident. Throughout the relevant period, Hughes held a controlling interest in, and was a person associated with, Divine. Hughes was also Divine's Chief Executive Officer and its General Securities Principal responsible for supervision of equities, institutional and retail sales. From approximately June 3, 2006 through September 6, 2006, Hughes was also Divine's Chief Compliance Officer.

3. Michael Buonomo, age 36, is a New Jersey resident. Throughout the relevant period Buonomo was a registered representative associated with Divine and participated in the offering of shares of Advanced Optics Electronics Inc. Throughout much of the relevant period Buonomo reported to Hughes, who was his supervisor.

B. OTHER RELEVANT ENTITIES

1. Advanced Optics Electronics Inc. ("ADOT") is a currently inactive Nevada corporation formerly headquartered in Albuquerque, New Mexico. Throughout the relevant period, ADOT's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act. During the period of January 1, 2006 through December 31, 2007, ADOT's shares were quoted on the OTC Bulletin Board under the symbol "ADOT" and its shares ranged between \$0.00013 and \$0.001 per share. ADOT was a development stage corporation with no earnings, no operating revenues and no final products. Throughout the relevant period ADOT's common shares were penny stock within the meaning of Rule 3a51-1 of the Exchange Act.

2. JDC Swan Inc. ("JDC Swan") is a Florida corporation wholly owned by Jason Claffey.

3. Jason Claffey ("Claffey"), age 36, is a Florida resident. Claffey is the president and sole owner of JDC Swan. Through JDC Swan, Claffey acquired over 9.8 billion shares of ADOT directly from the issuer and sold them shortly thereafter -- without a registration statement in effect -- into the public markets through an account he established at Divine.

C. FACTS

1. From at least as early as January 2006 through approximately June 2007, Claffey, through his company, JDC Swan, acquired a total of over 9.8 billion shares of ADOT in private transactions directly with the company. None of the 9.8 billion ADOT share certificates bore a restrictive legend.

2. On or about February 27, 2006, Claffey contacted Buonomo to open a securities account at Divine for the purpose of liquidating shares of bulletin board and pink sheet companies. Hughes and Buonomo did not know Claffey and conducted no due diligence into the securities he intended to sell. Nevertheless, on or about February 28, 2006, Hughes approved the opening of the JDC Swan account. The same day, Buonomo -- with Hughes' approval -- began publicly offering and selling unregistered shares of ADOT through Claffey's JDC Swan account.

3. In a span of two weeks, from February 28, 2006, through March 13, 2006, Claffey offered and sold a total of 325 million restricted shares through Divine. By September 4, 2006, the total ADOT restricted shares offered and sold through Divine had grown to over 2 billion for proceeds of over \$1 million.

4. From February 28, 2006, and continuing through June 2007, Buonomo offered and sold a total of over 9.8 billion shares of ADOT on behalf of JDC Swan, without a registration statement in effect or on file, generating over \$60,000 in commissions and other remuneration for Divine on sale proceeds of over \$2 million. Throughout the period, Buonomo memorialized numerous deliveries of ADOT certificates and sales in Divine's electronic client relationship database which was available to, and typically monitored by, Hughes.

5. Buonomo was extensively involved in the logistics of the ADOT sales. Claffey sent the ADOT certificates to Buonomo, who forwarded them to Divine's clearing broker, who then arranged to have the shares put in "street name." When the shares were ready for sale, Buonomo notified Claffey, who then placed the sale orders. Buonomo accepted the orders and arranged for the sales to be executed by a market maker. After execution, Claffey periodically sent wire requests to Buonomo to withdraw the sale proceeds. These wire requests were often approved by Hughes.

6. All of the offers and sales of the 9.8 billion shares of ADOT were made without a registration statement in effect, or on file and with no valid exemptions from registration. All of the offers and sales made use of means or instruments of transportation or communications in interstate commerce or of the mails.

7. Both Buonomo and Hughes knew or should have known that Claffey and JDC Swan had acquired the ADOT shares directly from the issuer. At no point did Buonomo or Hughes perform any due diligence to determine if there was a registration statement in effect or on file with respect to the offers and sales of ADOT shares.

a. Hughes Failed Reasonably to Supervise Buonomo By Ignoring Red Flags

i. In addition to being Divine's majority owner and CEO, Hughes was Buonomo's direct supervisor for much of the relevant time and was Divine's General Securities Principal in the areas of: (1) equities; (2) institutional and retail sales; (3) underwritings; and (4) private placements. From approximately June 3, 2006 to

September 6, 2006, Hughes also assumed the role of Divine's Chief Compliance Officer in a one-person compliance department. Hughes was also responsible for reviewing Divine's trade tickets for unusual concentrations, specifically to determine whether the trade tickets "involved sizable positions in a single security."

ii. From the inception of the account, Hughes ignored red flags that the ADOT sales constituted an unregistered distribution. Shortly after the JDC account was opened, Hughes was put on notice that the JDC Swan account was acquiring and would be selling share certificates received from an issuer. On the very first day of trading, Buonomo alerted Hughes that he had sold 45 million shares from the first (65-million share) ADOT certificate that Divine had received. Buonomo further advised Hughes that Divine would receive another share certificate the following day. Throughout the relevant period, Buonomo memorialized JDC Swan's certificate deliveries and sales in Divine's electronic client relationship database. Hughes was the administrator of the database and accessed the system frequently.

iii. In late August 2006, Buonomo alerted Hughes that the JDC Swan account had delivered a certificate for 65 million shares and asked if he could execute sales of these shares. On this occasion, Hughes instructed Buonomo to obtain the stock purchase agreements, which showed that JDC Swan had acquired the shares directly from ADOT. On at least one occasion, Hughes forwarded the stock purchase agreement to facilitate the ADOT sales.

iv. In September 2006, Hughes hired a new Chief Compliance Officer who alerted her on several occasions to the large number of ADOT shares flowing through the JDC Swan account. Hughes took no steps to prevent the sales or to ensure that the sales were either registered or exempt from registration.

b. Hughes and Divine Failed Reasonably to Supervise Buonomo By Maintaining Inadequate Supervisory Procedures

From approximately June 3, 2006 through September 6, 2006, Hughes was responsible for developing and maintaining the firm's supervisory policies and procedures. Throughout the February 27, 2006 through July 2007 period, Divine's supervisory policies were inadequate to provide guidance to supervisors regarding the appropriate inquiry to determine whether the public sale of shares acquired directly or indirectly from an issuer was prohibited by Section 5 of the Securities Act. For example, the policies did not address unregistered distributions through statutory underwriters. The supervisory procedures also failed to address situations in which certificates without restrictive legends were acquired by a customer from an issuer with a view to distribution. If Hughes and Divine had developed reasonable policies and procedures requiring appropriate due diligence in situations in which a customer sold large blocks of illiquid stock in a little-known company and prohibited re-sales of such shares, the firm likely would have prevented and detected Buonomo's violations of Section 5.

D. VIOLATIONS

1. As a result of the conduct described above, Buonomo and Divine willfully committed violations of Sections 5(a) and (c) of the Securities Act, which makes it unlawful for any person directly or indirectly to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or to offer to sell securities unless a registration statement has been filed as to such security.

2. As a result of the conduct described above, Divine and Hughes failed reasonably to supervise Buonomo with a view to detecting and preventing Buonomo's violations of Section 5(a) and (c) of the Securities Act.

III.

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

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

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

C. Whether, pursuant to Section 8A of the Securities Act, Divine and Buonomo should be ordered to cease and desist from committing or causing violations of, and any future violations of, the Securities Act and whether Divine and Buonomo should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act.

D. Whether, pursuant to Section 15(b) of the Exchange Act, it is appropriate and in the public interest to bar Divine and Buonomo from participating in any offering of penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock; or inducing or attempting to induce the purchase or sale of any penny stock.

IV.

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

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

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

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

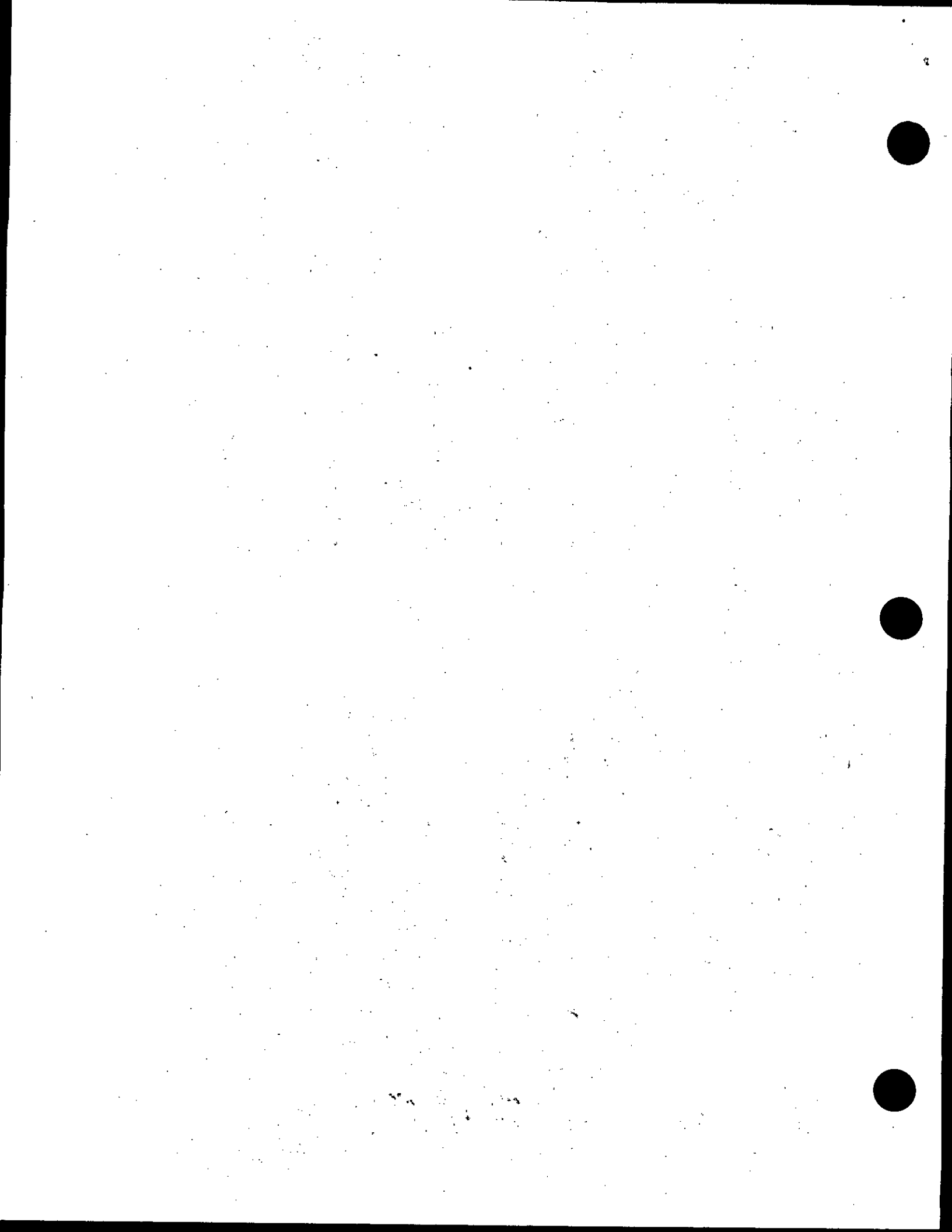
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary


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



II.

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

III.

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

1. Wilkinson, age 54, is and has been a certified public accountant licensed to practice in the State of Arizona. He served as the director of financial services of NutraCea, Inc. ("NutraCea") from April 2007 to February 2009.

2. NutraCea is a California corporation with its principal executive offices located in Phoenix, Arizona and is engaged in the business of manufacturing health food products. NutraCea's common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and trades on the OTC:BB under the symbol "NTRZ".

3. On January 13, 2011, the Commission filed a complaint against Wilkinson in SEC v. NutraCea, et al. (Civil Action No. CV 11-0092-PHX-SRB). On February 14, 2011, the court entered an order permanently enjoining Wilkinson, by consent, from future violations of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. Wilkinson was also ordered to pay a \$25,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that NutraCea, through the misconduct of Wilkinson and others, overstated its sales revenues for its fiscal year 2007 by engaging in improper revenue recognition practices. The complaint alleged that Wilkinson violated the books and records and internal controls provisions of the federal securities laws because he knew that NutraCea improperly accounted for a \$1.9 million sale in the fourth quarter of 2007. The complaint further alleged that Wilkinson also signed false management representation letters to NutraCea's auditors.



IV.

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

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

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

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

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

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

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

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

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

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of



accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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



SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-63986; File No. SR-FICC-2010-09)

February 28, 2011

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of a Proposed Rule Change to Introduce Cross-Margining of Certain Positions Cleared at the Fixed Income Clearing Corporation and Certain Positions Cleared at New York Portfolio Clearing, LLC

I. Introduction

On November 12, 2010, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2010-09 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act").¹ Notice of the proposed rule change was published in the Federal Register on November 30, 2010.² The Commission initially received thirteen comments to the proposed rule change.³ FICC, as well as one of the commenters,

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 63361 (November 23, 2010), 75 FR 74110 (November 30, 2010) (FICC-2010-09). In its filing with the Commission, FICC included statements concerning the purpose of and basis for the proposed rule change. The text of these statements are incorporated into the discussion of the proposed rule change in Section II below.

³ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Douglas Engmann, President, Engmann Options, Inc. (December 6, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC

submitted letters responding to the comments.⁴ For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

The proposed rule change allows FICC to offer cross-margining of certain positions cleared at its Government Securities Division (“GSD”) and certain positions cleared at New York Portfolio Clearing, LLC (“NYPC”).⁵ GSD members will be able to combine their positions at GSD with their positions at NYPC, or those positions of certain permitted affiliates cleared at NYPC, within a single margin portfolio (“Margin Portfolio”). The proposed rule change also makes certain other related changes to GSD’s rules.

A. Cross-Margining with NYPC

Under the proposed rule, a member of FICC that is also an NYPC clearing member (“Joint Clearing Member”) could in accordance with the provisions of the GSD and NYPC Rules, elect to participate in the cross-margining arrangement. FICC’s rules permit a GSD netting member that is a member (or that has an affiliate that is a member)

(December 21, 2010): Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

⁴ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011); and Letter from Alex Kogan, Vice President and Deputy General Counsel, NASDAQ OMX (January 10, 2011).

⁵ NYPC is jointly owned by NYSE Euronext and The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the parent company of FICC. On January 31, 2011, the Commodity Futures Trading Commission (“CFTC”) approved NYPC’s registration as a derivatives clearing organization (“DCO”) pursuant to Section 5b of the Commodity Exchange Act and Part 39 of the Regulations of the CFTC.

of one or more Futures Clearing Organizations (“FCO”),⁶ such as NYPC, to become a cross-margining participant in a cross-margining arrangement between FICC and one or more FCOs with the consent of FICC and each such FCO. A netting member shall become a cross-margining participant upon acceptance of FICC and each applicable FCO of an agreement executed by such cross-margining participant in the form specified in the applicable cross-margining agreement.⁷

Participating in the cross-margining arrangement would permit a Joint Clearing Member to have its margin requirement calculated taking into account both its positions at FICC and NYPC, which should provide a clearer picture of its risk exposure and generally facilitate better risk assessment by FICC. Specifically, each Joint Clearing Member would have its margin requirement with respect to Eligible Positions (i.e., positions in certain securities netted by FICC or certain futures contracts cleared by an FCO)⁸ in its proprietary account at NYPC and its margin requirement with respect to

⁶ “FCO” is defined in GSD Rule 1 as a clearing organization for a board of trade designated as a contract market under Section 5 of the Commodity Exchange Act that has entered into a Cross-Margining Agreement with FICC.

⁷ See GSD Rule 43, Cross-Margining Arrangements, Section 2. The cross-margining agreement between FICC and NYPC as well as the cross-margining participant agreements for joint and permitted affiliates are attached to FICC’s filing of proposed rule change SR-FICC-2010-09.

⁸ The term “Eligible Position” is currently defined in GSD’s rules as a position in certain Eligible Netting Securities netted by FICC, or certain Government securities futures contracts or interest rate futures contracts cleared by a FCO as identified in a Cross-Margining Agreement as eligible for cross-margining treatment.

“Eligible Netting Security” is defined in GSD Rule 1 as an Eligible Security that FICC has designed as eligible for netting.

“Eligible Security” is defined generally in GSD Rule 1 as a security issued or guaranteed by the United States, a U.S. government agency or instrumentality, a U.S. government-sponsored corporation, or any other security approved by FICC’s board of directors from time to time, or one or more categories of such

Eligible Positions at FICC calculated as a single portfolio, which would factor in the net risk of such Eligible Positions at both clearing organizations. In addition, an affiliate of a member of FICC that is also a clearing member of NYPC (“Permitted Margin Affiliate”)⁹ could similarly elect to participate in the cross-margining arrangement and have its margin requirement with respect to Eligible Positions in its proprietary account at NYPC calculated as a single portfolio with the Eligible Positions of the FICC member.

The proposed rule allows (i) Joint Clearing Members and (ii) members of FICC and their Permitted Margin Affiliates to have their margin requirements for positions at FICC and NYPC determined as a single portfolio, with FICC and NYPC each having a security interest in such members’ and Permitted Margin Affiliates’ margin deposits and other collateral to secure their obligations to FICC and NYPC.

The following types of FICC members will not be eligible to participate in the cross-margining arrangement (“NYPC Arrangement”), in order to allow FICC to maintain segregation of certain business or member types that are treated differently for purposes of loss allocation: (i) GSD Sponsored Members,¹⁰ (ii) Inter-Dealer Broker

securities as represented by a generic CUSIP number, that FICC has listed on the Eligible Securities master file maintained by it pursuant to GSD Rule 30.

⁹ The term “Permitted Margin Affiliate” is being added to GSD Rule 1 and is defined as an affiliate of a Member that is (i) also a member of GSD, and/or (ii) a member of an FCO with which FICC has entered into a Cross-Margining Agreement that provides for margining of positions between FICC and the FCO as if such positions were in a single portfolio and that directly or indirectly controls such particular member, or that is directly or indirectly controlled by or under common control with such particular member. Ownership of more than 50% of the common stock of the relevant entity (or equivalent equity interests in the case of a form of entity that does not issue common stock) will be conclusive evidence of prima facie control of such entity for purposes of this definition.

¹⁰ A “Sponsored Member” of GSD is any person that has been approved by FICC to be sponsored into membership by a “Sponsoring Member” pursuant to GSD Rule 3A. A “Sponsoring Member” is a member of GSD’s comparison and netting system whose application to become a sponsoring member has been approved by

Netting Members,¹¹ and (iii) Dealer Netting Members¹² with respect to their segregated brokered accounts. In addition, in order for a Bank Netting Member¹³ to combine its accounts into a Margin Portfolio with any other accounts, it will have to demonstrate to the satisfaction of FICC and NYPC that doing so will comply with the regulatory requirements applicable to the Bank Netting Member (e.g., by providing an opinion of counsel or otherwise outlining compliance with relevant statutory provisions).¹⁴

In order to distinguish the NYPC Arrangement from an existing cross-margining arrangement between the Chicago Mercantile Exchange (“CME”) and FICC (“CME Arrangement”), the proposed rule amends the definition of “Cross-Margining Agreement” in the GSD rules to mean an agreement entered into between FICC and one or more FCOs pursuant to which a Cross-Margining Participant,¹⁵ in accordance with the

the FICC’s board of directors pursuant to GSD Rule 3A. See GSD Rule 1, Definitions.

¹¹ The definition of “Inter-Dealer Broker Netting Member,” as revised by the proposed rule change, is an inter-dealer broker admitted to membership in GSD’s netting system. See GSD Rule 2A, Initial Membership Requirements.

¹² The definition of a “Dealer Netting Member,” as revised by the proposed rule change, is a registered government securities dealer admitted to membership in GSD’s netting system. See GSD Rule 2A, Initial Membership Requirements.

¹³ Under GSD Rule 2A, a person shall be eligible to apply to become a “Bank Netting Member” of GSD if it is a bank or trust company chartered as such under the laws of the United States, or a State thereof, or is a bank or trust company established or chartered under the laws of a non-U.S. jurisdiction, and participates in FICC through its U.S. branch or agency. A bank or trust company that is admitted to membership in GSD’s netting system, the netting system, pursuant to these Rules, and whose membership in the netting system has not been terminated, shall be a Bank Netting Member. See GSD Rule 2A, Initial Membership Requirements, Section 2.

¹⁴ See GSD Rule 4, Clearing Fund and Loss Allocation, Section 1a as proposed to be amended by the proposed rule change.

¹⁵ The term “Cross-Margining Participant” is defined in GSD Rule 1 as a Netting Member that is authorized by FICC to participate in the Cross-Margining Arrangement between FICC and one or more FCOs pursuant to a Cross-Margining Agreement. GSD Rule 1 defines the term “Cross-Margining

provisions of the GSD Rules and otherwise at the discretion of FICC, could elect to have its Required Fund Deposit¹⁶ with respect to Eligible Positions at FICC, and its (or its Permitted Margin Affiliates' Required Fund Deposit, if applicable) margin requirements with respect to Eligible Positions at such FCO(s), calculated either (i) by taking into consideration the net risk of such Eligible Positions at each of the clearing organizations or (ii) as if such positions were in a single portfolio. The CME Arrangement falls into clause (i) of the definition, whereas the NYPC Arrangement will fall into clause (ii). Conforming changes will be made to GSD Rule 1, Definitions, relating to cross-margining. GSD Rule 43, Cross-Margining Arrangements, also will be amended to add provisions regarding single-portfolio margining (i.e., the proposed NYPC Arrangement). To implement this proposal, FICC and NYPC will enter into a cross-margining agreement ("NYPC Agreement"). The NYPC Agreement was filed with the Commission as part of proposed rule change SR-FICC-2010-09 and will be appended to the GSD Rules and made a part thereof.

Pursuant to the NYPC Agreement, and consistent with previous approvals of cross-margining arrangements involving DCOs,¹⁷ cross-margining with certain NYPC positions will be limited to positions carried in proprietary accounts of clearing members of NYPC. Customers of NYPC clearing members will not be permitted to participate in

Arrangement" as the arrangement established between FICC and one or more FCOs pursuant to Cross-Margining Agreements and GSD Rule 43.

¹⁶ The definition of "Required Fund Deposit," as revised by the proposed rule change, is the amount that a Netting Member is required by a GSD rule to contribute to GSD's clearing fund. See GSD Rule 1, Definitions.

¹⁷ See, e.g., Securities Exchange Act Release No. 44301 (May 11, 2001), 66 FR 28207 (approving a proposed rule change establishing cross-margining between FICC and CME) and Securities Exchange Act Release No. 27296 (September 26, 1989), 54 FR 41195 (approving a proposed rule changes establishing cross-margining between The Options Clearing Corporation and the CME).

the NYPC Arrangement, as their participation would require the resolution of additional issues associated with fund segregation and operations. Neither FICC nor NYPC rules require their members to participate in the NYPC Arrangement, and any such participation by FICC and NYPC members will be voluntary. Joint Clearing Members and members of FICC and their Permitted Margin Affiliates will be required to execute the requisite cross-margining participant agreements.¹⁸

FICC will be responsible for performing the margin calculations in its capacity as the Administrator under the terms of the NYPC Agreement. Specifically, FICC will determine the combined FICC clearing fund and NYPC original margin requirement for each participant.¹⁹ FICC will calculate those requirements using a Value-at-Risk (“VaR”) methodology, with a 99 percent confidence level and a 3-day liquidation period for cash positions and a 1-day liquidation period for futures positions. In addition, each cross-margining participant’s “one-pot” margin requirement will be subject to a daily back test, and a supplemental risk-related charge referred to as a coverage component that will be applied to the participant in the event that the back test reflects insufficient coverage. The “one-pot” margin requirement for each participant would then be allocated between FICC and NYPC in proportion to the clearing organizations’ respective “stand-alone” margin requirements – in other words, an amount reflecting the ratio of what each clearing organization would have required from that participant if it was not participating in the cross-margining program (“Constituent Margin Ratio”). The NYPC Agreement provides that either FICC or NYPC can, at any time, require additional

¹⁸ The NYPC Agreement and the cross-margining participant agreements for Joint Members and Permitted Affiliates were filed with the Commission as part of the proposed rule change.

¹⁹ Original margin is the NYPC equivalent of the FICC clearing fund.

margin to be deposited by a Cross-Margining Participant above what is calculated under the NYPC Agreement based upon the financial condition of the participant, unusual market conditions, or other special circumstances (e.g., in the event of regulatory or criminal proceedings). The standards that FICC proposes to use for these purposes are the standards currently contained in the GSD rules, so that notwithstanding the calculation of a Cross-Margin Participant's clearing fund requirement pursuant to the NYPC Agreement, FICC will retain its rights under the GSD rules to charge additional clearing fund contributions under the circumstances specified in the GSD rules. For example, the GSD rules provide that if a Dealer Netting Member falls below its minimum financial requirement, it shall be required to make additional clearing fund contributions equal to the greater of (i) \$1 million or (ii) 25 percent of its Required Fund Deposit.

FICC will utilize the same VaR methodology for calculating margin for futures and cash positions. Under this method, the prior 250 days of historical information for futures positions and the prior 252 days of historical information for cash positions, including prices, spreads and market variables such as Treasury zero-coupon yields and London Interbank Offered Rate curves, are used to simulate the market environments in the forthcoming 1 day for futures positions and the forthcoming 3 days for cash positions. Projected portfolio profits and losses are calculated assuming these simulated environments will actually be realized. These simulations will be used to calculate VaR. Historical simulation is a continuation of the FICC margin methodology.

With respect to the confidence level, FICC currently utilizes extreme value theory²⁰ to determine the 99th percentile of loss distribution. Upon implementation of the

²⁰ Extreme value theory is used to analyze outcomes beyond the 99 percent confidence interval used for VaR and provides an assessment of the size of these events.

NYPC Arrangement, FICC will utilize a front-weighting mechanism to determine the 99th percentile of loss distribution. This front-weighting mechanism will place more emphasis on more recent observations. Additionally, FICC's VaR methodology will be enhanced to accommodate more securities; as a result, certain CUSIPs, which are now considered to be "non-priceable" (because, for example, of a lack of historical information regarding the security) and subject to a "haircut" requirement (i.e., fixed percentage charge) where offsets are not permitted, will be treated as "priceable" and therefore included in the core VaR calculation.

Based on preliminary analyses, FICC expects that the FICC VaR component of the clearing fund requirement may be reduced by as much as approximately 20 percent for common FICC-NYPC members as a result of the NYPC Arrangement. In order to help ensure that this reduction in clearing fund is appropriately correlated to more precise assessment of exposures associated with considering offsetting positions and will not result in increased risks to the clearing agency, FICC has performed back testing analysis to verify that there will be sufficient coverage after the FICC-NYPC cross-margining reductions are applied.

In the event of the insolvency or default of a member that participates in the NYPC Arrangement, the positions in such participant's "one-pot" portfolio, including, where applicable, the positions of its Permitted Margin Affiliate at NYPC, will be liquidated by FICC and NYPC as a single portfolio and the liquidation proceeds will be applied to the defaulting participant's obligations to FICC and NYPC in accordance with the provisions of the NYPC Agreement.

The NYPC Agreement provides for the sharing of losses by FICC and NYPC in the event that the "one-pot" portfolio margin deposits of a defaulting participant are not

sufficient to cover the losses resulting from the liquidation of that participant's trades and positions. This loss-sharing arrangement can be summarized as follows:

- If either clearing organization had a net loss ("worse-off party"), and the other had a net gain ("better-off party") that is equal to or exceeds the worse-off party's net loss, then the better-off party pays the worse-off party the amount of the latter's net loss. In this scenario, one clearing organization's gain will extinguish the entire loss of the other clearing organization.
- If either clearing organization had a net loss ("worse-off party") and the other clearing organization had a net gain ("better-off party") that is less than or equal to the worse-off party's net loss, then the better-off party will pay the worse-off party an amount equal to the net gain. Thereafter, if such payment did not extinguish the net loss of the worse-off party, the better-off party will pay the worse-off party an amount equal to the lesser of: (i) the amount necessary to ensure that the net loss of each clearing organization is in proportion to the Constituent Margin Ratio or (ii) the better-off party's "Maximum Transfer Payment" less the better-off party's net gain. The "Maximum Transfer Payment" will be defined with respect to each clearing organization to mean an amount equal to the product of (i) the sum of the aggregate margin reductions of the clearing organizations and (ii) the other clearing organization's Constituent Margin Ratio – in other words, the amount by which the other clearing organization reduced its margin requirements in reliance on the cross-margining arrangement. In this scenario, one clearing organization's gain does not completely extinguish the entire loss of the other clearing organization, and the better-off party will be required to make an

additional payment to the worse-off party. This potential additional payment will be capped as described in this paragraph.

- If either clearing organization had a net loss, and the other had the same net loss, a smaller net loss, or no net loss, then:
 - In the event that the net losses of the clearing organizations were in proportion to the Constituent Margin Ratio, no payment will be made.
 - In the event that the net losses of the clearing organizations were not in proportion to the Constituent Margin Ratio, then the clearing organization that had a net loss which was less than its proportionate share of the total net losses incurred by the clearing organizations (“better-off party”) will pay the other clearing organization (“worse-off party”) an amount equal to the lesser of: (i) the better-off party’s Maximum Transfer Payment or (ii) the amount necessary to ensure that the clearing organizations’ respective net losses were allocated between them in proportion to the Constituent Margin Ratio.
- If FICC had a net gain after making a payment as described above, FICC will pay to NYPC the amount of any deficiency in the defaulting member’s customer segregated funds accounts or, if applicable, such defaulting member’s Permitted Margin Affiliate held at NYPC up to the amount of FICC’s net gain.
- If FICC received a payment under the Netting Contract and Limited Cross-Guaranty (“Cross-Guaranty Agreement”)²¹ to which it is a party (i.e., because

²¹ FICC’s predecessors, the Government Securities Clearing Corporation (“GSCC”) and the MBS Clearing Corporation (“MBSCC”), filed rule filings in 2001 to enter into the Cross-Guaranty Agreement with The Depository Trust Company,

FICC had a net loss), and NYPC had a net loss, FICC will share the cross-guaranty payment with NYPC pro rata, where such pro rata share is determined by comparing the ratio of NYPC's net loss to the sum of FICC's and NYPC's net losses. This allocation is appropriate because the "one-pot" combines FICC and NYPC proprietary positions into a unified portfolio that will be margined and liquidated as a single unit. FICC will no longer need to share the cross-guaranty payments with NYPC once NYPC becomes a party to the Cross-Guaranty Agreement.

The GSD rules will further provide that FICC will offset its liquidation results in the event of a close out of the positions of a Cross-Margining Participant in the NYPC Agreement first with NYPC because the liquidation will essentially be of a single Margin Portfolio and then will present its results for purposes of the multilateral Cross-Guaranty Agreement.

B. Access to NYPC Arrangement

FICC has represented that the NYPC Arrangement has been structured in a way that access to, and the benefits of, the "one-pot" are provided to other futures exchanges and DCOs on fair and reasonable terms as described below. The proposed "one-pot" cross-margining method is expected to allow members to post margin that should more accurately reflect the net risk of their aggregate positions across asset classes, thereby releasing excess capital into the economy for more efficient use. By linking positions in fixed income securities held at FICC with interest rate products traded on NYSE Liffe

National Securities Clearing Corporation, Emerging Markets Clearing Corporation, and The Options Clearing Corporation. Securities Exchange Act Release No. 45868 (May 2, 2002), 67 FR 31394. Under the agreement, if the assets of a defaulting member at one clearing agency exceed its liabilities to that clearing agency, those excess assets may be made available to satisfy the liabilities of that defaulting common member to another clearing agency.

U.S. and other designated contract markets (“DCMs”), the NYPC Arrangement has the potential to create a substantial pool of highly correlated assets that are capable of being cross-margined. This pool will deepen as more DCOs and DCMs join NYPC, creating the potential for even greater margin and risk offsets.

The proposed “one-pot” is required to be accessed by other futures exchanges and DCOs via NYPC.²² FICC stated that this is done to ensure the uniformity and consistency of risk methodologies and risk management, to simplify and standardize operational requirements for new participants and to maximize the effectiveness of the one-pot arrangement.

FICC stated that NYPC will initially clear certain contracts transacted on NYSE Liffe U.S. and that NYPC will clear for additional DCMs that seek to clear through NYPC as soon as it is feasible for NYPC do so. Such additional DCMs will be treated in the same way as NYSE Liffe US, i.e., they must: (i) be eligible under the rules of NYPC, (ii) contribute to NYPC’s guaranty fund, (iii) demonstrate that they have the operational and technical ability to clear through NYPC, and (iv) enter into a clearing services agreement with NYPC.

Moreover, NYPC has also committed to admit other DCOs as limited purpose participants as soon as it is feasible, thereby allowing such DCOs to participate in the

²² Section 16 of the NYPC Agreement provides that FICC covenants and agrees that, during the term of the NYPC Agreement: (i) NYPC-cleared contracts shall have priority for margin offset purposes over any other cross-margining agreement; (ii) FICC will not enter into any other cross-margining agreement if such agreement would adversely affect the priority of NYPC and FICC under the NYPC Agreement with respect to available assets; and (iii) FICC will not, without the prior written consent of NYPC, amend the CME Agreement, if such further amendment would adversely affect NYPC’s right to cross-margin positions in eligible products prior to any cross-margining of CME positions with FICC-cleared contracts or adversely affect the priority of NYPC and FICC under the NYPC Agreement with respect to available assets.

one-pot margining arrangement with FICC through their limited purpose membership in NYPC.²³ Such DCOs will be required to satisfy pre-defined, objective criteria set forth in NYPC's rules.²⁴ In particular, such DCOs must: (i) submit trades subject to the limited purpose participant agreement between NYPC and each DCO that would otherwise be cleared by the DCO to NYPC, with NYPC acting as central counterparty and DCO with respect to such trades,²⁵ (ii) be eligible under the rules of NYPC and agree to be bound by the NYPC rules,²⁶ (iii) contribute to NYPC's guaranty fund,²⁷ (iv) provide clearing services to unaffiliated markets on a "horizontal" basis (i.e., not limit their provision of clearing services on a vertical basis to a single market or limited number of markets),²⁸ and (v) agree to participate using the uniform risk methodology and risk management

²³ See NYPC Agreement, Section 14.

²⁴ NYPC's rules can be viewed as part of NYPC's DCO registration application on the CFTC's website (www.cftc.gov), as well as on NYPC's website (www.nypclear.com).

²⁵ See NYPC Rule 801(b)(1).

²⁶ See NYPC Rule 801(b)(2).

²⁷ The NYPC Agreement provides that except as otherwise provided in a limited purpose participant agreement, a limited purpose participant shall make a contribution to the NYPC Guaranty Fund in form and substance similar to and in an amount that is no less than the amount of the NYSE Guaranty, which will initially consist of a \$50,000,000 guaranty secured by \$25,000,000 in cash during the first year of NYPC's operations. FICC and NYPC have subsequently clarified and affirmatively represented that the limited purpose participant agreements will be individually negotiated and that "the Guaranty Fund contribution that will be required by NYPC from any Limited Purpose Participant will be determined by risk-based factors without regard to whether such contribution amount is more or less than the amount contributed to the NYPC Guaranty Fund by NYSE Euronext." See Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011). See also Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

²⁸ See NYPC Rule 801(c)(1)(i).

policies, systems and procedures that have been adopted by FICC and NYPC for implementation and administration of the NYPC Arrangement.²⁹ Reasonable clearing fees will be allocated between NYPC and the limited purpose participant DCO as may be agreed by NYPC and the DCO, taking into account factors such as the cost of services (including capital expenditures incurred by NYPC), technology that may be contributed by the limited purpose participant, the volume of transactions, and such other factors as may be relevant.

FICC and NYPC anticipate that the limited purpose participant agreement will encompass the foregoing requirements for limited purpose membership contained in NYPC's rules. Because each DCO could present different operational issues, terms beyond the basic rules provisions will be discussed on a case-by-case basis and reflected in the respective limited purpose participant agreement accordingly. FICC and NYPC envision that a possible structure for DCO limited purpose participation could be an omnibus account, with the DCO limited purpose participant essentially acting as a processing agent for its clearing members vis-a-vis NYPC with respect to the submission of eligible positions of the DCO's clearing members to NYPC for purposes of inclusion in the one-pot arrangement with FICC. In order for their eligible positions to be included in the "one-pot," clearing members of the DCO limited purpose participant would be required to authorize the DCO to submit their positions to NYPC. Under such a structure, the DCO would be responsible for fulfilling all margin and guaranty fund requirements associated with the activity in the omnibus account.

With respect to both the clearance of trades for unaffiliated DCMs and the admission of DCOs as limited purpose participants, FICC has indicated that NYPC has

²⁹ See NYPC Rule 801(c)(1)(ii).

committed that it will complete the process to allow one or more DCMs or DCOs to be admitted and integrated into the “one-pot” cross-margining arrangement as soon as feasible, but no later than 24 months from the start of operations. FICC has represented that this provision is necessary to the effective implementation of the one-pot cross-margining methodology and that this window of time is required to allow for refinement and enhancement of certain systems after operations commence, to allow time for the possible simultaneous integration with multiple major clearing members so that fair market access is assured, and to allow time for the completion of the material operational challenge of connecting and integrating NYPC with the separate technologies of other DCMs and/or DCOs. However, during this interim period, NYPC may engage, and FICC has represented in its filing to the Commission that NYPC is engaging, in discussions with other DCMs and DCOs. FICC has also represented in its filing that NYPC anticipates that it will be able to complete the integration of additional DCMs and/or DCOs in advance of this two-year period.

C. Other GSD Proposed Rule Changes

The proposed rule filing allows FICC to permit margining of positions held in accounts of an affiliate of a member within GSD, akin to the inter-affiliate margining in the CME Arrangement and the proposed NYPC Arrangement. Thus, as in those arrangements, if a GSD member defaults, its GSD clearing fund deposits, cash settlement amounts and other available collateral will be available to FICC to cover the member’s default, as will the GSD clearing fund deposits and available collateral of any Permitted Margin Affiliate with which it cross-margins.

1. Loss Allocation

Under the current loss allocation methodology in GSD Rule 4, Clearing Fund and

Loss Allocation, GSD allocates losses first to the most recent counterparties of a defaulting member. The proposed changes to GSD Rule 4 will delete this step in the loss allocation methodology in order to achieve a more even distribution of losses among GSD members without a focus on recent counterparties.

Under the proposed rule change any loss allocation will be made first against the retained earnings of FICC attributable to GSD in an amount up to 25 percent of FICC's retained earnings or such higher amount as may be approved by the Board of Directors of FICC.

If a loss still remains, GSD will divide the loss between the FICC Tier 1 Netting Members and the FICC Tier 2 Netting Members. The terms "Tier 1 Netting Member" and "Tier 2 Netting Member" have been introduced in the GSD Rules to reflect two different categories of membership, which have been designated as such by FICC for loss allocation purposes. Currently, only investment companies registered under the Investment Company Act of 1940, as amended, (which companies are subject to regulatory requirements restricting their ability to mutualize losses) will qualify as Tier 2 Netting Members. Tier 2 Netting Members will only be subject to loss to the extent they traded with the defaulting members and will not be responsible for mutualizing losses with participants with which they do not trade, in order to account for regulatory requirements applicable to such registered investment companies.

Tier 1 Netting Members will be allocated the loss applicable to them first by assessing the Clearing Fund deposit of each such member in the amount of up to \$50,000, equally. If a loss remains, Tier 1 Netting Members will be assessed ratably in accordance with the respective amounts of their Required Fund Deposits based on the average daily amount of the member's Required Fund Deposit over the prior twelve months.

Consistent with the current GSD rules, GSD members that are acting as inter-dealer brokers will be limited to a loss allocation of \$5 million with respect to their inter-dealer broker activity.

2. Margin Calculation—Intraday Margin Calls

GSD proposes to calculate Clearing Fund requirements twice per day. GSD will retain its regular calculation and call as set out in the GSD rules. An additional daily intra-day calculation and call (“Intraday Supplemental Clearing Fund Deposit”) are being added to GSD’s rules.³⁰ The intra-day call will be subject to a threshold that will be identified in FICC’s risk management procedures.³¹ In addition, GSD will process a mark-to-market pass-through twice per day, instead of the current practice of once daily. The second collection and pass-through of mark-to-market amounts will include a limited set of components to be defined in FICC’s risk management procedures. All mark-to-market debits will be collected in full. FICC will pay out mark-to-market credits only after any intra-day clearing fund deficit is met.

Since GSD will be recalculating and margining a GSD member’s exposure intraday, the margin calculation methodology set forth in GSD Rule 4, Clearing Fund and Loss Allocation, will be revised to eliminate the “Margin Requirement Differential” component of the FICC clearing fund calculation. In addition, GSD Rule 4 will be revised to provide that in the case of a Margin Portfolio that contains accounts of a Permitted Margin Affiliate, FICC will apply the highest VaR confidence level applicable

³⁰ See GSD Rule 4, Clearing Fund and Loss Allocation, Section 2a as proposed to be amended by the proposed rule change.

³¹ Id. FICC shall establish procedures for collection of an amount calculated in respect of a Member’s Intraday Supplemental Fund Deposit, including parameters regarding threshold amounts that require payment, and the form and time by which payment is required to be made to FICC.

to the GSD member or the Permitted Margin Affiliate, in the event that multiple confidence levels are used to determine margin. Application of a higher VaR confidence level will result in a higher margin rate. Consistent with current GSD rules, a minimum Required Fund Deposit of \$5 million will apply to a member that maintains broker accounts.

3. Consolidated Funds-Only Settlement

The funds-only settlement process at GSD currently requires a member to appoint a settling bank that will settle the member's net debit or net credit amount due to or from GSD by way of the National Settlement Service of the Board of Governors of the Federal Reserve System ("NSS"). Any funds-only settling bank that will settle for a member that is also an NYPC member or that will settle for a member and a Permitted Margin Affiliate that is an NYPC member will have its net-net credit or debit balances at each clearing corporation, other than balances with respect to futures positions of a "customer" as such term is defined in CFTC Regulation 1.3(k), aggregated and netted for operational convenience and will pay or be paid such netted amount. The proposed rule change makes clear that, notwithstanding the consolidated settlement, the member will remain obligated to GSD for the full amount of its funds-only settlement amount.

4. Submission of Locked-In Trades from NYPC

The current GSD rules allow for submission of "locked-in trades" (i.e., trades that are deemed compared when the data on the trade is received from a single source)³²

³² The term "Locked-In Trade" means a trade involving Eligible Securities that is deemed a compared trade once the data on such trade is received from a single, designated source and meets the requirements for submission of data on a locked-in trade pursuant to GSD's rules, without the necessity of matching the data regarding the trade with data provided by each member that is or is acting on behalf of an original counterparty to the trade. The data regarding a locked-in

submitted by a locked-in trade source on behalf of a GSD member. Currently, designated locked-in trade sources are Federal Reserve Banks on behalf of the Treasury Department, Freddie Mac, and GCF-Authorized Inter-Dealer Brokers for GCF Repo transactions.

Under the proposed rule change, GSD Rule 6C, Locked-In Comparison, will be amended to include NYPC as an additional locked-in trade source. This is necessary because there will be futures transactions cleared by NYPC that will proceed to physical delivery.

NYPC will submit the trade data as a locked-in trade source for processing through FICC, identifying the GSD member that had authorized FICC to accept the locked-in trade from NYPC. Once these transactions are submitted to FICC, they will no longer be futures, but rather will be in the form of buys or sells eligible for processing by GSD. As will be the case with other locked-in trade submissions accepted by FICC, the GSD member designated in the trade information must have executed appropriate documentation evidencing to FICC its authorization of NYPC.

5. Deletion of the Category 1/Category 2 Distinction

The proposed rule change will delete the legacy characterization of certain types of members as either "Category 1" or "Category 2," a distinction that currently applies to "Dealer Netting Members," "Futures Commission Merchant Netting Members" and "Inter-Dealer Broker Netting Members" at GSD. Historically, the two categories were used to margin lower capitalized members (i.e., Category 2) at a higher rate. Following FICC's adoption of the VaR methodology for GSD in 2006,³³ FICC has determined that the distinction between Category 1 and Category 2 members is no longer necessary. Rather than margin netting members at higher rates solely due to a single static

trade are provided to FICC by a locked-in trade source that has been authorized by a member that is a party to the trade to provide such data to FICC.

³³ Securities Exchange Act Release No. 55217 (January 31, 2007), 72 FR 5774.

capitalization threshold, FICC is able, by use of the VaR margin methodology, to margin netting members at a higher rate by applying a higher confidence level against any netting member, which, regardless of size, FICC has determined poses a higher risk.

With the deletion of the Category 1/Category 2 distinction, Section 1 of GSD Rule 13, Funds-Only Settlement, is proposed to be changed to provide that all netting members could receive forward mark adjustment payments, subject to FICC's general discretion to withhold credits that would be otherwise due to a distressed netting member.

6. Amendment of CME Agreement

The proposed NYPC Arrangement will necessitate an amendment to the CME Agreement to clarify that the NYPC Arrangement will take priority over the CME Arrangement when determining residual FICC positions that will be available for cross-margining with the CME. As a result, only those FICC positions that are not able to be cross-margined with NYPC positions under the NYPC Arrangement will generally be considered for cross-margining with the CME. In addition, when calculating and presenting liquidation results under the CME Agreement, the amendment will provide that FICC's liquidation results will include FICC's liquidation results in combination with NYPC's liquidation results because the NYPC Agreement will provide for a right of first offset between FICC and NYPC. The CME Agreement showing the proposed changes was filed as an attachment to the proposed rule change as part of Exhibit 5.

D. Summary of Other Proposed Changes to Rule Text

In GSD Rule 1, Definitions, the following definitions are proposed to be added, revised or deleted:

The terms "Broker Account" and "Dealer Account" will be added to the text of the GSD Rules. A "Broker Account" is an account that is maintained by an inter-dealer

broker netting member, or a segregated broker account of a netting member that is not an inter-dealer broker netting member. An account that is not a Broker Account is referred to as a Dealer Account.

“Coverage Charge” will be revised to refer to the additional charge with respect to the member’s Required Fund Deposit (rather than its VaR Charge) which brings the member’s coverage to a targeted confidence level.

“Current Net Settlement Positions” will be corrected to clarify its current intent, that it is calculated with respect to a certain business day and not necessarily on that day, since it may be calculated after market close on the day prior to its application (i.e., before or after midnight between the close of business one day and the open of business on the next day).

“Excess Capital Differential” will be corrected to refer to the amount by which a member’s VaR Charge exceeds its excess capital, instead of by reference to the amount by which its required clearing fund deposit exceeds its excess capital.

“Excess Capital Premium Calculation Amount” will be deleted because, with the introduction of VaR methodology, the calculation is no longer applicable. The terms “Excess Capital Differential” and “Excess Capital Ratio” will be amended to delete archaic references to “Excess Capital Premium Calculation Amount” and to refer instead to the comparison of a member’s capital calculation to its VaR Charge. In addition, the text of Section 14 of GSD Rule 3 will be amended to provide that the “Excess Capital Premium” charge applies to any type of entity that is a GSD netting member rather than limiting its applicability to only the specified types formerly identified in the text.

“Excess Capital Ratio” will be amended to mean the quotient resulting from dividing the amount of a member’s VaR Charge by its excess net capital.

“GSD Margin Group” will be added to refer to the GSD accounts within a Margin Portfolio.

“Margin Portfolio” will be added to refer to the positions designated by the member as grouped for cross-margining, subject to the rules set forth in GSD Rule 4. “Dealer Accounts” and “Broker Accounts” cannot be combined in a common Margin Portfolio. A “Sponsoring Member Omnibus Account” cannot be combined with any other accounts.

“Unadjusted GSD Margin Portfolio Amount” will be added to define the amount calculated by GSD with regard to a Margin Portfolio, before application of premiums, maximums or minimums. It includes the VaR Charge and the coverage charge for GSD. In the case of a Cross-Margining Participant of GSD, the Unadjusted GSD Margin Portfolio Amount also will include the cross-margining reduction, if any.

The terms “Category 2 Gross Margin Amount,” “Margin Adjustment Amount,” “Repo Volatility Factor,” and “Revised Gross Margin Amount” will be deleted from GSD Rule 1 since they are no longer used elsewhere in the GSD Rules. The Schedule of Repo Volatility Factors will be deleted because it is no longer applicable.

In Section 2 of GSD Rule 3, Ongoing Membership Requirements, the requirement that GCF counterparties submit information relating to the composition of their NFE-related accounts,³⁴ will be amended to require the submission of such information periodically, rather than on a quarterly basis. GSD currently requires this information

³⁴ The term “NFE-Related Account” means each securities account and deposit account maintained by a GCF Clearing Agent Bank for an Interbank Pledging Member in which the GCF Clearing Agent Bank has, pursuant to agreement with the Interbank Pledging Member or by operation of law, a security interest or right of setoff securing or supporting the payment of obligations of such Interbank Pledging Member to the Bank, including each such account to which such Interbank Pledging Member’s Prorated Interbank Cash Amount is debited. See GSD Rule 1, Definitions.

every other month and by this change, FICC could institute periodic reporting on a schedule that is appropriate at such time, in response to current conditions. This has the potential to help tailor the frequency of reporting based on market conditions and thereby facilitate the risk management of the clearing agency.

In Section 9 of GSD Rule 4, Clearing Fund and Loss Allocation, concerning the return of excess deposits and payments, FICC's discretion to withhold the return of excess clearing fund to a member that has an outstanding payment obligation to FICC will be changed from being based on FICC's determination that the member's anticipated transactions or obligations over the next 90 calendar days may be reasonably expected to be materially different than those of the 90 prior calendar days, under the current rule, to being based on FICC's determination that the member's anticipated transactions or obligations in the near future may be reasonably expected to be materially different than those in the recent past. In addition, technical and clarifying changes are proposed to be made to the rules and cross-references to rule sections contained throughout. The rules have been reviewed by FICC and proposed to be corrected as needed to reflect the correct rule section references as originally intended.

III. Comments

The Commission received thirteen comments to the proposed rule change and four response letters responding to comments.³⁵ Nine commenters supported the proposed rule.³⁶ Of this group, seven commenters generally stated that the cross-

³⁵ See supra notes 3 and 4.

³⁶ Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS

marginizing proposal benefits competition by permitting “open access” to cross-margining.³⁷ In addition, six commenters argued that the proposed rule change permits risk minimization³⁸ and promotes transparency.³⁹

Three commenters opposed the proposed rule, absent changes to mitigate what they identified as anti-competitive features.⁴⁰ One commenter recommended further

Securities, LLC (December 20, 2010); Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from Douglas Engmann, President, Engmann Options, Inc. (December 6, 2010); and Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010).

³⁷ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); and Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010).

³⁸ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Douglas Engmann, President, Engmann Options, Inc. (December 6, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

³⁹ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

⁴⁰ Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); and

study of the rule and its risk methodology, but agreed with the commenters opposing the proposed rule change on the grounds that the rule should permit only non-exclusive arrangements that promote competition.⁴¹ The commenters against the proposed rule change generally stated that the cross-margining scheme is anti-competitive and raises risk management issues. These commenters raised concerns or provided comments related to the following major aspects of the cross-margining proposal: (1) the effect on competition; (2) risk management; and (3) the effect on efficiency and costs. FICC responded to these comments in three comment letters that it submitted.⁴²

A. Effect on Competition

Many of the commenters' concerns with respect to competition stemmed from FICC having an exclusive agreement to enter into a direct arrangement for "one-pot" cross-margining with NYPC.⁴³ NYPC is jointly owned by NYSE Euronext and DTCC. DTCC is the parent company of FICC. NYSE Liffe is the global derivatives business of the NYSE Euronext. These affiliations combined with the exclusive nature of the direct

Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010).

⁴¹ Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

⁴² Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

⁴³ Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

arrangement raised concerns for these commenters.

With regard to allowing other parties direct access to cross-margining, FICC argued that it is neither operationally feasible nor prudent to establish a framework of multiple, competing “one-pots” with multiple, competing DCOs under this arrangement.⁴⁴ Among other things, such an arrangement would result in FICC clearing members that are members of multiple DCOs cross-margining their futures positions against different segments of their portfolios at FICC, rather than having the risk of their positions being measured comprehensively.⁴⁵ FICC stated that it believes that the attendant risk of delays and errors in processing would substantially increase systemic risk as clearing members continuously moved positions at FICC from one cross-margin pot to another in order to maximize their margin savings.⁴⁶ For example, there is the potential that operational issues of managing such movements across multiple systems would create risks in the settlement process by adding complexities associated with linking and monitoring the use of multiple one cross-margin pot arrangements. Furthermore, FICC stated that the existence of multiple “one-pots” would likely greatly complicate the liquidation of a cross-margining participant that was in default at FICC and NYPC, thereby increasing systemic risk.⁴⁷

Commenters recognized that other DCOs (i.e., DCOs other than NYPC) will have the ability to obtain indirect access to the cross-margining arrangement by entering into a Limited Purpose Participant (“LPP”) agreement and becoming an LPP of NYPC.

⁴⁴ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ Id.

Commenters raised concerns about the potential for this type of indirect access, citing concerns about the requirements to agree to be bound by the rules of NYPC, agree to an allocation of clearing fees, and contribute to the NYPC guaranty fund in an amount equal to the contribution made by NYSE Euronext.⁴⁸

FICC responded to these comments.⁴⁹ Specifically, FICC stated that, while DCOs that are LPPs clearing through NYPC would need to abide by NYPC's rules, NYPC's intention is that there would be separate requirements (including with respect to margin deposits and guaranty fund contributions applied) to the LPP, on the one hand, and the LPP's members, on the other, unless: (i) NYPC and the LPP separately agree to allocate those amounts to the LPP and its members, or (ii) a clearing member of NYPC is also a clearing member of an LPP.⁵⁰ FICC and NYPC also represented that the NYPC rules would apply to a LPP but not to the members of the LPP, unless such members are otherwise clearing members of NYPC.⁵¹ In addition, FICC noted that NYPC Rule 801 is designed to permit maximum flexibility in structuring the admission of LPPs, as it is contemplated that any such admission would be subject to substantial negotiation

⁴⁸ Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

⁴⁹ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011) and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation; Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

⁵⁰ Id.

⁵¹ Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

between NYPC and the prospective LPP regarding the operational mechanics of margin deposits and related subjects.⁵²

In addition, FICC has represented to the Commission that the fees NYPC charges LPPs will be determined on a case-by-case basis based on the services provided to recoup operational and other costs that NYPC incurs in integrating the new LPP.⁵³ Moreover, FICC and NYPC clarified and affirmatively represented that the limited purpose participant agreements will be individually negotiated and that “the Guaranty Fund contribution that will be required by NYPC from any Limited Purpose Participant will be determined by risk-based factors without regard to whether such contribution amount is more or less than the amount contributed to the NYPC Guaranty Fund by NYSE Euronext.”⁵⁴

Three commenters also noted that under the proposed structure, it may take up to two years before other DCMs are permitted to clear at NYPC or before other DCOs might be given indirect access in order to participate in the NYPC Arrangement, which

⁵² Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011) and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011).

⁵³ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

⁵⁴ Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011) and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

may cause commercial impairment.⁵⁵ Two other commenters, however, argued that the delay is not unduly burdensome on competition,⁵⁶ with one in particular explaining that “[a]ny new arrangement needs the requisite time to ensure that it satisfies all of the underlying concerns and issues that may occur with any new concept.”⁵⁷ FICC responded, saying that the transition period is necessary to complete implementation, systems integration, and testing, among other things, and that it and NYPC have pledged to open the arrangement to other participants as soon as operationally feasible.⁵⁸ FICC also stated that attempting to integrate a pre-existing clearinghouse directly into the “one-pot” cross-margining arrangement would by necessity be even more difficult and likely more costly than the integration between FICC and NYPC, which was created in order to cross-margin positions with FICC.⁵⁹ In addition, FICC has previously stated that NYPC

⁵⁵ Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

⁵⁶ Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010) and Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010).

⁵⁷ Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010).

⁵⁸ FICC represented that “[f]ollowing the announcement of NYPC, FICC, the NYPC management team and senior management of NYSE Euronext have repeatedly reached out to [The Options Clearing Corporation], as well as other DCOs and DCMs, to initiate the process of integrating such other organizations into the ‘single pot’. While those efforts have not yet been productive, FICC and NYPC remain committed to expanding the ‘single pot’ to include other DCOs and DCMs.” Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011). See also supra Section II.B., at 16.

⁵⁹ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt

has committed that it will complete the process to allow one or more DCMs or DCOs to be admitted and integrated into the “one-pot” cross-margining arrangement as soon as feasible, but no later than 24 months from the start of operations.

The nine commenters in favor of the proposed rule change generally argued that the rule change will increase competition in trade execution and clearing which, in turn, will encourage innovation, efficiency, and improved choices.⁶⁰ Furthermore, FICC also indicated that its proposal promotes competition. Specifically, FICC stated that “[u]nlike the traditional ‘vertical’ relationship between futures exchanges and their affiliated ...DCOs..., NYPC has been uniquely structured... to allow unaffiliated DCOs and ... DCMs... ‘open access’ to the benefits of the ‘single pot’ cross-margining arrangement as soon as operationally feasible, subject to only certain object, reasonable and non-discriminatory criteria.”⁶¹ FICC also stated that the current market for clearing U.S. dollar-denominated interest rates is dominated by one entity and that its approach has the potential to introduce competition in this market.⁶²

Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011).

⁶⁰ See, e.g., Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010).

⁶¹ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

⁶² Id.

B. Risk Management

Five commenters believed that the proposal would increase the transparency of risks across asset classes and allow regulators to better monitor and assess risk.⁶³ These commenters supported the proposed rule's use of the Value at Risk (VaR) methodology, because it is well understood, has been extensively tested, and relies on historical information to simulate the market.⁶⁴ Moreover, two commenters noted that "one-pot" margining decreases the risk for market participants because it allows for the offset of risk between U.S. Treasury futures and U.S. Treasury cash bonds.⁶⁵ Additionally, two commenters believed that the proposal allows for a greater portion of financial instruments to be centrally cleared, which, among other things, reduces overall risk.⁶⁶

Two commenters, however, raised concerns about risk management, stating that because cross-margining allows for greater leverage than standard margining, in particular during periods of market stress and extreme volatility, the proposed rule may

⁶³ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

⁶⁴ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

⁶⁵ Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010) and Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010).

⁶⁶ Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010) and Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010).

increase systemic risk.⁶⁷ FICC responded by stating that “the NYPC-FICC margin model does not necessarily increase leverage and may, in fact, reduce leverage in highly risky portfolios with limited hedges.”⁶⁸ FICC further explained that, “[a]t the same time, the NYPC-FICC model can offer margin reductions for hedged portfolios because it more accurately estimates true economic risk by taking into account the benefits of highly correlated, offsetting positions in a single portfolio.”⁶⁹

One commenter suggested that the VaR method for calculating margin requirements should be tested further.⁷⁰ This commenter also suggested that the scenario-based Standard Portfolio Analysis of Risk (“SPAN”) method be considered and tested in comparison to VaR. FICC’s response noted that the proposed VaR methodology is based on a common method of historical simulation and that it has conducted risk-related testing, including sensitivity tests, back testing of the model’s validity, and stress tests of the sufficiency of the guaranty fund.⁷¹

One commenter requested that documentation of previous consideration of the risk aspects of the proposal be made public.⁷² In response, FICC provided a discussion

⁶⁷ Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010) and Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010).

⁶⁸ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

⁶⁹ Id.

⁷⁰ Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

⁷¹ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

⁷² Letter from Alex Kogan, Vice President and Deputy General Counsel, NASDAQ OMX (January 10, 2011).

and analysis of its VaR methodology compared to SPAN.⁷³ FICC explained that because it needs to measure the risk of combined portfolios for futures and cash positions, it believes that a historical VaR-based margin model provides a more accurate estimate of portfolio risk than SPAN.⁷⁴ FICC noted, however, that because it is standard practice for the futures industry to use SPAN to calculate and monitor margin requirements, it will make available SPAN formatted calculations of its VaR-based customer risk parameters to clearing members and their customers. FICC also noted that in initially listing NYPC-clearing contracts, NYSE Liffe U.S. will use, among other factors, SPAN-formatted input parameters to establish minimum customer initial margin requirements for each NYPC-cleared interest rate contract and intra- and inter-commodity spreads.⁷⁵

C. Effect on Efficiency and Costs

Four commenters stated that the proposal promotes the reduction of risk that will lead to margin and capital efficiencies and lower costs.⁷⁶ One commenter believed that

⁷³ Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011). The public record contains information regarding testing that went to the subject of risk management. The Commission also received from FICC proprietary, highly confidential information, including information about individual portfolios. This non-public information, in addition to the public information submitted in support of the rule proposal, supported the Commission's conclusion that the proposal is consistent with the Act, but was not included in the public record because of its sensitivity.

⁷⁴ Id.

⁷⁵ Letter from Alex Kogan, Vice President and Deputy General Counsel, NASDAQ OMX (January 10, 2011).

⁷⁶ Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010).

“one-pot” margining would increase cash flow and margin efficiencies for certain clearing members.⁷⁷ Two commenters also stated that the “one-pot” approach will reduce delivery costs because it offers direct delivery of expiring futures contracts into cash bonds held at FICC, which will minimize fails and squeezes and improve price convergence and stress on the settlement system.⁷⁸ Additionally, two commenters that were opposed to the cross-margining agreement as proposed also expressed their general support for “one-pot” cross-margining on the ground that it reduces risk while facilitating more efficient uses of capital markets.⁷⁹

According to FICC’s response, the proposed rule streamlines the delivery process for U.S. Treasury futures, which will improve operational efficiency and decrease systemic settlement risk.⁸⁰ FICC also stated that the proposal should increase liquidity by providing market participants with an alternate venue for trading U.S. dollar-denominated interest rate futures contracts.⁸¹

IV. Discussion

The Commission has carefully considered the proposed rule change and the comments thereto and the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder, including

⁷⁷ Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010)

⁷⁸ Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010) and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

⁷⁹ Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010) and Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010).

⁸⁰ Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

⁸¹ Id.

Sections 17A(a)(2)(A)(ii)⁸² and 17A(b)(3)(A), (F) and (I) of the Act.⁸³

The proposed rule change provides for modifications to certain risk management related processes and definitions under GSD's rules, including changes to the loss allocation methodology, intraday margining, categories of membership, and related definitional changes. The Commission believes that these changes to GSD's rules are consistent with Sections 17A(b)(3)(A) and (F) of the Act because they should help facilitate and promote the prompt and accurate clearance and settlement of securities transactions, and help assure the safeguarding of securities and funds under FICC's control or for which it is responsible. In particular, the Commission believes that these changes to GSD's rules, by virtue of strengthening FICC's risk management and related operations, should result in a more timely, accurate, and efficient system of settlement.

In addition, the proposed rule change would provide for a cross-margining arrangement between certain positions in GSD and NYPC. The Commission's staff has closely evaluated the proposed cross-margining arrangement including the risk management, competition and efficiency issues raised by the proposed rule change (as discussed below) against the requirements of the Act, including Sections 17A(b)(3)(F) and (I) of the Act. Based on our staff's analysis, and taking into consideration the matters discussed throughout, including the representations discussed below, the Commission finds the proposed rule change is consistent with the Act.

⁸² 15 U.S.C. 78q-1(b)(2)(A)(ii). This provision directs the Commission to use its authority to facilitate the establishment of coordinated facilities for clearance and settlement of transactions in securities and contracts of sale for future delivery.

⁸³ 15 U.S.C. 78q-1(b)(3)(A), (F) and I. In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

A. Risk Management

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible.⁸⁴ The Commission has historically supported and approved cross-margining at clearing agencies and has previously recognized the potential benefits of cross-margining systems, which include freeing capital through reduced margin requirements, reducing clearing costs by integrating clearing functions, reducing clearing organization risk by centralizing asset management and harmonizing liquidation procedures.⁸⁵ The Commission has encouraged cross-margining arrangements as a way to promote more efficient risk management across product classes.⁸⁶ Cross-margining arrangements may be consistent with Section 17A(b)(3)(F) in that they may strengthen the safeguarding of assets through effective risk

⁸⁴ 15 U.S.C. 78q-1(b)(3)(F).

⁸⁵ See, e.g., Securities Exchange Act Release No. 27296 (September 26, 1989), 54 FR 41195 (approving proposed rule changes establishing cross-margining between The Options Clearing Corporation and the Chicago Mercantile Exchange) and Securities Exchange Act Release No. 26153 (October 3, 1988), 53 FR 39561 (approving proposed rule changes concerning cross-margining between The Options Clearing Corporation and the Intermarket Clearing Corporation). Previously, the Interim Report of the President's Working Group on Financial Markets (May 1988) recommended that the SEC and CFTC facilitate cross-margining programs among clearing organizations. In addition, the Bachmann Task Force, which was formed by the Commission in response to the 1987 Market Break, presented its findings to the Commission in May 1992 that included, among other things, a recommendation that cross-margining programs among clearing agencies be implemented or expanded. See Securities Exchange Act Release No. 31904 (February 23, 1993), 58 FR 11806 (March 1, 1993).

⁸⁶ See Securities and Exchange Act Release No. 44301, 66 FR 28297 (May 11, 2001) (order approving a "two-pot" cross-margining proposal between FICC's predecessor and CME). In addition, the Interim Report of the President's Working Group on Financial Markets (May 1988) also recommended that the SEC and CFTC facilitate cross-margining programs among clearing organizations.

controls that more broadly take into account offsetting positions of participants in both the cash and futures markets, and promote prompt and accurate clearance and settlement of securities through increased efficiencies.

As set forth in the proposal, FICC will perform margin calculations using VaR methodology with a 99 percent confidence level and 3-day liquidation for cash positions and 1-day liquidation for futures, using historical information for the prior year (250 trading days for futures and 252 for cash positions) and the margin calculations will employ a front weighted mechanism that places a greater emphasis on more recent observations. FICC will also conduct daily back testing and assess an additional coverage component charged to participants if the back tests show insufficient coverage. In the event of unusual market conditions, FICC or NYPC could at any time require additional margin provided such requirements are consistent with the standards in Section 17A of the Exchange Act. The Commission believes these actions assist in the promotion under the proposed cross-margining arrangement of prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds consistent with the requirements under Section 17A(b)(3)(F) of the Act because they would facilitate appropriate risk management by FICC by providing flexibility and promoting ongoing monitoring of risk.⁸⁷

The proposal also contains provisions for managing risk in the event of a member default. The NYPC Agreement provides for the sharing of losses by FICC and NYPC in the event that the "one-pot" portfolio margin deposits of a defaulting participant are not sufficient to cover the losses resulting from the liquidation of that participant's trades and positions. In the event of a member default, the proposal requires that FICC and NYPC

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15 U.S.C. 78q-1(b)(3)(F).

would liquidate posted margin as a single portfolio, which will allow them to preserve the value of the assets posted as collateral. In addition, FICC and NYPC are providing financial guarantees to each other in the event the available collateral is insufficient. These features of the proposed rule change would help to ensure that FICC is able to meet its settlement obligations in the event of default. As a result, the Commission believes that the proposal would promote the prompt and accurate clearance and settlement of securities transactions and assure the safeguarding of securities and funds in a manner consistent with Section 17A(b)(3)(F) of the Act.⁸⁸

The Commission has previously noted that cross-margining systems entail certain risks.⁸⁹ For instance, even in normal market conditions, products that have been highly correlated in the past may diverge and may diverge even more so in extreme market conditions. Such a breakdown in correlation might lead to inadequate clearing margins or losses upon a liquidation. To address these concerns, as noted in the description of the proposed rule change and in FICC's response letters, FICC has performed testing of the VaR margining model. This included sensitivity tests of the model to changing market conditions, back tests of sample portfolios to check model validity, stress tests of sample portfolios to test the sufficiency of the NYPC guaranty fund, and back tests to verify the sufficiency of coverage after the FICC-NYPC cross-margining reductions are applied.

The Commission takes commenters' concerns about risk management seriously. As discussed below, to provide the Commission with enhanced ability to monitor FICC's risk management, FICC has represented and undertaken to make continuing risk analysis reports, discussed below, to the Commission. This ongoing reporting should also help

⁸⁸ 15 U.S.C. 78q-1(b)(3)(F).

⁸⁹ Securities Exchange Act Release No. 26153 (October 3, 1988), 53 FR 39561.

FICC conduct its own monitoring of the NYPC Arrangement. In addition, FICC is subject to the Commission's ongoing examination program, which examines registered clearing agencies with respect to their risk management systems and other aspects of their operations. The Commission believes FICC's prior analysis, as discussed above, as well as FICC's commitment to provide additional reports on a periodic basis will promote the prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds in a manner consistent with Section 17A(b)(3)(F) of the Act.

B. Competition

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency.⁹⁰ Section 17A(b)(3)(I) of the Act requires that the rules of the clearing agency do not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act.⁹¹

The Commission has carefully considered the comments and the responses submitted to the Commission. With respect to commenters' concerns regarding the exclusive nature of the agreement to enter into a direct arrangement for "one-pot" cross-margining with NYPC, the Commission believes that FICC has raised valid concerns regarding the potential for greater risk arising from connections to multiple DCOs. The Commission believes that the NYPC Arrangement, and FICC's representations in its responses, discussed above, regarding how indirect access would operate in practice, would provide increased potential for indirect access to the cross-margining arrangement

⁹⁰ 15 U.S.C. 78q-1(b)(3)(F).

⁹¹ 15 U.S.C. 78q-1(b)(3)(I).

by entering into a LPP agreement and becoming an LPP of NYPC.

The Commission believes that the proposed FICC indirect access arrangement would provide a viable option for those seeking to access the "one-pot" cross-margining arrangement because it would be open to all DCOs and DCMs and would contain membership criteria that are commensurate with risks associated with accessing the "one-pot" cross-margining arrangement. Accordingly, the Commission believes the proposed cross-margining arrangement is not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency consistent with Section 17A(b)(3)(F).⁹²

The Commission acknowledges that the admission and integration of other DCMs or DCOs will not be immediate. However, the Commission believes that, in light of existing technological limitations, FICC has raised valid concerns regarding the operational feasibility of providing multiple links for direct access to the cross-margining arrangement at this time. These potential operational risks associated with managing such an arrangement, such as maintaining appropriate account of the positions of participants and calculating appropriate margin, must be weighed against the desire for greater direct access immediately.

The Commission notes that FICC has previously indicated that NYPC has committed that it will complete the process to allow one or more DCMs or DCOs to be admitted and integrated into the "one-pot" cross-margining arrangement as soon as feasible, but no later than 24 months from the start of NYPC's operations. FICC has stated that the transition period is necessary to complete implementation, systems integration, and testing, among other things, and that it would open the arrangement to

⁹² 15 U.S.C. 78q-1(b)(3)(F).

other participants as soon as operationally feasible.⁹³ The Commission believes that the operational issues, including those cited by FICC, would need to be resolved prior to admitting a DCM or DCO as an LPP. The Commission believes that this aspect of the proposal would not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act consistent with Section 17A(b)(3)(I) of the Act.

Moreover, the Commission notes that FICC has stated that the proposal would provide market participants with an alternate venue for trading U.S. dollar-denominated interest rate futures contracts, thereby potentially helping to increase competition in this market. The Commission believes that these pro-competitive features of the proposal are consistent with the Act.

The Commission takes seriously commenters' concerns regarding competition. As discussed below, FICC has represented and undertaken to provide the Commission with information about the LLP agreements concerning the proposed cross-margining arrangements.

The Commission believes FICC's commitment to provide ongoing information with respect LLP agreements would help to evaluate its efforts to facilitate indirect access and would thereby help to ensure that the proposal would not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange

⁹³ FICC represented that following the announcement of NYPC, FICC, the NYPC management team and senior management of NYSE Euronext have been in discussions with other DCOs and DCMs to initiate the process of integrating such other organizations into the "one-pot." While those efforts have not yet been productive, FICC and NYPC remain committed to expanding the "one-pot" to include other DCOs and DCMs. Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

Act, consistent with Section 17A(b)(3)(I) of the Act.⁹⁴ The Commission anticipates that this information will be primarily used for the limited purpose of identifying any instances in which there is potential non-compliance with the terms of this order or the representations made by FICC.

The Commission has considered the concerns presented by commenters and has determined that the benefits of the proposal outweigh any anti-competitive effects of the proposal. The Commission believes that the proposal would not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act consistent with Section 17A(b)(3)(I) of the Act.⁹⁵

C. Effect on Efficiency and Costs

As previously discussed, both FICC and those commenting on the proposed rule change expect that the cross-margining proposal will reduce costs, including delivery costs, and increase cash flows through margin efficiencies. The Commission believes that the NYPC Arrangement has the potential to increase efficiencies by allowing clearing agencies to streamline the delivery process, employ common and coordinated risk management and margin methodologies, and lower costs for market participants.

A “two-pot” arrangement allows for offsets and lowered margin based on correlations in a members’ cleared positions at different clearinghouses; however, there is not a unified arrangement for risk management or loss allocations.⁹⁶ The “two-pot” cross-margining arrangements approved by the Commission in the past, including one between FICC and CME, have allowed clearinghouses to allow credit against the margin

⁹⁴ 15 U.S.C. 78q-1(b)(3)(I).

⁹⁵ 15 U.S.C. 78q-1(b)(3)(I).

⁹⁶ See Securities and Exchange Act Release No. 44301, 66 FR 28297 (May 11, 2001) (approving a “two-pot” cross-margining proposal between FICC’s predecessor and CME).

requirement for offsetting positions cleared at another clearinghouse, but each clearinghouse maintained and managed separate pools of collateral. The “one-pot” arrangement would offer greater margin reductions than a “two-pot” arrangement.

As result of these benefits in facilitating a more accurate and cost-effective system for settlement, the Commission believes that the proposal would promote the prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds in a manner consistent with Section 17A(b)(3)(F) of the Act.⁹⁷

D. Additional Reporting

As noted above, FICC has represented that it will provide certain information and reports to the Commission on an ongoing basis in order to facilitate ongoing monitoring of the cross-margining arrangement and thereby help ensure compliance with the standards in Section 17A of the Act.⁹⁸ In particular, with respect to information pertaining to risk matters, the Commission believes that these reports would assist the Commission in its efforts to monitor risk management practices under the cross-margining arrangement by providing information to help confirm that the actual performance of the models and systems are consistent with those anticipated during tests prior to launch. Specifically, FICC has agreed to provide the following information upon the proposed rule change becoming effective:

- For the first 250 trading days upon the proposed rule change becoming effective, FICC will provide the Commission staff with quarterly reports

⁹⁷ 15 U.S.C. 78q-1(b)(3)(F).

⁹⁸ Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

that itemize divergences between CME prices and NYSE Liffe prices for “look-alike contracts.”⁹⁹

- Semi-annually, FICC will provide the Commission staff with reports summarizing the sensitivity of the model used for the NYPC Agreement and the collected margin to the model’s assumptions and established parameters.
- Quarterly, FICC will provide the Commission staff with detailed portfolio analyses of members participating in the NYPC Arrangement.
- Monthly, FICC will provide the Commission staff with reports summarizing the details of: (1) any instances in which the account of a member participating in the NYPC Agreement experienced a loss that exceeded its margin requirement and the magnitude of such loss; (2) FICC’s analysis of the sufficiency of NYPC’s guaranty fund in conjunction with NYPC; and (3) FICC’s analysis of daily correlations between the futures and cash products that are subject to the NYPC Arrangement.
- FICC will provide the Commission staff with DTCC’s periodic default simulations that factor in members’ participation in the NYPC Agreement.
- For 24 months upon the proposed rule change becoming effective, FICC will provide the Commission staff with information on a quarterly basis regarding potential LPPs, including progress on negotiations and discussions of agreements or potential agreements with potential LPPs.

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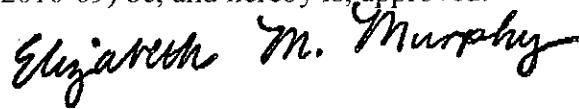
“Look-alike contracts” refers to contracts that have similar economic features but are traded separately on CME and NYSE Liffe.

- FICC will provide the Commission all agreements entered into between NYPC and any LPPs, as well as all amendments to such agreements, including, but not limited to, those regarding changes in the fee arrangements.

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act¹⁰⁰ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2010-09) be, and hereby is, approved.



Elizabeth M. Murphy

Secretary

¹⁰⁰. 15 U.S.C. 78q-1.

*Commissioner Casey,
Commissioner Fades
Disapproved*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63987 / February 28, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3248 / February 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14276

In the Matter of

KPMG AUSTRALIA,

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 4C AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND RULE 102(e) OF THE COMMISSION'S
RULES OF PRACTICE, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS 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 pursuant to Sections 4C¹ and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii)² of the Commission's Rules of Practice against KPMG Australia ("Respondent" or "KPMG Australia").

¹ Section 4C provides, in relevant part, 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 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 pertinent part, that:

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

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 Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds³ that:

A. OVERVIEW

This matter stems from the provision of non-audit services by KPMG Australia and certain other KPMG member firms to two audit clients of KPMG Australia, Companies A and B, both of which provided financial services in Australia and other jurisdictions and were audit clients with a class of securities registered with the Commission during the relevant period, in violation of the auditor independence requirements imposed by the Commission's rules and by generally accepted auditing standards in the United States of America ("U.S. GAAS), or, with respect to one financial reporting period relating to Company B, the standards of the Public Company Accounting Oversight Board ("PCAOB"). The violative services were rendered during fiscal years 2001 and 2002 in the case of Company A, and during fiscal years 2001 through 2004 in the case of Company B. Several distinct categories of non-audit services were rendered that violated Rule 2-01 of Commission Regulation S-X and therefore impaired independence. First, KPMG Australia and at least one other KPMG member firm outside Australia seconded non-tax professional staff to work at each client's premises, under the supervision and direction of each client, doing the same types of work that each client's own employees or managers ordinarily would perform, in violation of the prohibition under Rule 2-01(c)(4)(vi) against "[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client." Second, KPMG Australia received trailing commissions from an acquired subsidiary of Company B in exchange for KPMG Australia's earlier promotion of the subsidiary's products prior to the subsidiary's acquisition by Company B. These services violated the prohibition under Rule 2-01(c)(3) against direct business relationships with an audit client. Third, certain overseas subsidiaries of Company B retained a legal practice associated with another KPMG member firm to provide litigation services in violation of the prohibition under Rule 2-01 against acting as an advocate for an audit client.

³ 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.

The provision of these prohibited services came about in substantial part as a result of failures by KPMG Australia to take adequate steps both to educate its professional personnel and also to monitor compliance by such personnel with respect to the auditor independence requirements imposed by the Commission's rules and by U.S. GAAS or, with respect to the audit report on Company B's financial statements for its 2004 fiscal year, by PCAOB standards. As a result of these failures, on multiple occasions KPMG Australia failed to respond appropriately to problematic information concerning certain non-audit services to Company A and Company B that should have affected the independence determination.

Despite providing these prohibited services, KPMG Australia stated that it was "independent" in contemporaneous audit reports it issued on Company A's and Company B's financial statements, each of which was included, or incorporated by reference, in their respective public filings with the Commission throughout the relevant time period. By doing so, KPMG Australia violated Rule 2-02(b) of Commission Regulation S-X and caused its audit clients Company A and Company B to file periodic reports with the Commission that failed to include independently audited financial statements as required by Exchange Act Section 13(a), Exchange Act Rule 13a-1, and Regulation S-X.⁴

B. RESPONDENT

KPMG Australia is a partnership formed and existing under the laws of Australia which provides auditing and other professional services to a variety of companies, including companies whose securities were registered with the Commission and traded in U.S. markets. KPMG Australia is the Australian member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative.

C. RELEVANT ISSUERS

Company A is incorporated and headquartered in Australia. KPMG Australia served as the lead auditor of Company A's financial statements for its fiscal years 2001 through 2004. During this time period, Company A's American Depositary Shares and American Depositary Receipts were registered with the Commission pursuant to Exchange Act Section 12(b) and traded on the New York Stock Exchange. Company A, whose fiscal year ended September 30, filed annual reports on Form 20-F with the Commission pursuant to Exchange Act Section 13.

Company B is incorporated and headquartered in Australia. KPMG Australia served as the lead auditor of Company B's financial statements for its fiscal years 2001 through 2004. During this time period, Company B's Ordinary Shares and American Depositary Shares were registered with the Commission pursuant to Exchange Act Section 12(b) and traded on the New York Stock Exchange. Company B, whose fiscal year ended September 30, filed annual reports on Form 20-F with the Commission pursuant to Exchange Act Section 13.

⁴ This Order makes no finding with respect to Company A's or Company B's reported financial statements for any fiscal year in which the violations discussed herein occurred.

D. FACTS

1. Secondments

The term “secondment” is commonly used in Commonwealth countries and is analogous to the term “loaned staff engagements” used in the United States. KPMG Australia’s internal guidance explained that, “[a] secondment is a temporary transfer of a KPMG employee (the secondee) to the business of a client,” to perform work under the supervision and direction of the client rather than of KPMG Australia. Beginning in early 2001, KPMG Australia implemented a business development drive that entailed the designation of personnel as “product champions” to promote secondments and other service products as a means of serving clients, including audit clients, and thereby generating revenue. Secondments also came to be viewed as a means of providing KPMG Australia staff with practical business experience and client exposure.

a. KPMG Australia’s Deficient Auditor Independence Guidance On Secondments and Lack of Effective Compliance Monitoring

KPMG Australia’s secondment practice during the relevant period was premised on the view, pervasive throughout the firm, that secondments to audit clients with a class of securities registered with the Commission (“Commission-registered audit client”) were permitted under the Commission’s auditor independence rules, provided that the secondee did not function as management by making decisions that would bind the audit client without further client oversight or ratification.

This understanding reflected domestic Australian independence standards at that time, which permitted secondments to audit clients provided the secondee would not be involved in “making management decisions”; “approving or signing agreements or other similar documents”; or “exercising discretionary authority to commit the [audit] client”; and provided the audit firm implemented safeguards by ensuring that the secondee was not given audit responsibility for any function or activity they performed during their secondment and obtaining an acknowledgment from the audit client of its responsibility for directing and supervising the activities of the secondee. Institute of Chartered Accountants in Australia, *Professional Statement F.1, Professional Independence* § 2.89.

This understanding also was reinforced by two “Risk Alerts”⁵ issued internally by KPMG Australia in March and July 2001, following that firm’s receipt of guidance issued by the Department of Professional Practice (“DPP”) at KPMG LLP, the KPMG member firm in the United States (“KPMG U.S.”), directly to KPMG Australia and of “Professional Practice Letters” (“PPLs”) issued by DPP to professionals within KPMG U.S. and made available to

⁵ A Risk Alert was a bulletin containing written guidance issued periodically by the national risk management office at KPMG Australia and distributed to professionals within the firm. The guidance in such a Risk Alert was binding on all professionals within the firm.

KPMG Australia through the firms' mutual affiliation with KPMG International.⁶ The March 2001 Risk Alert advised that the Commission's independence rules did not "stop all secondments" but only precluded "act[ing] as a member of management while on secondment." The March 2001 Risk Alert also provided a sample engagement letter and sample terms and conditions for secondments, such as limits on secondees' use of audit clients' business cards, credit cards, and motor vehicles, as well as secondees committing audit clients to expenditures. In addition, in response to general concerns expressed by the Commission's Office of the Chief Accountant about the lack of quality controls on non-audit services rendered by non-U.S. accounting firms, the July 2001 Risk Alert introduced several new policies, including vesting responsibility in lead audit engagement partners for pre-approval and other quality controls with respect to non-audit services rendered to Australian Commission-registered audit clients.

In May 2002, KPMG U.S.'s DPP issued to its professionals in the United States a three-page PPL entitled "Loaned Staff Versus Advisory Services Engagements." This PPL stated in a "Background" section on its first page:

The SEC and [American Institute of Certified Public Accountants ("AICPA")] rules on auditor independence prohibit firm personnel from acting either permanently or temporarily as an employee of the audit client. Therefore, it is important to ensure that engagements resulting from requests from clients for staff assistance be structured to avoid the appearance that the firm's staff may be acting as an employee of the client.

The PPL advised that "every effort should be made to structure . . . engagement[s] under KPMG supervision, with a defined timeline and scope of work," but that "[i]f the engagement cannot be structured as a discrete engagement, then it is considered a loaned staff engagement and stringent requirements apply." With respect to Commission-registered audit clients, the PPL specified the following restrictions: (i) loaned staff engagements were permitted only with respect to staff level personnel and not with respect to managers and above; (ii) audit engagement partners were responsible for reviewing proposals for loaned staff engagements; and (iii) loaned staff engagements were limited to four weeks for public audit clients, unless otherwise approved by KPMG U.S.'s DPP. The PPL further specified that the following restrictions had to be "clearly defined in the engagement letter": (a) the KPMG staff member could not function in a management or employee role, could not make any management decisions, and could not sign reports or letters in KPMG's name; (b) the KPMG staff member could not be listed in client directories or publications and could not use the client's name on business cards; (c) a KPMG partner had to be responsible for oversight and verification of ongoing compliance with the terms of the engagement; and (d) the loaned KPMG staff had to prepare a memorandum summarizing the engagement activity for each payroll cycle. The PPL further dictated the use of standard engagement letters and terms and conditions, as well as the inclusion in the standard work papers of "the signed engagement letter(s); . . . copies of periodic status reports; and documentation of partner oversight of engagement letter compliance (e.g. review of status reports and memorandum to work papers)."

⁶ A PPL was a bulletin containing written guidance issued from time to time by KPMG U.S.'s DPP to professionals within that firm and, on occasion, to other KPMG member firms through their mutual affiliation with KPMG International.

The May 2002 PPL was received and reviewed by KPMG Australia's national risk management office. In June 2002 that office issued another two-page Risk Alert to all KPMG Australia professional personnel. That Risk Alert repeated guidance from the first half of the May 2002 PPL that every effort should be made to structure the temporary provision of staff as engagements under KPMG supervision and the general restrictions labeled (i) to (iii) above, including the prohibition on seconding managers or above. The June 2002 Risk Alert, however, failed to expressly reference the substantive guidance set forth in the entire second half of the May 2002 PPL, including items (a) through (d) above, which the PPL required be clearly defined in the engagement letter, as well as the work paper documentation requirements introduced by the PPL. The June 2002 Risk Alert cross-referenced the earlier March 2001 Risk Alert for further guidance, including on the use of engagement letters and the terms and conditions forming part of the engagement, but these cross-referenced materials likewise did not include all the prohibitions set forth in items (a) through (d) above or impose work paper documentation requirements.

In July 2002, following issuance of the June 2002 Risk Alert, KPMG Australia held a training program for its personnel which included instruction on the Commission's independence rules. The training instruction cautioned that the "Perception/appearance" of independence was a "huge" issue in the United States, and that even arrangements, such as "secondments," which would not pose a problem under Australian GAAS, would "most likely be an issue for US GAAS." This training instruction did not repeat the substantive guidance and the documentation requirements from the May 2002 PPL that had been omitted from the June 2002 Risk Alert.

The truncated guidance was compounded by KPMG Australia's failure to adopt contemporaneous quality controls adequate to monitor independence compliance with respect to both firm guidance and the Commission's independence rules, particularly by divisions of the firm such as its Corporate Recovery Department⁷ that were not under the direct supervision of the lead audit engagement partners. As a result, KPMG Australia's partners, particularly those in such divisions, continued to arrange and extend secondments of the firm's professional personnel to Company B into 2003, although on a limited basis. More than five secondments rendered at various times from mid-2002 into 2003 violated not only the Commission's substantive independence rules but also internal firm guidance and procedures with respect to the pre-approval and duration of secondments.

b. Violative Secondments Rendered to Company A

During 2001 and the first half of 2002, KPMG Australia rendered secondments to Company A, and at least one other KPMG member firm rendered secondments to Company A's foreign operations in another country. At least 30 secondments rendered during that period violated U.S. GAAS and the Commission's auditor independence rules.

Examples of secondees seconded to act in a managerial capacity with financial reporting responsibilities, in violation of the auditor independence rules, include the following. Between November 2000 and June 2001, an assistant manager was seconded to Company A to fill in for a "Market Operations Support and Control Manager" who was out of the office on maternity

⁷ The Corporate Recovery Department separated from KPMG Australia in 2004.

leave, and in that role he managed a team of 20 to 25 Company A employees who reconciled trading information, cleared account items, and prepared monthly reports. Likewise, between May and August 2001, an accountant was seconded by another KPMG member firm to an overseas subsidiary of Company A in the role of "Acting Senior Financial Controller, Personal Financial Services," in which capacity he hired and supervised staff, provided overall financial control for the unit, and oversaw the preparation of monthly financial reports. From March to July 2002, a KPMG Australia manager was seconded to manage the life insurance accounting team at a division of Company A where he functioned essentially as a controller of the team, including giving guidance on accounting questions to the accountants working under him who were preparing the life insurance accounts. From September 2001 to August 2002, another KPMG Australia manager was seconded to the life insurance accounting team, in which role he supervised Company A personnel and also reported to the other KPMG Australia secondees.

In March 2001, a KPMG Australia senior manager was seconded to a funds management subsidiary of Company A, in which role he was assigned the title "Acting CFO."

In addition to the foregoing, secondments included implementing a general ledger system for Company A in 2001 and conducting loan file reviews as part of internal audit procedures that were then relied on as part of the external audit in both 2001 and 2002. Another secondment entailed preparing the financial statements for one of Company A's foreign subsidiaries.

These and other violative secondments occurred because the Company A audit engagement team instituted inadequate safeguards and controls prior to 2002 for purposes of monitoring ongoing compliance with auditor independence rules governing the provision of non-audit services. Further, internal communications in March and April 2001 within the audit engagement team for Company A included information about the "Acting CFO" secondment noted above which, had it been properly focused on, should have caused KPMG Australia to stop that secondment from being arranged or continuing in order to avoid an impairment in appearance of the firm's auditor independence, as required by the Commission's rules and U.S. GAAS.

c. Violative Secondments Rendered to Company B

During the period November 2000 through October 2003, KPMG Australia rendered secondments to Company B. At least 20 secondments rendered during that period violated U.S. GAAS, and the Commission's auditor independence rules.

During that three-year period, KPMG Australia seconded four managers and a director (a level above manager but below partner) from the firm's Corporate Recovery Department for periods lasting from five weeks to fifteen months to perform loan file portfolio functions at Company B's Credit Restructuring Unit ("CRU"). Each of the five secondees managed a portfolio of problematic "retention" loan files on behalf of Company B with the goal of continuing payments on the loans. If this proved impossible, the files were redesignated as "exit" files and referred to another division of the CRU. In this role, the secondees reviewed loan files; met personally with customers of Company B; appointed third-party advisers; developed and implemented strategies for recovery on the loans; and were assisted in the

foregoing by CRU analysts whose work they supervised from time to time. The secondees were given delegated credit authority, which enabled them to implement recovery strategies for loan files below a set dollar amount without obtaining prior approval from their CRU supervisors, although these decisions were subject to subsequent overview by their CRU supervisors. For purposes of communicating with customers and other third parties, the secondees used Company B titles, business cards and letterhead. In two instances loan files assigned to and worked on by these corporate recovery secondees in their capacity as "account managers" were selected for audit procedures by the KPMG Australia audit engagement team, and in one instance the provisioning for a loan file was adjusted as a result of those audit procedures.

Moreover, two of the corporate recovery secondees held supervisory positions in Company B's CRU. In one such secondment, the secondee from KPMG Australia served with the client title "Executive, Credit Restructuring Retention" in the CRU office in Melbourne during August and September 2002, with responsibility for supervising the CRU managers who handled retention loan files. In that capacity, the secondee regularly made decisions, without regard to oversight, concerning recovery strategies for loan files that exceeded the CRU managers' delegated credit authority.

KPMG Australia also seconded personnel from other practice areas to work for divisions and subsidiaries of Company B that were consolidated into Company B's financial statements. For example, a KPMG Australia partner was seconded to serve as "Acting Global IT Audit Manager" at Company B between late 2000 and August 2001, and later in the same reporting period, while serving on the external audit engagement team at KPMG Australia, he reviewed internal audit documentation he himself had prepared for the purpose of scoping the substantive testing of Company B's information technology. Between January and March 2002, a KPMG Australia senior manager was seconded to Company B to calculate an adjustment with respect to the purchase price for the sale of a unit of the financial institution.

KPMG Australia also seconded personnel from other practice areas to work on assignments for trusts and funds managed by Company B or its subsidiaries, but which were not consolidated into Company B's financial statements. For example, between late 2000 and mid-2001, three KPMG Australia employees were seconded to a subsidiary of Company B for several months to serve as "managers" with responsibility for reviewing and approving daily pricing activities involving trusts managed by the subsidiary. Among this group, one secondee supervised a team of nine employees and another secondee was seconded specifically to fill in for employees who had resigned. Additionally, two secondees worked for a Company B subsidiary preparing *pro forma* financial statements for managed investment funds, and two secondees prepared or amended *pro forma* trust financial statements. And from late 2002 through early 2003, a manager was seconded to serve as a liaison and coordinate the flow of information and meetings between the external audit engagement team at KPMG Australia and a subsidiary of Company B in respect of KPMG Australia's audit of trusts for which the subsidiary was the responsible entity, the accounts of which were not consolidated into Company B's financial statements.

By late 2002 KPMG Australia had sufficient collective knowledge to be on notice of secondments to Company B that violated the Commission's independence rules. In November

2002, there were internal communications within the firm about bringing to an end one secondment that had been ongoing since January 2002 in violation of the policies contained in the July 2002 Risk Alert. There was also information about a later secondment which, had it been properly communicated and focused on, should have caused the firm to stop that secondment from being arranged or continuing.

d. KPMG Australia's Termination of Non-Tax Secondments

On March 4, 2004, after the Commission's commencement of a formal investigation of this matter, KPMG U.S.'s DPP issued to professionals in that firm a PPL revising that firm's policy to prohibit the provision of loaned staff services to Commission-registered audit clients not involving the provision of tax services. This PPL was received and reviewed by KPMG Australia's national risk management office. On April 1, 2004, that office issued a bulletin to all KPMG Australia professional personnel prohibiting all non-tax secondments to Commission-registered audit clients.

2. Other Violative Services Rendered to Company B

a. Commission Payments

Between July 2000 and November 2005, KPMG Australia received trailing commissions from an affiliate of Company B, in return for having previously recommended the affiliate's products to its clients, prior to the affiliate's acquisition by Company B in 2000. Between 1996 and 2000, KPMG Australia had recommended the products to its clients in exchange for receiving both initial commissions and subsequently, if the product was retained by the client, trailing commissions as well. Between 2000 and 2005, KPMG Australia received over 67,000 AUD in commissions for products sold before 2000 but which continued to be held by 29 individuals and one corporate entity. In response to an anonymous inquiry received in 2005 relating to whether the payments impaired KPMG Australia's independence in relation to Company B, KPMG Australia terminated the relationship in November 2005 and returned to the Company B affiliate the total amount of commission payments received from 2000 to 2005.

b. Advocacy Services

Between March 2002 and March 2004, a legal practice that at the time was associated with a KPMG member firm other than KPMG Australia rendered litigation services to overseas subsidiaries of Company B. These legal services included representing the subsidiaries at "employment tribunals" on claims of illness, injury, stress, discrimination, and unfair or wrongful dismissal as well as representation of the subsidiaries in litigation on diverse subjects including a bounced check, the liquidation of a customer corporation, a life insurance dispute, a personal injury claim, and an unfair dismissal claim. Most of these legal services were terminated shortly after the Company B audit committee adopted, in November 2002, a policy prohibiting legal services being provided by the auditor, but the representation in both a personal injury and an unfair dismissal litigation continued up until April 1, 2004. The KPMG Australia audit engagement team noted the foregoing services and associated fees in a chart of non-audit

services and fees prepared monthly during the relevant period. The legal practice separated from the KPMG member firm on April 1, 2004.

E. LEGAL ANALYSIS

1. Independence Principles

a. Secondments

Since February 2001, Rule 2-01 of the Commission's Regulation S-X has contained three provisions relevant to KPMG Australia's secondment practice. First, Rule 2-01(b) sets forth a general standard that deems independence to be impaired whenever "a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement." Second, Preliminary Note 2 to Rule 2-01 articulates four preliminary factors to be considered "in the first instance" under the general standard, including consideration of whether "the provision of a service . . . results in the accountant acting as management or an employee of the audit client." And third, the Rule sets forth "a non-exclusive specification of circumstances inconsistent with" the general standard, including a specification under the heading "Management functions," which prohibits an accountant from "[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client." Rule 2-01(c), (c)(4)(vi). Thus, acting either as a manager or employee of an audit client is inconsistent with independence under Rule 2-01. This principle is consistent with prior enforcement proceedings, *see In the Matter of Moret Ernst & Young Accountants, n/k/a Ernst & Young Accountants*, Exch. Act Rel. No. 46130 (June 27, 2002); *In the Matter of Bernard Tarnowsky*, Exch. Act Rel. No. 34-32635 (July 15, 1993). *See also Codification of Financial Reporting Policies* § 602.02.d. As described above, KPMG Australia and another KPMG member firm rendered at least 30 secondments to Company A, and KPMG Australia rendered at least another 20 secondments to Company B, which violated this principle.⁸

b. Direct Business Relationship

At the same time, Rule 2-01 has also prohibited, as inconsistent with the general standard of independence, "any direct or material indirect business relationship with" the audit client, excepting the relationship of "a consumer in the ordinary course of business." Rule 2-01(c)(3). *See also Codification of Financial Reporting Policies* § 602.02.g; *Commission Letter dated 2/14/89, responding to 3/29/88 Petition by Arthur Andersen & Co. and Others* (available at:

⁸ As noted above, certain secondments were to Company B units whose operations were not included in Company B's consolidated financial statements and may not have been subject to audit procedures during an audit of the company's financial statements. However, Rule 2-01(c)(4)(vi) has never contained a qualification that would permit secondments of this type, even though qualifications for services where it is reasonable to conclude that the results of the services will not be subject to audit procedures during an audit of the financial statements were added to other subparagraphs of Rule 2-01(c)(4) in the amendments that took effect on May 6, 2003.

<http://www.sec.gov/info/accountants/naction/aartan1.htm>) (the "1989 Response"). This guidance prohibits any business relationship in which an auditor and an audit client: (i) "have joined together in a profit-seeking venture," thereby creating a "unity of interest"; (ii) have, to some extent, rendered "the auditor's interest . . . wedded to that of its client" thereby creating a situation of "interdependence"; and (iii) are working together as "coventurers" to generate "interdependent" revenues from a third party. *1989 Response*, at 4. Such relationships create an impermissible "mutuality or identity of interest" between the auditor and the audit client since "the advancement of the auditor's interest would, to some extent, be dependent upon the client," thereby rendering such relationships inconsistent with the essential requirement that the appearance of independence be maintained. *Id.* at 7. The Commission also has brought numerous proceedings to enforce this prohibition. *In the Matter of Ernst & Young*, Initial Decision Rel. No. 249, Admin. Proc. File No. 3-10933 (Apr. 16, 2004), *finality order*, Rel. No. 33-8413 (Apr. 26, 2004); *In the Matter of Ernst & Young LLP, et al.*, Securities Exchange Act Release No. 58309, AAER No. 2858, Admin. Proc. File No. 3-13114 (Aug. 5, 2008). Applying these principles, the trailing commission payments described above constituted a direct business relationship between KPMG Australia and its audit client Company B.

c. Acting as an Advocate

Finally, Rule 2-01 has also included among its four preliminary factors a prohibition on those services that "place[] the accountant in a position of being an advocate for the audit client." Preliminary Note 2 to Rule 2-01. And Rule 2-01 has also prohibited legal services to the audit client, subject to certain qualifications, as inconsistent with the general standard of independence. Rule 2-01(c)(4)(ix). *See also Codification of Financial Reporting Policies* § 602.02.e.ii. As described above, the litigation services put the associated legal practice in the position of acting as an advocate of KPMG Australia's audit client Company B.

As a result of these non-audit services, KPMG Australia violated Rule 2-01 of Regulation S-X and therefore did not maintain independence in appearance from its audit clients Company A and Company B.

2. Violation of Rule 2-02(b) of Reg. S-X and of Issuer Reporting Provisions

Because these non-audit services impaired KPMG Australia's independence as defined by Rule 2-01 of Regulation S-X, they both constituted and caused certain statutory and regulatory violations.

Each time KPMG Australia signed an audit report for Company A or Company B where either the period covered by the audit, or the period of the audit work, or both, overlapped with the non-audit services recited above, KPMG Australia directly violated 2-02(b) of Regulation S-X. *See* Rule 2-02(b) (requiring accountant's report to "state whether the audit was made in accordance with generally accepted auditing standards").⁹ Issuing an audit report incorrectly

⁹ Pursuant to Commission Release 33-8422, GAAS, as used in Regulation S-X, means the standards of the PCAOB and any applicable Commission rules. Audit reports dated on or after May 24, 2004 – the effective date of PCAOB Auditing Standard 1 – were required to state they were performed in accordance with PCAOB standards; reports dated prior to May 24, 2004 were required to state that they were performed in accordance with the standards

stating that the audit was performed in accordance with U.S. GAAS or PCAOB standards, which include independence requirements, violates Rule 2-02(b). The KPMG Australia audit reports on financial statements for Company A's 2001 and 2002 fiscal years and for Company B's 2001 through 2003 fiscal years improperly stated that the audits had been performed in accordance with U.S. GAAS. The KPMG Australia audit report on Company B's financial statements for the 2004 fiscal year improperly stated that the audit had been performed in accordance with PCAOB standards.

Likewise, each time non-independent audit reports were filed with Company A's or Company B's annual reports on Form 20-F, the issuer violated federal securities statutes and rules requiring that those Commission filings include financial statements that were audited by independent accountants. See Exchange Act § 13(a) and Exchange Act Rule 13a-1 thereunder (requiring annual reports to include independently audited financials).¹⁰ By issuing consents for inclusion of these audit reports in Commission filings, KPMG Australia bears responsibility for causing all of these reporting violations, since it should have known that the non-audit services would cause Company A and Company B to lack independent audits and thus to violate the reporting provisions listed above.

3. Firm Responsibility

KPMG Australia as a firm bears responsibility for these violations for the additional reason that it failed to adopt adequate quality controls to educate and to monitor its personnel during the relevant period with respect to the independence requirements of U.S. GAAS or PCAOB standards and applicable Commission rules. During the relevant period, audit firms were required to educate firm personnel assigned to engagements for Commission-registered audit clients about these independence requirements. See, e.g., American Institute of Certified Public Accountants, QC Section 20.09 ("Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and appearance) in all required circumstances."). These same firms were required to monitor on an ongoing basis whether personnel were complying with these independence requirements. See *id.* QC Section 20.08 ("[P]olicies and procedures for the quality control element of Monitoring are established to provide the firm with reasonable assurance that the policies and procedures related to each of the other elements are suitably designed and are being effectively applied."). In this context:

Monitoring involves an ongoing consideration and evaluation of the: (a) relevance and adequacy of the firm's policies and procedures; (b) appropriateness of the firm's guidance materials and any practice aids; (c) effectiveness of professional development

of GAAS. PCAOB independence standards under Rule 3600T require auditors to be independent from their audit clients.

¹⁰ See also Form 20-F, Part I, Item 8.A.1 (requiring that the filing contain consolidated financial statements audited by an independent auditor and accompanied by an audit report); *id.* Part 1, Item 8.A.2. (requiring that financial statements be audited in accordance with GAAS and with Commission standards for auditor independence).

activities; and (d) compliance with the firm's policies and procedures. When monitoring, the effects of the firm's management philosophy and the environment in which the firm practices and its clients operate should be considered.

American Institute of Certified Public Accountants, QC Section 20.20.

As discussed above, KPMG Australia's national risk management office failed to provide its personnel with fulsome independence guidance with respect to secondments and also failed to adopt quality controls adequate to monitor compliance by the firm's personnel with respect to both firm guidance and the Commission's independence rules. In addition, KPMG Australia failed to adopt quality controls adequate to monitor the full range of non-audit services provided to Commission-registered audit clients not only by the firm's personnel but also by personnel at associated KPMG member firms in other countries.¹¹ As a result of these failures, on multiple occasions KPMG Australia's personnel failed to inform themselves adequately or respond appropriately to problematic information concerning non-audit services to Company A and Company B that should have affected the independence determination. *See In the Matter of KPMG Peat Marwick LLP*, Rel. No. 34-43862, 2001 SEC LEXIS 98, at *97 (Jan. 19, 2001), *reconsideration denied*, Rel. Nos. 34-44050 and AAER-1374 (Mar. 8, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002) (firm's failure, at high levels, to inform itself about facts material to independence determination constitutes negligence).

4. Improper Professional Conduct

Rule 102(e) of the Commission's Rules of Practice and Exchange Act Section 4C both define "improper professional conduct" to include: (i) "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards" in circumstances in which the "accountant," in the case of Rule 102(e), or "registered public accounting firm or associated person," in the case of Section 4C, "knows, or should know, that heightened scrutiny is warranted"; or (ii) "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." The Commission has made clear that auditor independence is *always* an area requiring heightened scrutiny. *See* Adopting Release for Rule 102(e), Rel. Nos. 33-7593, 34-40567, 1998 SEC LEXIS 2256 (Oct. 19, 1998) ("Because of the importance of an accountant's independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant's independence always merit heightened scrutiny."). Here, KPMG Australia's conduct with respect to the non-audit services

¹¹ As the firm that signed the audit reports on the financial statements of Company A and Company B, KPMG Australia bore ultimate responsibility for the independence of the audit engagement. Under the Commission's Rule 2-01, the independence of the audit engagement may be compromised when non-audit services are rendered not just by the firm that leads the audit engagement but also by any associated entities in other countries. *See* Rule 2-01(f)(2) ("Accounting firm means an organization . . . that is engaged in the practice of public accounting . . . and all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States."). Moreover, Rule 2-01(c)(7) requires, effective May 6, 2003, that all non-audit services receive pre-approval from the client's audit committee, and as a matter of practice any communications between the auditor and the audit committee are typically coordinated through the firm that leads the audit engagement. Thus, Rule 2-01 implicitly contemplates that any associated entities will typically apprise the firm that leads the audit engagement of any non-audit services prior to rendering such services to the client.

rendered to Company A and Company B constituted improper professional conduct under both prongs of this definition.

IV.

Based on the foregoing, the Commission finds that Respondent KPMG Australia: (a) engaged in improper professional conduct pursuant to Exchange Act Section 4C and Rule 102(e)(1)(ii) of the Commission's Rules of Practice; (b) violated Rule 2-02(b) of Regulation S-X; and (c) caused Company A and Company B to violate Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1 thereunder.

V.

Respondent has undertaken to:

1. Retain, within sixty (60) days after the entry of this Order, an independent consultant ("Independent Consultant"), not unacceptable to the staff of the Commission, to review and evaluate whether KPMG Australia's quality controls are designed and implemented in a manner reasonably sufficient under PCAOB standards and applicable Commission rules both to educate and to monitor its personnel with respect to the independence requirements concerning non-audit services to, advocacy on behalf of, and business relationships with Commission-registered audit clients. KPMG Australia shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to its own files, books, records, and personnel as reasonably requested for the review;
2. Require that the Independent Consultant issue a report, within six (6) months of being retained, summarizing the review and recommending policies and procedures reasonably designed to ensure compliance with the education and monitoring of firm personnel with respect to the independence requirements, under PCAOB standards and applicable Commission rules, concerning non-audit services to, advocacy on behalf of, and business relationships with Commission-registered audit clients. Simultaneously with providing that report to KPMG Australia, KPMG Australia shall require that the Independent Consultant contemporaneously transmit a copy to Nina B. Finston, Assistant Director, Division of Enforcement, U.S. Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-5631;
3. Adopt all recommendations in the report of the Independent Consultant; provided, however, that within sixty (60) days after the Independent Consultant serves that report, KPMG Australia shall in writing advise the Independent Consultant and the Commission of any recommendations that it considers to be unnecessary, unduly burdensome, impractical, or costly. With respect to any recommendation that KPMG Australia considers unnecessary, unduly burdensome, impractical or costly, KPMG Australia need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose. As to any recommendation on which KPMG Australia and the Independent Consultant do not agree, such parties shall attempt in good faith to reach an agreement within sixty (60) days after KPMG Australia serves the written advice. In the event

KPMG Australia and the Independent Consultant are unable to agree on an alternative proposal, KPMG Australia will abide by the determinations of the Independent Consultant;

4. Require the Independent Consultant to review and evaluate whether KPMG Australia's quality controls are designed and implemented in a manner reasonably sufficient under PCAOB standards both: (i) to educate its personnel, and (ii) to monitor compliance by its personnel, with respect to the independence requirements, under PCAOB standards and applicable Commission rules, concerning non-audit services to, advocacy on behalf of, and business relationships with Commission-registered audit clients. This review shall encompass whether KPMG Australia's quality controls are designed and implemented in a manner reasonably sufficient under PCAOB standards to monitor for prohibited non-audit services, advocacy, and business relationships as between KPMG member firms in other countries and Commission-registered audit clients for which KPMG Australia signs audit reports under Rule 2-02(b) of Regulation S-X. The Independent Consultant shall disclose to the staff of the Commission in the event that KPMG Australia or any of its employees, agents, consultants, joint venturers, contractors, or subcontractors, refuse to provide information necessary for the performance of the Independent Consultant's responsibilities. KPMG Australia agrees that it will not take any action to retaliate against the Independent Consultant for such disclosures;

5. Require the Independent Consultant to enter into an agreement with KPMG Australia that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with KPMG Australia, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Securities and Exchange Commission's Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with KPMG Australia, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement;

6. Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Nina B. Finston, Assistant Director, Division of Enforcement at the address given above with a copy to the Office of Chief Counsel of the Enforcement Division at the same address as above but using zip code 20549-6553 no later than sixty (60) days from the date of the completion of the undertakings;

7. These undertakings shall be binding upon any acquirer or successor in interest to KPMG Australia's or substantially all of KPMG Australia's audit practice for Commission-registered audit clients; and

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

VI.

In determining to accept the Offer, the Commission considered the remedial steps taken by KPMG Australia since the time of the conduct described above, such as additional national risk management staff and resources, increased training, revised policies, and strengthened controls, as well as the cooperation by KPMG Australia and its personnel during the investigation of this matter.

VII.

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, effective immediately, that Respondent KPMG Australia be, and hereby is, censured.

IT IS FURTHER ORDERED, effective immediately, that Respondent KPMG Australia shall cease and desist from committing any violations and any future violations of Rule 2-02 of Regulation S-X, and from causing any violations and any future violations of Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1 thereunder.

IT IS FURTHER ORDERED that Respondent KPMG Australia shall, within ten (10) days of the entry of this Order, pay disgorgement of \$1,982,000 and prejudgment interest of \$760,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, 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 KPMG Australia as a Respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Nina B. Finston, Assistant Director, Division of Enforcement, at the address given above.

IT IS FURTHER ORDERED that Respondent KPMG Australia shall comply with its undertakings enumerated in Section V above.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63990 / February 28, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14277

In the Matter of

**Electrochemical Industries (1952) Ltd.,
Empire Alliance Properties, Inc.,
Encore Environmental Solutions, Inc.
(f/k/a Oiram, Inc.), and
Environmental Products Group, 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 Electrochemical Industries (1952) Ltd., Empire Alliance Properties, Inc., Encore Environmental Solutions, Inc. (f/k/a Oiram, Inc.), and Environmental Products Group, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Electrochemical Industries (1952) Ltd. (CIK No. 201739) is an Israeli corporation located in Haifa, Israel with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Electrochemical Industries is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a net loss of over \$12.2 million for the prior twelve months.

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2. Empire Alliance Properties, Inc. (CIK No. 922935) is an Ontario corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Empire Alliance is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Registration Statement on Form 20-FR on May 9, 1994, which reported a net loss of \$345,765 (Canadian) for the twelve months ended June 30, 1993.

3. Encore Environmental Solutions, Inc. (f/k/a Oiram, Inc.) (CIK No. 1079991) is a permanently revoked Nevada corporation located in Morristown, Tennessee with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Encore Environmental Solutions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2002, which reported a net loss of \$5,000 since the company's February 16, 1999 inception.

4. Environmental Products Group, Inc. (CIK No. 1080850) is a forfeited Delaware corporation located in Burlington, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Environmental Products Group 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 November 30, 2000, which reported a net loss of \$184,249 for the prior three months.

B. DELINQUENT PERIODIC FILINGS

5. 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.

6. 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.

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

III.

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

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

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

IV.

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

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

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

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