SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **August 2011**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Kathleen L. Casey served as SEC Commissioner
July 17, 2006 until August 5, 2011

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

(57 Documents)

SECURITIES AND EXCHANGE COMMISSION

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LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65227 / August 30, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13847

In the Matter of MORGAN ASSET MANAGEMENT, INC.; MORGAN KEEGAN & COMPANY, INC.; JAMES C. KELSOE, JR.; and JOSEPH THOMPSON WELLER, CPA, Respondents.	Order Appointing Fund Administrator

On June 22, 2011, the Securities and Exchange Commission ("Commission") accepted an offer of settlement in administrative proceedings against Morgan Asset Management, Inc., Morgan Keegan & Co., Inc., James C. Kelsoe, Jr., and Joseph Thompson Weller, CPA ("Respondents") involving fraud charges based on Respondents' valuation practices with respect to subprime mortgage-backed securities. See Corrected Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, and Imposing Suspension Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, Exchange Act Release No. 64720 (June 22, 2011) ("Order").

In the Order, the Commission authorized the establishment of a Fair Fund, comprised of $100,300,000 in disgorgement and penalties paid by Respondents, for distribution to investors who suffered losses as a result of Respondents' fraudulent conduct. The Order provided that the Commission shall appoint a Fund Administrator to "identify the investors in the Funds who suffered losses as a result of the violations determined herein, evaluate investor claims and propose and effectuate a plan to distribute the Fair Fund resulting from this order." The Order further provided that the Fair Fund should be distributed pursuant to that distribution plan, in accordance with the Commission Rules on Fair Fund and Disgorgement Plans. The staff has recommended, upon its review and consideration of several proposals, that the Commission appoint A.B. Data, Ltd. ("A.B. Data"), as the Fund Administrator.

It is hereby ORDERED, pursuant to Fair Fund Rule 1105(a), that A.B. Data is appointed as the Fund Administrator.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

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Kathleen L. Casey served as SEC Commissioner
July 17, 2006 until August 5, 2011

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

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

November 4, 2010

In the Matter of	
8000, Inc.,	**ORDER OF SUSPENSION OF TRADING**
File No. 500-1	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of 8000, Inc. because of questions regarding the accuracy of statements made by 8000, Inc. in press releases concerning, among other things, a cash dividend the company announced it would pay stockholders and Monk's Den, an investment program and online investor network the company disclosed it acquired in September 2010.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of 8000, Inc.

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. EDT on November 4, 2010, through 11:59 p.m. EST on November 17, 2010.

By the Commission.

Elizabeth M. Murphy
Secretary

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

1 of 57

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 17, 2010

IN THE MATTER OF **SUPATCHA RESOURCES 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 Supatcha Resources Inc. ("Supatcha") because of questions regarding the accuracy of assertions by Supatcha in public statements to investors concerning, among other things: (1) a geological report on certain mining prospects in Ukraine; and (2) a tender offer for Supatcha's outstanding shares.

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 of the securities of the above-listed company is suspended for the period from 9:30 a.m. EST, December 17, 2010 through 11:59 p.m. EST, on December 31, 2010.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Walter not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63578 / December 20, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3220 / December 20, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14166

In the Matter of **MILAN BELANS (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 Milan Belans ("Respondent" or "Belans") 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. Milan Belans, 43, also known as Milan Eli Belans II, a resident of Farmington Hills, Michigan, served in various positions at Delphi Corporation ("Delphi") from 1998 until August 2005. From August 1998 to January 2000, he served in Delphi's controller's office as Director of Financial Accounting and Reporting, reporting to the Chief Accounting Officer. From January 2000 to August 2001, he served in Delphi's treasury department as Director of Capital Planning, Structured Finance and Pension Analysis, reporting to the Assistant Treasurer and/or the Treasurer. Belans was licensed as a CPA in Michigan in 1991.

2. Delphi was, at all relevant times, an auto parts supplier headquartered in Troy, Michigan. It was incorporated in Delaware in 1998. At all relevant times, Delphi's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and was listed on the New York Stock Exchange ("NYSE") under the symbol "DPH."

3. On October 30, 2006, the Commission filed a complaint against Belans and others in SEC v. Delphi Corporation and Milan Belans, et al. (Civil Action No. 2:06-cv-14891-AC-SDP). On December 13, 2010, the court entered an order permanently enjoining Belans, by consent, from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. Belans was also ordered to pay disgorgement of $17,835, prejudgment interest of $13,865, and a $55,800 civil money penalty.

4. The Commission's complaint alleged, among other things, that Belans engaged in three fraudulent schemes which resulted in Delphi filing materially false and misleading financial statements in the company's quarterly report on Form 10-Q for the third quarter of 2000, and on the company's annual report on Form 10-K for the fiscal year ended December 31, 2000. Specifically, the Complaint alleged as follows:

Warranty Settlement

a. In the third quarter of and full year 2000, Delphi improperly accounted for and disclosed a payment that it made to its former parent company, pursuant to a settlement agreement. Delphi treated the payment as related primarily to certain pension and other post-employment benefit ("OPEB") matters, even though Delphi knew that the settlement in fact related exclusively to warranty claims made by its former parent company. As a result, Delphi materially overstated its originally reported earnings per share ("EPS") and net income for the third quarter of and full year 2000. The misstatements were reflected in Delphi's Form 10-Q for the period ended September 30, 2000, as filed with the Commission on or about October 11, 2000, and its Form 10-K for the period ended December 31, 2000, as filed with the Commission on or about February 8, 2001.

b. The Commission alleged that Belans, at his supervisors' direction and approval, added a provision to a September 22, 2000 warranty settlement agreement that released the former parent company from a pension/OPEB claim that the former parent company had never asserted against Delphi, and had no basis to assert; specifically, a claim that, in calculating the pension/OPEB true-up payments, the companies should have used certain 1999 actuarial assumptions, rather than 1998 assumptions. The Commission alleged that to support Delphi's false and misleading accounting, Belans had Delphi's actuarial consultant provide a rough estimate of what Delphi's pension/OPEB true-up payments would be if the companies had used the 1999 assumptions. While Delphi's actuaries did not perform any type of formal analysis, they sent Delphi a one-page fax that suggested that Delphi's pension and OPEB payments to the former parent company could have been about $202 million higher.

c. The Commission alleged that Belans knew or was reckless in not knowing that engineers and financial analysts from Delphi and the former parent company had valued the 27 warranty items at $237 million and that the former parent company would not back down from its claim for $237 million. The Commission alleged that he also knew or was reckless in not knowing that at no time during any of the negotiations leading to the September 2000 warranty settlement did anyone at the former parent company make any claim relating to pension/OPEB actuarial assumptions. Rather the Commission alleged that he included, or allowed the inclusion of, the reference to increases in pension/OPEB costs in the warranty settlement solely to allow Delphi to falsely account for $202 million of the payment as a pension/OPEB payment to the former parent company.

d. Belans knew or was reckless in not knowing that Delphi's accounting for the $202 million of the $237 million payment to the former parent company, as reflected in its Form 10-K for the period ended December 31, 2000, was materially and intentionally false and misleading.

Inventory Transactions

e. In the fourth quarter of 2000, Delphi sold approximately $270 million of inventory to two third-parties while simultaneously agreeing to repurchase the inventory in the following quarter for the original sales price, plus interest charges and structuring fees. By improperly accounting for the transactions as true sales, rather than as financing transactions, Delphi improperly recognized a material amount in cash flow from operations and materially overstated its reported EPS and net income for the fourth quarter of 2000 and, combined with the warranty misstatements, further materially overstated its net income for the year 2000. The misstatements were reflected in Delphi's Form 10-K for the period ended December 31, 2000, as filed with the Commission on or about February 8, 2001.

Precious Metals Transaction with a Bank

f. In the last few days of 2000, Delphi entered into an agreement with a bank (the "Bank"), purporting to sell it approximately $200 million of precious metals. The metals, known collectively as either "Platinum Grade" or "Precious Group" metals, or simply as "PGMs," were used in the production of auto parts, including, primarily, catalytic converters. As agreed at the time of the sale, Delphi repurchased the identical metals from the Bank before the end of January 2001. Under the terms of its agreement, the Bank purported to own the metals for the one-month period, and Delphi agreed to pay the Bank approximately $3.5 million. The purpose of the transaction was to permit Delphi to accelerate recognition of inventory liquidation gains, feign greater liquidity, and otherwise appear to achieve analyst targets and other financial goals. As a result of the transaction, Delphi improperly recognized $54 million in net income. Delphi also improperly boosted its cash flow from operations by approximately $200 million.

g. Delphi's financial forecasts and guidance to investors and analysts for the fourth quarter of and year-end 2000 contemplated material reductions in inventory levels and increases in cash flow from operations and net income, consistent with a sale of approximately $200 million of PGMs to Delphi's former parent company. Delphi's Treasurer was unsure, however, whether Delphi's former parent company would agree to purchase the metals before year end 2000, therefore he directed Belans to conceive an alternative structured finance plan. This initiative was described as "Off-balance sheet financing of PGM inventory." Under the plan, Delphi would temporarily sell the metals to a third-party before year end and then buy them back in early 2001 in time to sell the metals to the former parent company.

h. The transaction with the Bank had two components: a purchase agreement, pursuant to which the Bank agreed to purchase the PGM inventory from Delphi in December 2000, and a forward agreement, pursuant to which Delphi agreed to repurchase the identical metals from the Bank in January 2001, at specified prices. Neither contract stated how the parties arrived at the specified prices.

i. Delphi and the Bank executed the agreements on December 28, 2000, and the Bank wired $199,256,785.65 to Delphi. Delphi treated approximately $193 million of this amount as a reduction in inventory and approximately $6 million as a credit to cost of sales, resulting in an equivalent increase to income. On January 29, 2001, Delphi wired $202,514,626.18 back to the Bank. Between December 28 and January 29, the metals remained under Delphi's control and, in fact, continued to be used by Delphi in its production process. The transaction enabled Delphi to report a $54 million last-in first-out inventory ("LIFO") gain at the end of 2000.

j. The price at which Delphi sold the metals to the Bank, and the higher price at which it repurchased the metals, were both well below market price for the metals. The Commission alleged that, in a misleading effort to demonstrate it was following its auditor's advice that the price at which Delphi sold the metals should be market prices, however, Belans created a memorandum that falsely justified the prices as being appropriately discounted from market price. While acknowledging that there was huge volatility in the price of PGMs, the memorandum also justified the forward price as an appropriate approximation of the one-month future price of the metals. However, the memorandum's analysis was contrived. The forward price was calculated by taking the purchase price and adding $3,257,840.52 in the Bank's fees and costs.

Batteries and Cores Transaction with The Consulting Company

k. In December 2000, Belans engaged in negotiations and Delphi entered into an agreement with B.N. Bahadur, the principal of a consulting company ("the Consulting Company"), to sell automotive batteries and generator cores to the Consulting Company. Delphi also had an oral repurchase arrangement with Bahadur, however, pursuant to which it agreed it would repurchase the identical inventory from the Consulting Company in the first quarter of 2001, at its original price, plus a transaction fee. Delphi's purpose in entering into the transaction was to accelerate recognition of $27 million in inventory LIFO liquidation gains and achieve net income targets.

l. As with the transaction with the Bank, Delphi's goal was to structure the transaction in a way that would assure that Delphi would obtain the auditor's approval for true sale accounting treatment. On the face of the agreement with the Consulting Company, such accounting treatment seemed appropriate. The Commission alleged that Belans, however, deliberately omitted material terms of the actual agreement from the written documents.

m. Bahadur's counsel, who drafted the contract, proposed to Belans and recommended to Bahadur that Delphi's repurchase obligation be put in writing. The Commission alleged that Belans refused to put the repurchase obligation in writing.

n. Belans and Bahadur negotiated the specific price for the repurchase: Delphi would sell the inventory to the Consulting Company for $70,000,000, the approximate book value of the inventory, and repurchase it from the Consulting Company for $70,000,000 plus a 0.5% fee. On December 27, 2000, Delphi and the Consulting Company entered into an "Inventory Purchase Agreement," pursuant to which the Consulting Company agreed to purchase cores and batteries from Delphi. The agreement made no mention of Delphi's repurchase obligation or its agreement to pay a fee to the Consulting Company.

o. In late December 2000, Delphi learned from Bahadur that the Consulting Company would be unable to obtain financing before year end and thus would be unable to immediately pay for the inventory. Belans and others discussed the fact that, without receiving payment from the Consulting Company in 2000, Delphi would be unable to use the scheme as part of its plan to meet operating cash flow targets. Nevertheless, because the transaction was also important to Delphi's inventory reduction scheme, Belans was directed to go forward with the transaction.

p. After January 1, 2001, while the Consulting Company was still working on securing financing, Belans came up with an alternative plan that essentially resulted in Delphi financing the transaction itself. At Belans' direction, Delphi first arranged with Bahadur for the Consulting Company to be enrolled in the supplier financer program. Then, again at Belans' direction, Delphi arranged with Bahadur to have the Consulting Company issue an invoice to Delphi for $70,840,214.28. This amount was calculated by Delphi so that, after the third-party supplier financer took its fee, the Consulting Company would receive the net proceeds of $70,350,000.

q. The Consulting Company received the $70,350,000 from the third-party supplier financer on or about January 12, 2001 and immediately paid $70 million to Delphi as payment for its purchase of the inventory. The Consulting Company retained $350,000 as its fee. A month later, Delphi paid $70,840,214.28 to the third-party supplier financer. When the transaction was complete, Delphi had paid the Consulting Company $350,000, and had paid the third-party supplier financer $538,385.63, to move inventory off of Delphi's books for approximately two weeks. At a cost of almost $900,000, Delphi manufactured an inventory LIFO gain of $27 million. No inventory ever left Delphi's premises.

r. The Commission alleged that Belans hid material facts concerning the transaction from Delphi's auditor. In 2001, when the auditor learned of the January repurchase, the auditor questioned whether there had been any pre-existing agreement with the Consulting Company to repurchase the inventory. Belans assured the auditor there was none.

IV.

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

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

A. Belans 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

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63889 / February 11, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14251

In the Matter of

Score One, Inc., and
Global Peopleline Telecom,
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 Score One, Inc. ("Score One") and Global Peopleline Telecom, Inc. ("Global Peopleline").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Score One, Inc. (CIK No. 1090062) is a Nevada corporation located in Kowloon, Hong Kong, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Score One is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $19,886 for the prior nine months. On December 19, 2007, the

Commission temporarily suspended trading in the company's securities. As of January 12, 2011, Score One's stock traded on the grey market under the ticker symbol "SREA."

2. Global Peopleline Telecom, Inc. (CIK No. 1082603) is a Florida corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Global Peopleline is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2008, which reported a net loss of $121,557 for the prior six months. On January 20, 2009, Global Peopleline was the subject of a cease trade order by the British Columbia Securities Commission for its failure to file required financial statements. As of January 12, 2011, quotations for Global Peopleline stock were removed from the Pink Sheets, operated by OTC Markets Group, Inc., due to the unavailability of adequate current information.

B. DELINQUENT PERIODIC FILINGS

3. As discussed above, the Respondents are delinquent in their periodic filings with the Commission and have repeatedly failed to meet their obligations to file timely periodic reports.

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 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's 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 Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63888 / February 11, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14250

In the Matter of **CHINA DIGITAL MEDIA CORPORATION,** **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 China Digital Media Corporation ("China Digital" 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.

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III.

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

A. <u>China Digital Media Corporation</u>, a Nevada corporation based in Hong Kong, China, is in the business of Cable TV operations, digital television technology development and trading of TV contents in China. Since at least January 2005, the common stock of China Digital has been registered under Section 12(g) of the Exchange Act and the company has filed annual reports on Forms 10-K and 10-KSB and quarterly reports on Forms 10-Q and 10-QSB, pursuant to Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder. At all relevant times, China Digital stock has been quoted on the OTC BB and "Pink Sheets" which is dissemination by the Pink OTC Markets.

B. China Digital has failed to comply with Sections 10(b) and 13(a) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1 and 13a-11 thereunder, while its common stock was registered with the Commission in that it made materially false and misleading statements in several 2005 public filings, including its 2005 Form 10-KSB and Forms 8-K, concerning the sale of securities by an officer and director, the description of the market for and trading range of its securities, and the offer and sale of its securities pursuant to Regulation E of the Exchange Act.

IV.

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

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

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

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

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

Commissioner Casey not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
March 21, 2011

In the Matter of **HELI ELECTRONICS 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 Heli Electronics Corp. ("HELI"), a Nevada corporation with headquarters and operations in the People's Republic of China, which trades in the over-the-counter market under the symbol "HELI."

Questions have arisen regarding the accuracy and completeness of information contained in HELI's public filings with the Commission concerning, among other things, the company's cash balances and accounts receivable. The company has failed to disclose that the company's independent auditor has resigned due to accounting irregularities involving (a) discrepancies between HELI's accounting records for cash balances and official bank statements obtained by the auditors from the company's bank, (b) discrepancies concerning the existence and location of company customers, and (c) the possibility that accounting records could have been falsified. Due to these irregularities, the company's auditor has resigned from its engagement to audit the company's consolidated financial statements for the year ended December 31, 2010, and has withdrawn its audit opinion issued June 15, 2010 relating to the audit of the company's consolidated financial statements as of December 31, 2009 and 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 above-listed company is suspended for the period from 9:30 a.m. EDT, March 21, 2011, through 11:59 p.m. EDT, on April 1, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 28, 2011

In the Matter of **Euro Solar Parks, 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 Euro Solar Parks, Inc. ("Euro Solar") because of possible manipulative conduct occurring in the market for the company's stock. Euro Solar is quoted on the OTC Bulletin Board and OTC Link under the ticker symbol ESLP.

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. EDT on March 28, 2011, through 11:59 p.m. EDT on April 8, 2011.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9247 / August 1, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64998 / August 1, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14274

In the Matter of **DIVINE CAPITAL MARKETS, LLC, DANIELLE HUGHES AND MICHAEL BUONOMO** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO DIVINE CAPITAL MARKETS, LLC AND DANIELLE HUGHES**

I.

On February 25, 2011, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings 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"), and Danielle Bionda Hughes ("Hughes"), among others.

II.

Divine and Hughes (collectively the "Respondents") have each submitted an Offer of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, the Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of

1933 and Section 15(b) of the Securities Exchange Act of 1934 as to Divine Capital Markets, LLC and Danielle Hughes ("Order"), as set forth below.

III.

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

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 stocks within the meaning of Rule 3a51-1 under 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

[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.

directly from the issuer and sold them shortly thereafter -- without a registration statement in effect or on file -- 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. Buonomo did not know Claffey and conducted no due diligence into the securities he intended to sell. Nevertheless, on or about February 27, 2006, Hughes approved the opening of the JDC Swan account. On February 28, 2006, 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 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 monitored by, Hughes.

5. 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 in some cases approved by Hughes.

6. 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 adequate 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

1. In addition to being Divine's majority owner and CEO, Hughes was Buonomo's direct supervisor during some of the relevant period and was a General Securities Principal at Divine. From approximately June 3, 2006 to September 6, 2006, Hughes also assumed the role of Divine's Chief Compliance Officer. 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."

2. From the inception of the account, Hughes ignored red flags that the ADOT sales constituted an unregistered distribution. Shortly after the JDC Swan account was opened, Hughes was put on notice that the JDC Swan account 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 an administrator of the database and accessed the system frequently.

3. 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.

4. 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 failed to take appropriate 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. 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, Respondent Divine willfully[2] 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, Respondent Hughes failed reasonably to supervise Buonomo with a view to detecting and preventing his violations of Sections 5(a) and (c) of the Securities Act.

E. UNDERTAKINGS

1. Respondent Hughes undertakes to provide to the Commission, within 30 days after the end of the 4 month suspension period described below, an affidavit stating that she has complied fully with the sanctions described in Section IV.D. below.

2. Respondent Divine undertakes to provide to the Commission, within 30 days after the end of the 12 month suspension period described below, an affidavit stating that it has complied fully with the sanctions described in Section IV.C. below.

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 Section 15(b) of the Exchange Act it is hereby ORDERED that:

A. Respondent Divine is censured.

B. Respondent Divine cease and desist from committing or causing any violations and any future violations of Section 5(a) and (c) of the Securities Act.

C. Respondent Divine be and hereby is, suspended from participating, directly or indirectly, in any offering of a penny stock, including: acting directly or indirectly

[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)).

as a promoter, finder, consultant, agent or other person who engages in activities with another 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 for a period of twelve months, effective on the second Monday following the entry of this Order.

D. Respondent Hughes be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of four months. The foregoing suspension shall be effective on the second Monday following the entry of this Order, except that the four month suspension from association in a supervisory capacity with any broker or dealer shall be effective on September 5, 2011.

E. Respondent Divine shall, within 10 days of the entry of this Order, pay disgorgement of $33,762 and prejudgment interest of $6,921 and a civil money penalty in the amount of $60,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. 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, 100 F Street NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Divine as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, 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, D.C. 20549-6109.

F. Respondent Hughes shall pay a civil money penalty in the amount of $25,000 to the United States Treasury. The penalty shall be paid in quarterly installments of $6,250 each, beginning within 10 days of entry of this Order. The final payment shall be made within 364 days of 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. 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, 100 F Street NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Hughes as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, 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, D.C. 20549-6109.

G. Such civil money penalties may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9248 / August 1, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64999 / August 1, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14274

In the Matter of **DIVINE CAPITAL MARKETS, LLC, DANIELLE HUGHES, AND MICHAEL BUONOMO,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO MICHAEL BUONOMO**

I.

On February 25, 2011, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings 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 Michael Buonomo ("Buonomo" or "Respondent"), among others.

II.

Buonomo 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, the Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, as to Michael Buonomo (the "Order") as set forth below.

III.

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

A. RESPONDENTS

1. Michael Buonomo, age 36, is a New Jersey resident. Throughout the relevant period, Buonomo was a registered representative associated with Divine Capital Markets, LLC and participated in the offering of shares of Advanced Optics Electronics Inc., which is a penny stock. Throughout much of the relevant period, Buonomo reported to Danielle Hughes, who was his supervisor.

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. 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.

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 stocks within the meaning of Rule 3a51-1 under 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 or on file -- into the public markets through an account he established at Divine.

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

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. Buonomo did not know Claffey and conducted no due diligence into the securities he intended to sell. Nevertheless, on or about February 28, 2006, Buonomo 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 at least $29,017 in commissions and other remuneration for Buonomo on sale proceeds of over $2 million.

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.

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. Buonomo knew or should have known that Claffey and JDC Swan had acquired the ADOT shares directly from the issuer. At no point did Buonomo 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.

D. VIOLATIONS

As a result of the conduct described above, Respondent Buonomo willfully[2] committed

[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.

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.

E. DISGORGEMENT AND CIVIL PENALTIES

Respondent has submitted a sworn Statement of Financial Condition dated April 27, 2011, and other evidence and has asserted his inability to pay a civil penalty, full disgorgement plus prejudgment interest.

F. UNDERTAKINGS

Respondent has undertaken to provide to the Commission, within 30 days after the end of the 12 month suspension period described below, an affidavit stating that he has complied fully with the sanctions described in Sections IV.B, IV.C, and IV.D below.

IV.

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

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

A. Respondent Buonomo cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act.

B. Respondent Buonomo be, and hereby is, suspended 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 for a period of twelve months, effective on the second Monday following the entry of this Order.

C. Respondent Buonomo be, and hereby is, suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of 12 months, effective on the second Monday following the entry of this Order.

D. Respondent shall pay disgorgement of $29,017 and prejudgment interest of $5,948, but that payment of such amount except for $3,000 is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated April 27, 2011, and other documents

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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)).

submitted to the Commission. The payment required by this Order shall be made to the United States Treasury, payable in four quarterly installments of $750 each, the first payment to be made within 10 days of the entry of this Order. All four payments shall be made within 364 days of the date of this Order. If timely payment is not made, interest shall accrue pursuant to SEC Rule of Practice 600. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717 shall be due and payable immediately, without further application. 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, 100 F St., NE, Stop 6042, Washington DC 20549; and (D) submitted under cover letter that identifies Buonomo as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, 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, D.C. 20549-6109.

E. Based upon Respondent's sworn representations in his Statement of Financial Condition dated April 27, 2011, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

F. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law and directing payment of disgorgement and prejudgment interest. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty, disgorgement and interest should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law, or contest the amount of disgorgement and interest to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9246; 34-64996; 39-2477; IC-29740]

Adoption of Updated EDGAR Filer Manual

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual to reflect updates to the EDGAR system. The revisions are being made primarily to retire the offline EDGARLink tool and the associated templates; to support the electronic filing of submission form types 13H, 13H-A, 13H-Q, 13H-I, 13H-T, 13H-R, for large trader registration, and N-PX-CR, N-PX-FM, N-PX-NT, N-PX-VR and their amendments; to update submission form types N-PX and N-PX/A; to update the OMB information on Forms 3, 4, 5, and 25-NSE; to support minor validation updates for Form N-MFP submissions; and to add four new applicant types to the Form ID. The EDGAR system is scheduled to be upgraded to support this functionality on August 1, 2011.

The filer manual is also being revised to address changes previously made in EDGAR.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 10 (August 2011), Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 17 (August 2011), and Volume III entitled EDGAR Filer Manual Volume III: "N-SAR Supplement" Version 2 (August 2011). The updated manual will be incorporated by reference into the Code of Federal Regulations.

EFFECTIVE DATE: [Insert date of publication in the Federal Register.] The incorporation by reference of the EDGAR Filer Manual is approved by the Director of the Federal Register as of [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: In the Division of Corporation Finance, for questions concerning Form 8-K Item 1.04, Exhibit 95, and Forms 3, 4, 5 contact Cecile Peters, Chief, Office of Information Technology, at (202) 551-3600; in the Division of Investment Management for questions regarding submission form types N-PX, N-PX/A, N-PX-CR, N-PX-FM, N-PX-NT, N-PX-VR, and Form N-MFP contact Ruth Armfield Sanders, Senior Special Counsel, Office of Legal and Disclosure, at (202) 551-6989; in the Division of Trading and Markets for questions concerning Form 13H contact Richard R. Holley III, Senior Special Counsel, at (202) 551-5614, for questions concerning addition of new applicant types contact Catherine Moore, at (202) 551-5718, and for questions concerning Submission form type 25-NSE contact Steven Kuan, at (202) 551-5624 ; in the Office of Interactive Disclosure for questions concerning US GAAP 2011 Taxonomy contact Jeffrey Naumann, Assistant Director of the Office of Interactive Disclosure, at (202) 551-5352 and in the Office of Information Technology, contact Rick Heroux, at (202) 551-8800.

SUPPLEMENTARY INFORMATION: We are adopting an updated EDGAR Filer Manual, Volume I, Volume II, and Volume III. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1]

[1] We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on January 11, 2011. See Release No. 33-9169 (January 5, 2011) [76 FR 1514].

It also describes the requirements for filing using EDGARLink Online[2], and the Online Forms/XML website.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.[3] Filers may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.[4]

The EDGAR system will be upgraded to Release 11.2 on August 1, 2011 and will retire the offline EDGARLink tool and the associated templates. As communicated in a notice posted on April 26, 2011 on the Information for EDGAR Filers web page (http://www.sec.gov/info/edgar.shtml), starting August 1, 2011, filings created by the offline tool EDGARLink client or those constructed by filers according to the EDGAR XFDL Technical Specification will no longer be accepted by EDGAR. The EDGARLink Online Application, available from the EDGAR Filing Website (https://www.edgarfiling.sec.gov/), must be used to file all submissions previously supported by the offline EDGARLink tool. Those filers that use the EDGAR XFDL Technical Specification to create filer-constructed submissions without the use of the EDGARLink tool, and wish to do the same outside of the EDGARLink Online Application, can do so by following the EDGARLink Online XML Technical Specification, available from the Information for EDGAR Filers web page.

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[2] This is the filer assistance software we provide filers filing on the EDGAR system.

[3] See Rule 301 of Regulation S-T (17 CFR 232.301).

[4] See Release No. 33-9169 (January 5, 2011) [76 FR 1514] in which we implemented EDGAR Release 10.4. For additional history of Filer Manual rules, please see the cites therein.

New submission form types 13H, 13H-A, 13H-Q, 13H-I, 13H-T, and 13H-R will be added to the EDGAR Filing Website and will be available for use if the Commission adopts a final rule associated with Proposing Release No.34-61908. If adopted by the Commission, the submission form types will be accessible by selecting a "File 13H" link on the EDGAR Filing Website. These non-public submissions will not be disseminated by EDGAR.

The Commission has proposed rulemaking that would amend Form N-PX so that institutional investment managers would be able to use Form N-PX to report their proxy votes on certain executive compensation matters. For institutional investment managers, new submission form types N-PX-CR, N-PX-NT, N-PX-VR and their amendments will be added on EDGARLink Online for use if the proposed amendments are adopted.

The Commission has also proposed rulemaking that would amend Form N-PX to add a new submission form type N-PX-FM for use by registered management investment companies that include proxy votes of institutional investment managers. New submission form type N-PX-FM will be added to EDGARLink Online for use if the proposed amendments are adopted. Additionally, existing EDGARLink Online submission form types N-PX and N-PX/A, will no longer support co-registrants and can only be filed by registered management investment companies. These submission types will be available to filers on November 1, 2011, or later, pending additional Commission rulemaking related to the amendments to Form N-PX.

The validation rules for submission form type N-MFP and its variants have been updated to require "Item 5" (Name of Administrator) and "Item 6" (Name of Transfer Agent) and to allow "Report Date" to be the last business day of the month or any calendar day of the month after the last business day of the month. Previously, the "Report Date" had to be the last business day of the month. In addition, Form N-MFP submissions will be disseminated 60 calendar days after the last calendar day of the Report Date month. Previously, they were disseminated 60 calendar days after the Report Date listed in the submission.

The OMB expiration date on Forms 3, 4, 5, and 25-NSE will be updated. Forms 3 and 4 will be updated to November 30, 2011; Form 5 will be updated to January 31, 2014; and Form 25-NSE will be updated to January 31, 2012.

The Point-to-Point Protocol transmission method, used to connect to the EDGAR Filing Website using direct dial lines via modem in case internet is not available, will be terminated. Filers will use the EDGAR Filing Website, via the internet, to submit filings in EDGAR.

Four additional applicant types will be available for the filers to select when completing the Form ID to apply for EDGAR access codes. These additional applicant types are Institutional Investment Manager (Form 13F Filer), Investment Company (or insurance product separate account) or Business Development Company, Large Trader, and Non-Investment Company Applicant under the 1940 Act.

The filer manual is also being revised to address software changes made previously in EDGAR. The updates include addition of new 8-K Item 1.04 (Mine Safety – Reporting of Shutdowns and Patterns of Violations) and addition of new Exhibit 95 (Mine Safety Disclosure Exhibit) for submission form types 10-K, 10-K/A, 10-KT, 10-KT/A, 10-Q, 10-Q/A, 10-QT, 10-QT/A, 20-F, 20-F/A, 40-F, and 40-F/A5. The 8-K Item and the Exhibit 95 will be available for use if the Commission adopts a final rule associated with Proposing Release No.34-63548.

Filers may upload the required notarized authentication document in PDF when completing the process to "Convert Paper Only Filer to Electronic Filer" from the EDGAR Filer Management Website (https://www.filer management.edgarfiling.sec.gov).

Because the Commission establishes a company record on EDGAR for approved Broker-Dealer Registration Applications and creates a central index key (CIK) for that company, Broker-dealers, who may be required to file certain forms electronically on EDGAR, should complete the process to "Convert Paper Only Filer to Electronic Filer ", from the EDGAR Filer Management website, instead of completing the Form ID (see EDGAR Filer Manual, Volume I, General Information for details). This is because the Form ID should be completed by those for which a CIK has not already been established on EDGAR. Once a Broker-Dealer has completed this process and received the necessary access codes, they will be able to file electronically on EDGAR.

In addition, EDGAR was previously updated to support the US GAAP 2011 Taxonomy. And, Appendix G has been revised to give clearer guidance to Form 13F filers to facilitate the correct preparation, assembling, and submission of these filings.

Along with adoption of the Filer Manual, we are amending Rule 301 of Regulation S-T to provide for the incorporation by reference into the Code of Federal Regulations of today's revisions. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.

You may obtain paper copies of the updated Filer Manual at the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. We will post electronic format copies on the Commission's website; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml.

Since the Filer Manual relates solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA).[6] It follows that the requirements of the Regulatory Flexibility Act[7] do not apply.

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA,[8] we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 11.2 is scheduled to become available on August 1, 2011. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,[9] Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act of 1934,[10] Section 319 of the Trust Indenture Act of 1939,[11] and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.[12]

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[6] 5 U.S.C. 553(b).

[7] 5 U.S.C. 601- 612.

[8] 5 U.S.C. 553(d)(3).

[9] 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

[10] 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

[11] 15 U.S.C. 77sss.

[12] 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 232 - REGULATION S-T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

1. 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.

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2. Section 232.301 is revised to read as follows:

§232.301 EDGAR Filer Manual.

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions. The requirements for becoming an EDGAR Filer and updating company data are set forth in the updated EDGAR Filer Manual, Volume I: "General Information," Version 10 (August 2011). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 17 (August 2011). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 2 (August 2011). All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. You must comply with these requirements in order for documents to be timely received and accepted. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Electronic copies are available on the Commission's website. The address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You can also inspect the document at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to: http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 01, 2011

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65012 / August 2, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3309 / August 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13350

In the Matter of **JORDAN H. MINTZ**	**ORDER PERMITTING ATTORNEY TO RESUME APPEARING AND PRACTICING UNDER RULE 102(e)(5) OF THE COMMISSION'S RULES OF PRACTICE**

I.

On January 26, 2009, the Commission, pursuant to Rule 102(e)(3)(i) of its Rules of Practice, suspended attorney Jordan H. Mintz ("Mintz") from appearing or practicing before the Commission as an attorney, with the right to apply to resume appearing and practicing after two years. *See* Opinion and Order, Securities Exchange Act of 1934 Release No. 2926 (January 26, 2009). As part of a separate consent judgment to resolve a related civil injunctive action brought by the Commission, Mintz was ordered by the U.S. District Court for the Southern District of Texas to pay a civil penalty of $25,000 and $1.00 disgorgement.

II.

On or about January 27, 2011, more than two years after his suspension by the Commission, Mintz filed an application for reinstatement. Mintz has paid the $25,000 civil penalty and $1.00 disgorgement in the related enforcement action. As part of the reinstatement process, Mintz has sworn under penalty of perjury that he has complied with the 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 Order, no information has come to the attention of the Commission relating to Mintz's character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for an adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice.

III.

III.

Based on the foregoing, the Commission has determined that it is appropriate to reinstate Mintz, pursuant to Rule 102(e)(5), to appear or practice as an attorney before the Commission.

Accordingly, it is HEREBY ORDERED that Mintz may resume practicing as an attorney before the Commission.

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. 65005 / August 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14494

In the Matter of JAMES E. PRATT, ESQ., 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 James E. Pratt ("Respondent" or "Pratt") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the

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

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . 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.

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 , paragraph 2, 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. Pratt, age 77, is and has been an attorney licensed to practice in the State of New York. Pratt sold shares of Eldorado Exploration, Inc., Bentley Sports, Inc. and Younger America, Inc., f/k/a Infinity Acquisition, Corp. f/k/a Infinity Music, Corp. between January 1, 2004 and December 31, 2008. Pratt also wrote legal opinion letters regarding shares of stock in Eldorado Exploration, Inc. and Younger America, Inc., f/k/a Infinity Acquisition, Corp. f/k/a Infinity Music, Corp.

2. On April 2, 2009, the Commission filed a complaint against Pratt in SEC v. Frank C. Calmes, et al. (Civil Action No. 09-CV-80524, S.D. of Florida). On May 4, 2011, the court entered an order permanently enjoining Pratt, by consent, from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933.

3. The Commission's complaint alleged, among other things, that Pratt worked with co-defendants Frank Calmes, Lynn Rowntree, and Manny Shulman to distribute shares of newly quoted micro-cap companies to the public without the required registration statements being filed with the Commission. The Complaint further alleged that as part of this process, Pratt obtained shares in these micro-cap companies and sold the shares despite the fact that no registration statement had been filed or was in effect with the Commission with respect to the shares. In addition, the Complaint alleged that Pratt wrote letters to the companies' transfer agents falsely stating that the shares he held, and those held by the co-defendants, were exempt from the registration requirements 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 Pratt's Offer.

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

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 EXCHANGE ACT OF 1934
Release No. 65009 / August 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14497

In the Matter of **FRANZ N. TUDOR,** **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 Franz N. Tudor ("Tudor" 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. Tudor, age 38, resides in Nashville, Tennessee. During the relevant time period, Tudor was a registered representative and a proprietary trader at Schottenfeld Group LLC, a New York limited liability company and registered broker-dealer based in New York, New York.

2. On July 26, 2011, a judgment was entered by consent against Tudor, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Franz N. Tudor, Civil Action Number 10-CV-8598, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged, inter alia, that, while working as a trader at Schottenfeld in 2007, Tudor was tipped material, nonpublic information concerning the acquisition of Axcan Pharma Inc. ("Axcan"), which had been misappropriated in violation of a duty. The complaint further alleged that Tudor traded in the securities of Axcan based on that material, nonpublic information and that he knew, or should have known, that the information was obtained in breach of a fiduciary or other duty of trust and confidence owed to the source of the information.

4. On October 29, 2009, Tudor 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. Franz Tudor, 09-CR-1057.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Tudor be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer or transfer agent, and 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.

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. 65017 / August 3, 2011

Administrative Proceeding
File No. 3-11524

In the Matter of **PILGRIM BAXTER & ASSOCIATES, LTD.,** **Respondent.**	**ORDER DISBURSING FUNDS, TERMINATING FAIR FUND, DISCHARGING PLAN ADMINISTRATOR, AND TRANSFERRING REMAINING FUNDS TO THE U.S. TREASURY**

On June 21, 2004, in the above-captioned matter, the Securities and Exchange Commission ("Commission") issued an Order instituting and simultaneously settling public administrative and cease-and-desist proceedings against Pilgrim Baxter & Associates, Ltd. (the "PBA Order"). In the PBA Order, the Commission authorized and established a Fair Fund of $90 million in disgorgement and penalties paid by Pilgrim Baxter & Associates, Ltd. ("PBA"). According to the PBA Order, the Fair Fund was to be distributed to investors injured by market timing in the PBHG Funds pursuant to a distribution plan to be developed by an Independent Distribution Consultant (the "IDC"). In September 2004, PBA engaged Kenneth Lehn, Ph.D., as the IDC.

In two related matters: *Gary L. Pilgrim*, Admin. Proc. File No. 3-11739 (Nov. 17, 2004) and *Harold J. Baxter*, Admin. Proc. File No. 3-11740 (Nov. 17, 2004), the Commission issued two orders simultaneously instituting and settling administrative and cease-and-desist proceedings against the former principals of PBA, Gary L. Pilgrim ("Pilgrim") and Harold J. Baxter ("Baxter"). Among other things, the Commission authorized and established in each of these Orders a Fair Fund comprised of $80 million in disgorgement and penalties paid by Pilgrim and Baxter for distribution in accordance with the distribution plan developed by the IDC, Dr. Lehn.

On June 30, 2006, the Commission published a proposed Plan of Distribution in connection with the Fair Fund, which was comprised of $250 million plus accumulated interest (the "PBA Fair Fund"), and issued a Notice of Proposed Distribution Plan and Opportunity for Comment (Exchange Act Release No. 54073) 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 November 22, 2006, the Commission approved the proposed Plan of Distribution as modified (the "Plan") and appointed Boston Financial Data Services as Administrator to the Plan ("Plan Administrator"). (Exchange Act Release No. 54812).

The Plan provided for distribution to all eligible investors of their proportionate share of the disgorgement and civil penalties paid by PBA, Pilgrim, and Baxter to compensate such investors for injury they may have suffered as a result of market timing in PBHG Funds for the period spanning June 1998 through December 2001. Under the Plan, eligible investors in the PBHG Funds were to receive a *pro rata* share of the PBA Fair Fund, calculated by Dr. Lehn as a percentage of the value of the PBHG fund held by an accountholder on a given day multiplied by the fund's daily settlement proceeds. The Plan further provided that any monies not distributed directly to investors (the "Residual") was to be distributed to the PBHG Funds based on the proportion of aggregate excess profits by market timers accounted for by each PBHG Fund.

Pursuant to the Plan, a total amount of $267,001,327.14 was disbursed directly to investors in a series of three disbursements: $124,999,781.40 on April 12, 2007, $73,276,568.19 on May 30, 2007, and $68,724,977.55 on August 24, 2007.[1] Also pursuant to the Plan, on February 25, 2009, the Commission ordered the disbursement of the Residual, in the amount of $35,380,631. (Exchange Act Rel. No. 59445).

The Plan Administrator submitted a Final Accounting pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans and paragraph 8.17 of the Plan, which was approved by the Commission. According to the Final Accounting, $3,718,899.60 remains in the PBA Fair Fund. The Commission has determined to transfer to the U.S. Treasury: all funds remaining in the PBA Fair Fund after the disbursement of $6,117.66 to the Tax Administrator (in the amount of $3,712,781.94), and any additional funds that may be subsequently returned for the PBA Fair Fund.

Accordingly, it is ORDERED that:

A. A disbursement of $6,117.66 shall be made from the PBA Fair Fund to the Tax Administrator;
B. After the payment to the Tax Administrator any remaining funds in the PBA Fair Fund shall be transferred to the U.S. Treasury;
C. Any additional funds that may be subsequently returned for the PBA Fair Fund shall be transferred to the U.S. Treasury;

[1] *See* Exchange Act Rel. Nos. 55627 (Apr. 12, 2007); 55831 (May 30, 2007), and 56320 (Aug. 24, 2007), respectively.

D. The PBA Fair Fund is terminated; and

E. The Plan Administrator is discharged.

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. 65018 / August 3, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3256 / August 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14498

In the Matter of **FRANK R. PEPERNO,** **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 Frank R. Peperno ("Respondent").

II.

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

III.

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

1. Respondent, age 41, working from an Old Forge, PA office, was a registered representative associated with a broker-dealer registered with the Commission. Respondent is presently incarcerated in a Federal Correctional Institution located in Bradford, PA.

2. On April 14, 2010, Respondent pleaded guilty to, *inter alia*, one count of mail fraud in violation of Title 18 United States Code, Section 1341 before the United States District Court for the Middle District of Pennsylvania, in *United States v. Frank R. Peperno*, No. 3:03-CR-115 (Munley, J.) (filed April 7, 2010). On July 22, 2010, the Court entered judgment in the criminal case against the Respondent, who was sentenced to a prison term of 43 months followed by five years of supervised release.

3. According to the Criminal Information to which Respondent pleaded guilty, from January 2003 to September 2005, during the conduct of his employment by a broker-dealer, Respondent placed funds from at least nine customers in high-commission real estate investment trust investments by forging customer signatures or otherwise falsifying customer income, net worth figures and investment experience in account application documents that he forwarded via U.S. Mail or other interstate mail carriers to the broker-dealer with whom he was associated. According to the Criminal Information, the scheme generated Respondent at least $54,088.66 in commissions over a 32-month period from January 2003 through September 2005. The Criminal Information also states the customers did not give Respondent permission to sign their names on the account application documents or to provide falsified information to the broker-dealer with whom he was associated.

4. According to the Criminal Information, from September 2003 to January 2006, during the conduct of his employment by a broker-dealer, Respondent also fraudulently obtained approximately $380,000 from two customers by representing to them that he would invest their money in securities; however, rather than investing their money, Respondent converted his customers' funds to his own use.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Peperno 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 and 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.

Any reapplication for association by 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 restitution order the Court may issue against Respondent in *United States v. Frank R. Peperno*, No. 3:03-CR-115; (b) any disgorgement ordered against Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (c) any arbitration award related to the conduct that served as the basis for the Commission order; (d) 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 (e) 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 Walter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3257 / August 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14499

In the Matter of FRANCISCO ILLARRAMENDI, 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 Francisco Illarramendi ("Illarramendi" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. From 2005 to 2010, Illarramendi was a co-owner and associated person of Highview Point Partners, LLC, a Stamford, Connecticut-based investment adviser registered with the Commission. From 2006 to 2011, Illarramendi was a majority owner of Michael Kenwood Capital Management, LLC, an unregistered investment adviser located in Stamford, Connecticut. Through both Highview Point Partners and Michael Kenwood Capital Management, Illarramendi advised several hedge funds. Illarramendi, 42 years old, is a resident of New Canaan, Connecticut.

2. On March 7, 2011, Illarramendi pled guilty to two counts of wire fraud, one count of securities fraud, one count of investment adviser fraud and one count of conspiracy to obstruct justice in violation of Title 18 United States Code, Sections 1343 and 1512 (wire fraud, conspiracy), Title 15 United States Code Section 78j(b), Title 17 Code of Federal Regulations, Section 240.10b-5 (securities fraud), Title 15 United States Code, Section 80b-6 and 80b-17 (investment adviser fraud) before the United States District Court for the District of Connecticut, in United States v. Francisco Illarramendi, Crim. Information No. 3:11 Cr. 41 (SRU).

3. The counts of the criminal information to which Illarramendi pled guilty alleged, inter alia, that Illarramendi used money provided by new investors to the hedge funds he advised to pay out the returns he promised to earlier investors, created fraudulent and misleading documents related to the hedge funds' assets, made false representations to investors in an effort to obtain new investments and to prevent them from seeking to liquidate their investments, improperly commingled the investments in each individual hedge fund with investments in the other hedge funds, and engaged in transactions that were not in the best interests of the 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 Illarramendi's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Illarramendi 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.

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. 65023 / August 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-12448

In the Matter of **STRONG CAPITAL MANAGEMENT, INC.,** **Respondent.**	**NOTICE OF PROPOSED PLAN OF DISTRIBUTION AND OPPORTUNITY FOR COMMENT**

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

On September 29, 2006, the Commission issued an Order instituting settled administrative and cease-and-desist proceedings against Strong Capital Management, Inc. ("Respondent") in this matter (the "Order"). Pursuant to the Order, a Fair Fund was established, comprised of disgorgement, prejudgment interest and penalties paid by the Respondent, for distribution to investors in the Strong High-Yield Municipal Bond Fund ("HYMBF") affected by misconduct involving certain disclosures concerning forbearance agreements in the HYMBF's 2002 and 2003 annual and semiannual reports to shareholders.

OPPORTUNITY FOR COMMENT

Pursuant to this Notice, all interested parties are advised that they may print a copy of the proposed Distribution Plan from the Commission's public website, http://www.sec.gov. Interested parties may also obtain a written copy of the proposed Distribution Plan by submitting a written request to James Davidson, Assistant Regional Director, United States Securities and Exchange Commission, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604. All persons who desire to comment on the Distribution Plan may submit their comments, in writing, no later than 30 days from the date of this Notice:

1. by sending a letter to the Office of the Secretary, United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-2090;

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

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

Comments submitted by e-mail or via the Commission's website should include "Administrative Proceeding File Number 3-12448" on the subject line. Comments received will be publicly available. Persons should submit only information that they wish to make publicly available.

DISTRIBUTION PLAN

The Fair Fund is comprised of $2,185,927.60 in disgorgement, prejudgment interest and penalties paid by the Respondent, plus accumulated interest, less any federal, state, or local taxes on the interest. The Distribution Plan provides for the distribution of the Fair Fund on a pro rata basis to shareholders of the HYMBF according to the following schedule: 25% to shareholders who owned shares in the HYMBF as of December 31, 2002, 50% to shareholders who owned shares in the HYMBF as of December 31, 2003, and 25% to shareholders who owned shares in the HYMBF as of June 30, 2004. As proposed in the Distribution Plan, if approved, Eligible Recipients will be all direct retail shareholders, transparent intermediary accounts, and omnibus accounts that held shares in the HYMBF on December 31, 2002, December 31, 2003, and June 30, 2004. Each Eligible Recipient's pro rata allocation for each of the three applicable dates will be added together to determine the total amount of the distribution that will be paid to each Eligible Recipient. Eligible Recipients will not need to go through a claims process, rather they will be determined from Respondent's records. Eligible Recipients will not be required to make claims or submit documentation to establish their eligibility.

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. 65022 / August 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-12448

In the Matter of STRONG CAPITAL MANAGEMENT, INC., Respondent.	ORDER APPOINTING FUND ADMINISTRATOR AND WAIVING BOND REQUIREMENT

On September 29, 2006, Respondent consented to an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Section 203(e) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"). The Order found, among other things, that Respondent was the investment adviser to Strong High-Yield Municipal Bond Fund, Inc. ("Fund") and that Respondent made a materially misleading statement about the Fund and failed to effectively disclose material facts in the Fund's 2002-2003 shareholder reports concerning forbearance agreements that the Fund entered into with two obligors on bonds in the Fund's portfolio. The Order established a Fair Fund under Section 308(a) of the Sarbanes-Oxley Act of 2002.

Pursuant to the Order, a plan will be proposed for the distribution of the Fair Fund. The Fair Fund is comprised of $2,185,927.60 paid by the Respondent, plus accumulated interest, less any federal, states, or local taxes on the interest.

The Division of Enforcement ("Division") seeks approval of the appointment of Michael R. Gibbons ("Gibbons") as Fund Administrator for the Proposed Plan of Distribution and approval of the waiver of the bond requirement for Gibbons for good cause shown and pursuant to Rule 1105(c) of the Commission's Rules of Fair Fund and Disgorgement Plans.

The proposed plan contemplates the distribution of funds now at the Department of Treasury Bureau of Public Debt to shareholders in the Fund who owned shares of the Fund on December 31, 2002, December 31, 2003, and/or June 30, 2004. Gibbons will not have possession of the Fair Fund.

IT IS HEREBY ORDERED that Gibbons is appointed as the Fund Administrator and that the bond requirements of the Fund Administrator is waived for good cause shown.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3257 / August 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14499

In the Matter of **FRANCISCO ILLARRAMENDI,** **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 Francisco Illarramendi ("Illarramendi" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. From 2005 to 2010, Illarramendi was a co-owner and associated person of Highview Point Partners, LLC, a Stamford, Connecticut-based investment adviser registered with the Commission. From 2006 to 2011, Illarramendi was a majority owner of Michael Kenwood Capital Management, LLC, an unregistered investment adviser located in Stamford, Connecticut. Through both Highview Point Partners and Michael Kenwood Capital Management, Illarramendi advised several hedge funds. Illarramendi, 42 years old, is a resident of New Canaan, Connecticut.

2. On March 7, 2011, Illarramendi pled guilty to two counts of wire fraud, one count of securities fraud, one count of investment adviser fraud and one count of conspiracy to obstruct justice in violation of Title 18 United States Code, Sections 1343 and 1512 (wire fraud, conspiracy), Title 15 United States Code Section 78j(b), Title 17 Code of Federal Regulations, Section 240.10b-5 (securities fraud), Title 15 United States Code, Section 80b-6 and 80b-17 (investment adviser fraud) before the United States District Court for the District of Connecticut, in United States v. Francisco Illarramendi, Crim. Information No. 3:11 Cr. 41 (SRU).

3. The counts of the criminal information to which Illarramendi pled guilty alleged, inter alia, that Illarramendi used money provided by new investors to the hedge funds he advised to pay out the returns he promised to earlier investors, created fraudulent and misleading documents related to the hedge funds' assets, made false representations to investors in an effort to obtain new investments and to prevent them from seeking to liquidate their investments, improperly commingled the investments in each individual hedge fund with investments in the other hedge funds, and engaged in transactions that were not in the best interests of the 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 Illarramendi's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Illarramendi 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.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro
Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9249 / August 4, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65037 / August 4, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3259 / August 4, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29745 / August 4, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14279

In the Matter of **RAJAT K. GUPTA,** **Respondent.**	**ORDER DISMISSING PROCEEDINGS**

On March 1, 2011, the Commission instituted these public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 against Rajat K. Gupta.

On March 18, 2011, Mr. Gupta filed a lawsuit against the Commission in the U.S. District Court for the Southern District of New York challenging the institution of these proceedings.

The Commission has determined that it is in the public interest to dismiss these proceedings. Dismissing these proceedings will not prevent the Commission from filing an action against Mr. Gupta in United States District Court.

Accordingly, IT IS ORDERED, that this proceeding be, and hereby is, dismissed.

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. 65029 / August 4, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3258 / August 4, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14448

In the Matter of **PATRICK L. MARTIN,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940**

On June 30, 2011, the Securities and Exchange Commission ("Commission") initiated proceedings pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Patrick L. Martin ("Martin" 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 Pursuant to Section 15(b)(6) of the Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, as set forth below.

III.

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

1. Martin was the chief manager of LandOak Securities, LLC ("LandOak Securities"), an investment adviser registered with the Commission, since April 2000. LandOak Securities is also a broker-dealer registered with the Commission. Martin is currently the sole owner and principal operator of LandOak Securities and has owned at least 75% of it since April 2003. Prior to that time, Martin owned at least 25% of LandOak Securities. Martin has been a registered representative of LandOak Securities, the registered broker-dealer, from April 1996 to the present.

2. On March 29, 2011, a final judgment was entered by consent against Martin, permanently enjoining him from future violations of Sections 206(1), 206(2), 206(4), 207, and 204 and Rule 204-2 of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. LandOak Securities, LLC, Patrick L. Martin, and Michael A. Atkins, Civil Action Number 3:08-cv-0209, in the United States District Court for the Eastern District of Tennessee.

3. The Commission's complaint alleged the following: Between July 1997 and July 1998, Martin and his co-defendant Michael A. Atkins ("Atkins") sold investors approximately $3.6 million in promissory notes and membership interests in LandOak Mortgage, a Tennessee limited liability company. More than a third of LandOak Mortgage investors were LandOak Securities advisory clients, who together invested a total of $1.8 million in LandOak Mortgage. Between July 2002 and January 2003, Martin and Atkins misappropriated, diverted, or misused approximately $2.8 million from LandOak Mortgage. In July 2002, Martin and Atkins took $1,545,000 and diverted or loaned it to Tice Technologies, Inc. ("Tice"). Martin and Atkins did not disclose to LandOak Mortgage's investors, several of whom were advisory clients of LandOak Securities, that Martin had a conflict of interest because he was a director of Tice and owned a substantial stake in that company. Martin also failed to maintain certain books and records required of investment advisors registered with the Commission, and also made false statements and material omissions in LandOak Securities' Form ADV and amendments filed with the Commission.

IV.

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

Respondent shall 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 Aguilar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65030 / August 4, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3310 / August 4, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14500

In the Matter of **KARLHEINZ REDEKOPP, CGA,** **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 Karlheinz Redekopp, CGA ("Respondent" or "Redekopp") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the 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

[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.

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. Redekopp, age 40, is the former Chief Financial Officer of International Commercial Television, Inc. ("ICTV"), having served in that capacity from approximately March 2006 to August 2008, when he tendered his resignation. Redekopp holds an active Certified General Accountant designation issued in 1998 in British Columbia, Canada. Redekopp is a resident of Vancouver, Canada.

2. ICTV was, at all relevant times, a Nevada corporation headquartered in Bainbridge Island, Washington. Founded in 2001, the Company sells health and beauty products internationally via infomercials and through various televised shopping networks. ICTV's common stock is registered under Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and is quoted on the Pink Sheets under the symbol "ICTL."

3. On July 26, 2011, a final judgment was entered against Redekopp, permanently enjoining him 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, 13a-14 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Karlheinz Redekopp, Civil Action Number 3:10-cv-05557, in the United States District Court for the Western District of Washington. The final judgment also prohibits Redekopp from acting as an officer or director of a public company for a period of 5 years.

4. The Commission's complaint alleged, among other things, that Redekopp engaged in a financial reporting fraud which caused ICTV to materially overstate revenue and net income in periodic reports filed with the Commission during a six-quarter period in 2007 and 2008. The Complaint alleged that Redekopp engaged in a number of improper accounting practices that materially increased ICTV's annual and quarterly revenue and net income in a departure from Generally Accepted Accounting Principles. These practices included, among other things, recognizing revenue on sales that did not exist, prematurely recognizing revenue on product sales through the Home Shopping Network, improperly recognizing revenue on sales made directly to consumers prior to expiration of a free trial period, failing to establish a return allowance, and failing to properly recognize returns on direct consumer sales. During the relevant period, ICTV sold securities in a private placement, and the related subscriptions agreements, counter-signed by Redekopp on behalf of ICTV, included the materially false representation that "[a]ll of the accounts receivable and net receivables of the Company are valid and enforceable claims, are subject to no

known set-off or counterclaim, and to the knowledge of the Company are fully collectible in the normal course of business."

IV.

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

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

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

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

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

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

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

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

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

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his CGA designation is current and he has resolved all other disciplinary issues with the applicable boards of accountancy. However, if his CGA designation 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

Chairman Schapiro, Commissioner Aguilar, Commissioner Paredes not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3260 / August 5, 2011

INVESTMENT COMPANY ACT OF 1940
Rel. No. 29746 / August 5, 2011

Admin. Proc. File No. 3-12978

In the Matter of

ROBERT L. BURNS

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

Grounds for Remedial Action

Accepting prohibited compensation from brokerage firms

Equity trader, who was affiliated person of investment adviser, willfully accepted compensation from brokerage firms that sought and obtained orders to buy or sell securities on behalf of trader's advisory clients, in violation of Section 17(e)(1) of the Investment Company Act of 1940. *Held*, it is in the public interest to censure respondent, impose a cease-and-desist order, order disgorgement of $141,822.50, and assess a $40,000 civil penalty.

APPEARANCES:

Robert L. Burns, *pro se*.

Frank C. Huntington, for the Division of Enforcement.

Appeal filed: February 9, 2011
Last brief received: April 29, 2011

I.

Robert L. Burns, a former equity trader at FMR Co., Inc., a registered investment adviser, appeals an administrative law judge's decision. The law judge found, on summary disposition, that Burns willfully violated Section 17(e)(1) of the Investment Company Act of 1940 by accepting compensation from brokerage firms to which he transmitted orders to buy and sell securities on behalf of certain mutual funds that were advisory clients of FMR Co. The law judge censured Burns, imposed a cease-and-desist order, and ordered Burns to disgorge $135,281.45 plus prejudgment interest and to pay a $40,000 civil penalty. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

The salient facts of this case are not in dispute. From 1986 until he was dismissed in December 2004, Burns was an equity trader at FMR Co., Inc., a wholly-owned subsidiary of Fidelity Management and Research Company that provides portfolio management services to, among other clients, the Fidelity Investments group of mutual funds. As an equity trader, Burns received orders from mutual fund portfolio managers and had discretion to choose the brokers, from a list of brokers approved by Fidelity, to whom he would send orders to buy or sell securities.

From 2002 through 2004, Burns sent orders to more than fifty brokerage firms, including ten firms from which he accepted gifts such as wine, travel, and tickets to various concerts, sporting events, and theater productions.[1] The record demonstrates, through a combination of Burns' written admissions, investigative testimony, e-mails between Burns and brokers, and

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1 The Commission instituted administrative proceedings against eight other equity traders and two supervisors of the equity trading desk at FMR Co. for engaging in similar conduct during the same time period. All have settled those proceedings. *See Thomas H. Bruderman*, Investment Advisers Act Rel. No. 3184 (Apr. 4, 2011), __ SEC Docket __; *Kirk C. Smith*, Advisers Act Rel. No. 2819 (Dec. 11, 2008), 94 SEC Docket 12347, 12349; *Steven P. Pasucci*, Advisers Act Rel. No. 2818 (Dec. 11, 2008), 94 SEC Docket 12343, 12345; *Christopher J. Horan*, Advisers Act Rel. No. 2817 (Dec. 11, 2008), 94 SEC Docket 12339, 12341; *Edward S. Driscoll*, Advisers Act Rel. No. 2816 (Dec. 11, 2008), 94 SEC Docket 12334, 12336; *Scott E. DeSano*, Advisers Act Rel. No. 2815 (Dec. 11, 2008), 94 SEC Docket 12321, 12324; *Timothy J. Burnieika*, Advisers Act Rel. No. 2814 (Dec. 11, 2008), 94 SEC Docket 12317, 12318-19; *Jeffrey D. Harris*, Advisers Act Rel. No. 2813 (Dec. 11, 2008), 94 SEC Docket 12313, 12314-15; *David K. Donovan*, Advisers Act Rel. No. 2812 (Dec. 11, 2008), 94 SEC Docket 12309, 12311; *Bart A. Grenier*, Advisers Act Rel. No. 2714 (Mar. 5, 2008), 92 SEC Docket 3060, 3061-62. FMR Co. and its parent, Fidelity Management & Research Company, also settled administrative proceedings arising out of these events. *See Fid. Mgmt. & Research Co.*, Advisers Act Rel. No. 2713 (Mar. 5, 2008).

brokerage firms' expense reports and receipts, that Burns received at least thirty-nine gifts from these brokers. Examples of the gifts include tickets to the finals weekend at Wimbledon in 2002 (eight tickets), 2003 (eight tickets) and 2004 (twelve tickets); fourteen tickets to the U.S. Open tennis tournament in September 2002; a case of 1993 Château Pétrus Pomerol wine in December 2003; tickets to see Prince, the Rolling Stones, Bruce Springsteen, Madonna, and several other performers in concert; tickets to see the Celtics, Red Sox, and Patriots play (sometimes in playoff games); and tickets to numerous theater productions, including "The Lion King," "The Producers," "Avenue Q," and "Hairspray."

The record also demonstrates that Burns often expressed gratitude for the gifts he received, and that brokers often alerted him to the difficulty of obtaining the gifts. For example, when Burns received eight tickets to a Broadway production of the musical "Hairspray" in December 2002 from a broker named Kevin Quinn, Quinn e-mailed Burns to tell him that "[T]hese tixs are not easy by the way," to which Burns replied, "I know. That's why I asked Kevin 'The Man' Quinn for a big favor."[2] In February 2003, Burns sent an e-mail thanking a broker at Soundview Technology Corp. ("Soundview") for giving him tickets to a sporting event; in response, the broker wrote, "The demand for those tix was the highest I have had – sans playoffs – in years. I was holding them out for a quality friend and confidente [sic]. I am not surprised that you ended up w/ them." When Burns requested tickets from Quinn to a Red Sox playoff game in October 2003, Quinn e-mailed him to say, "I have miraculously been able to make 4 great seats appear. I have no doubt that you will reward me for being a true friend. A friend in need is a friend indeed."

For many of the items Burns received, the Division introduced documentary evidence consisting of brokers' expense reports and related receipts that demonstrate the cost paid by the broker to purchase the gift for Burns. These items, and the cost of each as shown by record evidence, are given in Table A below:

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2 Quinn, a former account executive and senior vice president of equity and sales at Jefferies & Co. ("Jefferies"), settled Commission administrative proceedings charging him with giving gifts to several traders (including Burns) and, among other things, thereby aiding and abetting and causing the traders' violations of Section 17(e)(1). *Kevin W. Quinn*, Investment Co. Act Rel. No. 27588 (Dec. 1, 2006), 89 SEC Docket 1381, 1383. Jefferies also settled Commission administrative proceedings against it arising from these activities. *Jefferies & Co., Inc.*, Exchange Act Rel. No. 54861 (Dec. 1, 2006), 89 SEC Docket 1362, 1364-65.

Table A:
Gifts to Burns of Known Cost Paid by the Giving Brokers

Date	*Gift*	*Price paid*
July 2002	Eight tickets to the finals weekend of the Wimbledon tennis tournament from Jefferies & Co. ("Jefferies") at $1,675 per ticket for Saturday's matches and $3,100 per ticket for Sunday's matches	$19,100
Sept. 2002	Two tickets to the U.S. Open tennis tournament from Robert W. Baird & Co. ("Baird")	$3,700
Oct. 2002	Four tickets to a Bruce Springsteen concert from Jefferies	$800
Nov. - Dec. 2002	Five bottles of wine from Jefferies at $149.95 each and three bottles at $1,675 each; one bottle from Morgan Stanley & Co. ("Morgan Stanley") at $118.47	$5,893.22
Dec. 2002	Eight tickets to the "Hairspray" theater production from Jefferies	$3,610
Apr. 2003	Four tickets to an Alvin Ailey Dance Company show from Jefferies	$700
May 2003	Four tickets to a Red Sox game from Soundview	$1,100
June 2003	Four tickets to a Broadway performance from Lehman Brothers, Inc. ("Lehman")	$800
July 2003	Eight tickets to the finals weekend of the Wimbledon tennis tournament from Jefferies at $2,091 each for Saturday's matches and $3,095 each for Sunday's matches	$31,216
Aug. 2003	Four tickets to a Justin Timberlake and Christina Aguilera concert from Jefferies	$600
Sept. 2003	Four tickets to the finals weekend of the U.S. Open tennis tournament from Jefferies	$7,200
Oct. 2003	Four tickets to a Red Sox playoff game from Soundview	$1,950
Dec. 2003	A case (twelve bottles) of 1993 Château Pétrus	$7,627.77

	Pomerol wine from Jefferies at $625 per bottle; one bottle of champagne from Morgan Stanley at $127.77	
Jan. 2004	One ticket to a Patriots playoff game from Fidelity Capital Markets ("FCM")	$503.75
Mar. 2004	Tickets to an Erykah Badu concert from Jefferies	$1,080
Apr. 2004	A Masters golf tournament shirt from Jefferies	$125
June 2004	Four tickets to a Red Sox game from Needham & Co. ("Needham")	$900
July 2004	Twelve tickets to the finals weekend of the Wimbledon tennis tournament from Jefferies costing £20,200 plus a 3.4% service charge, or $38,207.59, and four nights' lodging at the Lanesborough Hotel in London costing £6,575.28 or $12,470.21	$51,016.76
	Total:	$137,922.50

For certain other gifts, the Division did not submit evidence of the actual cost of the gift but provided an estimate that was countered by an estimate Burns himself provided in documents he submitted to FMR Co. in the course of its investigation. On appeal, the Division does not object to the use of Burns' estimates in place of its own. Under Commission Rule of Practice 250(a),[3] we may take as evidence Burns' estimates as admissions on summary disposition, and we do so here. We identify the gifts for which Burns provided an estimate of the value in Table B below:

Table B:
Gifts to Burns for Which Burns Provides an Estimate of Value

Date	*Gift*	*Burns' estimate*
Apr. 2003	Federal Cup tennis tournament tickets (twelve from Jefferies)	$30 - $40 each
May 2003	"Lion King" tickets (four from an unidentified broker)	$85 - $100 each
Aug. 2003	Use of vacation home in Wellfleet, MA for	$500 - $1,000

3 17 C.F.R. § 201.250(a).

	one week (from Knight Securities, L.P. ("Knight")). Burns stated he reimbursed the broker $700 - $800 for this trip	
Jan. 2004	Use of vacation condominium in New Hampshire for a weekend (from Knight)	$300
Feb. 2004	"Moving Out" and "Avenue Q" tickets (four tickets each from Jefferies)	$65 - $85 each
Mar. 2004	Use of vacation condominium in New Hampshire for a weekend (from Knight)	$300
June 2004	Madonna concert tickets (four from Jefferies)	$100 each
Aug. 2004	"Avenue Q" and "Caroline, or Change" tickets (four each from Baird)	$65 - $85 each
Aug. 2004	Prince concert tickets (from Baird)	Burns conceded that six cost $75 each and estimates other four cost $65 each.
Sept. 2004	Red Sox tickets (six from Knight and Needham)	$75 each
		Total: $4,400 - $5,770

Burns also received several gifts for which neither the Division nor Burns provided evidence of value. In addition, there were a number of gifts that Burns requested and received not for himself but for Peter Lynch, who served as vice chairman and director of FMR Co. and Fidelity Management & Research Company and was the former portfolio manager of Fidelity's Magellan Fund.[4] We group both of these types of gifts together in Table C, below, because these gifts serve as evidence of Burns' violation[5] but, as we will discuss later with respect to the appropriate sanction in this case, they do not contribute to the figure Burns should disgorge.

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4 Lynch settled Commission administrative proceedings against him based on his alleged request and receipt of tickets to sporting and entertainment events from Burns and another FMR Co. trader, which allegedly caused certain of the traders' violations of Advisers Act Section 17(e)(1). *See Peter S. Lynch*, Investment Co. Act Rel. No. 28189 (Mar. 5, 2008), 92 SEC Docket 3101, 3102-03.

5 *See infra* note 12 and accompanying text.

Table C: Gifts to Burns for Which the Record Contains No Evidence of Value, or Which Burns Gave to Lynch	
Date	*Gift*
Mar. 2002	Celtics tickets (two from Robertson Stephens, Inc. ("Robertson Stephens"))
Sept. 2002	Rolling Stones tickets (two from Jefferies)
Sept. 2002	U.S. Open tennis tournament tickets (ten total from Jefferies, Lehman, and Morgan Stanley)
Oct. 2002	"Lion King" tickets for Lynch (three from Jefferies)
Dec. 2002	Wine (from Needham)
Feb. 2003	Unidentified sporting event (unknown number of tickets from Soundview). We note that, although the law judge does not appear to have counted this item as a benefit Burns received, we conclude that e-mail correspondence between Burns and the Soundview broker sufficiently establishes that the broker gave Burns tickets to a sporting event in February 2003, and that Burns considered them to be of some value.
Apr. 2003	Celtics playoff game (four from Soundview)
July 2003	Red Sox game (two from Soundview)
Sept. 2003	"The Producers" tickets for Lynch (two from Jefferies)
Dec. 2003	Case of wine (from Instinet, LLC ("Instinet"))
Feb. 2004	"The Producers" tickets (four from Baird)
Summer 2004	Red Sox tickets (four from Schwab Soundview Capital Markets ("Schwab"), fka Soundview)
Sept. 2004	Ryder Cup gold tournament tickets for Lynch (twelve from Baird)
Sept. 2004	Red Sox playoff game tickets for Lynch (two from Knight or Needham)
2003 or 2004	Neil Diamond concert tickets for Lynch (two from Jefferies)

Burns does not dispute that he received any of the items at issue.[6] Nor does Burns contest the Division's representation that, according to data supplied by Fidelity, Burns sent securities transactions involving more than 2 billion shares to the ten brokerage firms from which he received gifts during 2002 - 2004.[7]

III.

Section 17(e)(1) of the Investment Company Act prohibits, with certain exceptions not relevant here, the receipt by an affiliated person of an investment company, acting as agent, of compensation from any other source for the purchase or sale of the company's property.[8] First, the record demonstrates, and Burns concedes, that Burns was an "affiliated person" under Section 17(e)(1) because he was an employee of an investment adviser (FMR Co.) to an

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6 Although Burns does not contest that he received any of the gifts at issue in this proceeding, we exclude from consideration three items that the law judge appears to have found that Burns received but which we find are not established with sufficient clarity to support a finding of liability. These items were alleged to be three tickets to an unidentified theater event in October 2002, two tickets to an unidentified event in November 2002, and an unknown number of seats to an unidentified sporting event in January 2003. In excluding these items we are mindful of the fact that, in reviewing appeals of decisions made on motions for summary disposition, the "facts of the pleading of the party against whom the motion is made shall be taken as true. . . ." *Conrad P. Seghers*, Advisers Act Rel. No. 2656 (Sept. 26, 2007), 91 SEC Docket 2293, 2301 & n.30 (quoting Rule of Practice 250(b), 17 C.F.R. § 201.250(b)).

7 Specifically, according to the Division, from 2002 - 2004 Burns directed transactions involving 541,555,078 shares to FCM, 442,264,543 to Lehman, 331,783,942 to Morgan Stanley, 279,835,684 to Baird, 202,485,456 to Jefferies, 132,818,191 to Knight, 82,147,580 to Instinet, 29,076,719 to Needham, 33,309,252 to Soundview and Schwab Soundview, and 1,114,100 to Robertson Stephens.

8 Section 17(e)(1) of the Investment Company Act provides that

> it shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such a person, acting as agent, to accept from any source any compensation (other than regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker[.]

investment company (the Fidelity Funds).[9] Second, Burns concedes, and the record demonstrates, that Burns, who directed securities trades to brokers for execution on behalf of mutual funds, was "acting as agent" within the meaning of the statute.[10] Third, the record demonstrates that the various gifts Burns received constitute "compensation" within the meaning of Section 17(e)(1), which is broadly defined to include "any economic benefit paid directly or indirectly to an adviser."[11] The gifts listed above, for which Burns often expressed appreciation and gratitude in correspondence with the givers, were of at least some value to Burns.[12] The record therefore supports finding that the first three prongs of Section 17(e)(1) are satisfied.

The fourth requirement for liability under Section 17(e)(1) is that the compensation be received "for the purchase or sale of any property to or for" a registered investment company. Congress intended the scope of Section 17(e)(1) to be broad. In *United States v. Deutsch*, the U.S. Court of Appeals for the Second Circuit examined the legislative history of the Investment Company Act and noted that Section 17 was "aimed specifically at insuring the independence of

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[9] As noted, Section 17(e)(1) applies to "any affiliated person of a registered investment company, or any affiliated person of such person." The Investment Company Act defines an "affiliated person of another person" as "any officer, director, copartner, or employee of such other person; [and,] if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof." 15 U.S.C. § 80a-2(a)(3)(D)-(E).

[10] "[A]n affiliated person is acting as agent within the meaning of § 17(e)(1) in all cases when he is not acting as broker for the investment company." *United States v. Deutsch*, 451 F.2d 98, 111 (2d Cir. 1972), *cert. denied*, 404 U.S. 1019 (1972).

[11] *See also William Lewis Morgan*, 51 S.E.C. 622, 627 n.21 (1993) (characterizing "compensation" under Section 17(e)(1) as a "synonym for economic benefit") (citing *Investors Research Corp.*, 46 S.E.C. 1209, 1216 n. 28 (1978)), *remanded on other grounds*, 628 F.2d 168 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980); *Steadman Security Corp.*, 46 S.E.C. 896, 910 n. 38 (1977), *aff'd and remanded on other grounds*, 603 F.2d 1126 (5th Cir.1979), *aff'd* (as to standard of proof), 450 U.S. 91 (1981); *United States v. Milken*, 759 F. Supp. 109, 120 (S.D.N.Y. 1990) ("Section 17(e)(1) requires only that the affiliated person believe that the gratuity he has received constitutes 'something of value' at the time he received it. The precise value of the gratuity in the marketplace is of little importance.") (citing *United States v. Deutsch*, 451 F.2d 98, 108 (2d Cir. 1971), *cert. denied*, 404 U.S. 1019 (1972)).

[12] In his petition for review, Burns "disagree[s]" with the law judge's determination that gifts he accepted for Lynch meet the compensation requirement of Section 17(e)(1). However, Burns himself identifies the value of these items: he states that the "only benefit or value that I received from such actions was to keep my boss happy and favorably disposed to me – to keep my job." As demonstrated by the case law cited above, this kind of benefit qualifies as "something of value" within the broad scope of the statute. We find that the gifts Burns accepted for Lynch support a finding that Burns received prohibited compensation under Section 17(e)(1).

management" of investment companies and "was designed in part quite clearly to establish broad standards which would more easily enable the government to convict affiliated persons for self-dealing in the management of investment companies – an industry the very nature of which made it difficult to gather proof."[13] The Court concluded that Section 17(e)(1) is "cast in the familiar 'for' terminology of the [federal] gratuity statutes where the only intent required is that the payment be given and accepted in appreciation of past, or in anticipation of future, conduct."[14] Indeed, the Court found, "[t]he paying of compensation is evil in itself, even though the payor does not corruptly intend to influence the affiliated person's acts, for it tends to bring about preferential treatment in favor of the payor which can easily injure the beneficiaries of investment companies."[15]

In *Decker v. SEC*, the U.S. Court of Appeals for the Tenth Circuit further explained the meaning of the phrase "for the purchase or sale of any property."[16] In that case, the Court agreed with *Deutsch*'s conclusion that this provision did not require the Division to prove any "intent to influence."[17] It explained that, instead, the Division must simply establish that respondent was "in a position where his own interests and the interests of [his employing investment advisor] were in conflict with the interests of the [mutual funds]." Once the Division establishes that a conflict existed, the Court reasoned, "'the burden shifts to the party in conflict to prove that he has been faithful to his trust.'"[18] That is, it becomes Burns' burden to produce evidence that none of the gifts he received were in exchange for the brokerage business he distributed.[19]

The record shows, and Burns does not contest, that Burns accepted numerous gifts from multiple brokers to whom Burns had directed (and continued to direct) securities transactions on behalf of mutual funds to which he, affiliated with the funds' adviser, owed a fiduciary duty. We therefore conclude that the Division made a prima facie showing that, in accepting these gifts, Burns' interest conflicted with that of the investment companies he was advising. As *Decker* provides, the burden of proof then shifted to Burns to prove that none of the gifts he received was in exchange for the brokerage business he gave to the giftors.

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13 451 F. 2d 98, 108 (2d Cir. 1971).

14 *Id.* at 112 (citing 18 U.S.C. §§ 201 (f-i) (1964).

15 *Id.* at 112.

16 631 F.2d 1380, 1383 n.4 (10th Cir. 1980).

17 *Id.* at 1384.

18 *Id.* at 1385 (quoting *Investors Research Corp. v. SEC*, 628 F.2d 168, 175 (D.C. Cir. 1980)).

19 *Id.*

Burns has offered no such evidence. In lieu of such proof, he points out that the Division has not provided a "particularized, gift-by-gift inquiry" showing how each and every gift he received caused him to direct his securities orders differently. He argues that, although he took gifts from brokers, the Division "failed to find ANY circumstance where [Burns] purchased securities for other than the lowest possible price." However, under *Decker*, it is not the Division's task to prove the quid pro quo that Burns provided in exchange for each gift; instead, once the Division shows Burns placed himself in a position where his interests conflicted with the trust placed in him by the investment companies and, by extension, their shareholders, it became Burns' task to prove that none of the gift-giving violated that trust.[20] He has not done so.

Burns claims that, if he must demonstrate that he has been "faithful to his trust," then "trial discovery is the appropriate time to gather all such evidence on this critical point." However, to defeat summary disposition, the opposing party must present facts demonstrating a genuine issue of fact that is material to the charged violation.[21] Burns suggests that at a hearing he would present evidence that he never "traded to the detriment of the Fidelity Funds" and which "might go a long way in proving lack of improper intent." However, Rule 250 provides that the law judge "shall deny or defer the motion" if "it appears that a party, for good cause shown, cannot present by affidavit prior to hearing facts essential to justify opposition to the motion."[22] In connection with the Rule 250 motion before the law judge, Burns neither presented the evidence to which he refers nor made a showing why he could not do so, nor does he do so now.

Moreover, even if Burns were to establish that he never traded to the detriment of the mutual funds, this would not preclude liability under Section 17(e)(1). The facts in evidence– none of which Burns contests– demonstrate that the brokers who gave Burns tens of thousands of dollars in tickets to baseball games, basketball games, concerts, Broadway shows, and tennis matches, among other things, gave them to Burns in recompense for sending them trades and in hopes that Burns would send them more. Burns has never argued that these gifts had no connection to his status as a trader for Fidelity mutual funds or to the discretion he wielded in directing billions of shares of securities transactions to brokers for execution. To be plain, brokers sent Burns gifts because of his position. Even if Burns could prove his assertion that he "never bought securities at more than the lowest price for the volume requested [or] . . . [sold] securities at other than the highest price attainable," this does not cure the obvious "abuse of trust in the investment company industry" inherent in this gift-giving – the kind of abuse that Section

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20 *See id.*

21 Rule of Practice 250(b), 17 C.F.R. §201.250(b); *Gary M. Kornman*, Exchange Act Rel. No. 59403 (February 13, 2009), 95 SEC Docket 14246, 14263 *aff'd. Kornman v. SEC*, 592 F. 3d 173 (D.C. Cir. 2010).

22 Rule of Practice 250(b). *See also Kornman v. SEC, 592* F. 3d at 182 (quoting language of Rule 250(b) with approval).

17(e)(1) was designed to eliminate.[23] And it is not exempt from the "flat ban" imposed by Section 17(e)(1) on "conduct tending to compromise the fiduciary judgment of affiliated persons," even in the absence of any "larcenous intent."[24]

We conclude that there is no genuine issue with regard to any material fact, and that the Division has demonstrated as a matter of law that Burns willfully violated Investment Company Act Section 17(e)(1).[25]

V.

Burns takes issue with the sanctions imposed by the law judge, arguing that neither a censure nor a cease-and-desist order is warranted, that the law judge erred in calculating disgorgement, and that he is unable to pay disgorgement or a civil penalty. He makes several representations that are not disputed by the Division and which we accept as true for purposes of review on summary disposition.[26]

Burns notes that, unlike other traders at FMR Co. who were sanctioned by the Commission for accepting gifts from brokers, Burns did not accept gifts that were

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23 *Deutsch*, 451 F.2d at 108 (citing Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940) at 131 and 971).

24 *Investors Research Corp. v. SEC*, 628 F.2d 168, 177 & n.53 (D.C. Cir. 1980) (finding no scienter requirement in Section 17(e)(1) and noting that the statute "sets forth a flat ban on certain conduct tending to compromise the fiduciary judgment of affiliated persons. There is no language suggesting a scienter requirement. Indeed, the legislative history of section 17 demonstrates specifically that Congress did not intend to saddle the Commission with the difficult problem of proving fraudulent or 'larcenous intent.'") (citing Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940)).

25 *Cf. Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986) (holding that, where "the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial'") (quoting analogous Federal Rule of Procedure 56(e) and citing *First Nat'l Bank of Arizona v. Cities Serv. Co.*, 391 U.S. 253, 289 (1968)).

A willful violation of the securities laws means the intentional commission of an act that constitutes the violation; there is no requirement that the actor be aware that he is violating any statutes or regulations. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted).

26 Rule of Practice 250(a).

"embarrassing" to FMR Co. "[W]hile wrong," Burns states, "my actions in accepting gifts . . . did not result in any loss for my employer or my employer's clients." He asserts that he has fully cooperated with the Commission's investigation of the matter and has no prior disciplinary history. He has been unemployed since FMR Co. terminated him in 2004 and asserts that the "extreme losses" he has suffered as a result of this proceeding have taught him a "lesson [that] will surely never be forgotten." Burns asserts that he will not accept gifts again and simply wants to "bring this awful situation to a close" so that he can "turn [his] energies to finding employment."

A. Censure

Investment Advisers Act Section 203(f) authorizes the Commission to censure, place limitations on, suspend, or bar a person associated with an investment adviser if we determine that the person has, among other things, willfully violated the federal securities laws and that it is in the public interest to do so.[27] In determining whether these sanctions are in the public interest, we consider the factors articulated in *Steadman v. SEC.*[28] Those factors include the egregiousness of a respondent's actions, the degree of scienter involved, the isolated or recurrent nature of the infraction, the recognition of the wrongful nature of the conduct, the sincerity of any assurances against future violations, and the likelihood that the respondent's occupation will present opportunities for future violations.[29] This inquiry is flexible, and no single factor is dispositive.[30]

The misconduct at issue was serious. Burns accepted over $150,000 in gifts of sporting and theater tickets, travel, and wine from at least ten brokerage firms over the course of nearly three years. Although there is no allegation that Burns acted with scienter, Burns must have known that the gifts he was accepting were difficult to acquire and of substantial value.[31] Burns has, nevertheless, made assurances that he understands his conduct was wrong and that he will not engage in future violations of this sort. The Division has not contested Burns' representations. In light of these facts, we conclude that a censure will appropriately serve the remedial purpose of "alert[ing] the public . . . of the unacceptability of [Burns'] conduct" and will

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[27] 15 U.S.C. § 80b-3(f).

[28] 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

[29] *Id.*; *see also KPMG Peat Marwick, LLP*, 54 S.E.C. 1135, 1183-84 (2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

[30] *See Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004).

[31] Indeed, certain emails in the record suggest that, for at least some of the gifts, Burns was well aware of the scarcity and value of the gifts. *See* n. 2 and accompanying text.

have the additional salutary effect of encouraging other traders to observe scrupulously the fiduciary duties they owe their investment advisory clients.[32]

B. Cease-and-Desist Order

Investment Company Act Section 9(f) and Investment Advisers Act Section 203(k) authorize the Commission to impose a cease-and-desist order if we find that any person has violated the federal securities laws or rules thereunder.[33] In our public interest analysis for cease-and-desist orders, we look to whether there is some risk of future violations.[34] The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction; indeed, a single violation can be sufficient to indicate some risk of future violations.[35] We also consider whether other factors demonstrate a risk of future violations, including the factors discussed above in regard to Burns' censure as well as whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions.[36] This inquiry is flexible, and no single factor is dispositive.[37]

As noted above, Burns engaged in serious misconduct over almost three years, accepting numerous gifts of substantial value from brokers to whom he directed business. However, we note that the conduct at issue last occurred seven years ago and that there has been no evidence presented showing that it caused demonstrable harm to investors. We also note Burns' lack of scienter and his assurances that he has learned that his acceptance of gifts from brokers was wrong. Nevertheless, Burns states that he intends to re-enter the industry as soon as these proceedings are concluded and, given his age (49), he has the potential for a long career working with investment companies and advisers. In light of the seriousness of Burns' misconduct and the fact that, given our determination not to impose a bar or suspension, he will be able to re-enter the industry at any time, we conclude that a cease-and-desist order is necessary to protect the investing public against possible future violations by Burns should he again become a

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32 *Philip L. Spartis*, Exchange Act Rel. No. 64489 (May 13, 2011), __ SEC Docket __, __ & n.61.

33 15 U.S.C. §§ 80a-9(f), 80b-3(k).

34 *KPMG Peat Marwick LLP,* 54 S.E.C. 1135, 1185 (2001), *petition denied,* 289 F.3d 109 (D.C. Cir. 2002).

35 *Id.* at 1191; *Geiger v. SEC,* 363 F.3d 481, 489 (D.C. Cir. 2004).

36 *KPMG,* 54 S.E.C. at 1192.

37 *Id.*

securities professional.[38] We find that a cease-and-desist order would have remedial value by encouraging Burns and other similarly situated securities professionals to take their fiduciary responsibilities more seriously.[39]

C. Disgorgement

Investment Company Act Section 9(g) and Investment Advisers Act Section 203(j) authorize disgorgement, including reasonable prejudgment interest, in a cease-and-desist proceeding and a proceeding in which a civil money penalty may be imposed.[40] Disgorgement is an equitable remedy designed to deprive wrongdoers of their unjust enrichment and to deter others from similar misconduct.[41] "[T]he amount of disgorgement should include all gains flowing from the illegal activities."[42]

Disgorgement "need only be a reasonable approximation of profits causally connected to the violation."[43] Once the Division shows that its disgorgement figure is a reasonable approximation of the amount of unjust enrichment, the burden shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation.[44] The Division has shown, by offering documentary evidence consisting of brokers' expense reports and related receipts, that brokers paid a total of $137,922.50 for eighteen items given to Burns, as listed above in Table A.

For the gifts listed in Table B, for which Burns provided his own value estimate in the absence of evidence from the Division supporting a different valuation, we use Burns' estimate. Where Burns provided a range for the value of the item, we use the lowest value consistent with the requirement to construe the facts on summary disposition in the light most favorable to

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38 *See KPMG*, 54 S.E.C. at 1191.

39 *Cf. Vladlen Larry Vindman*, Securities Act Rel. No. 8679 (Apr. 14, 2006), 87 SEC Docket 2626, 2648 (stating that, "[a]lthough we have ordered a penny stock bar and the payment of a civil penalty, the issuance of a cease-and-desist order should serve the remedial purpose of encouraging Vindman to take his responsibilities more seriously in the future").

40 15 U.S.C. §§ 80a-9(g), 80b-3(j).

41 *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989).

42 *David Henry Disraeli*, Exchange Act Rel. No. 57027 (Dec. 21, 2007), 92 SEC Docket 852, 879, *aff'd*, 2009 WL 1791547 (D.C. Cir. 2009) (slip copy).

43 *First City Fin. Corp.*, 890 F.2d at 1231.

44 *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006); *First City Fin. Corp.*, 890 F.2d at 1232.

Burns. Doing so gives an amount of $4,400. However, this amount includes the $500 which Burns estimated was the low end of the range of the value of the rental cost of the Knight broker's summer home in Wellfleet in August 2003. Burns also estimatess, without challenge from the Division, that he reimbursed the broker between $700 to $800 for this gift. Accordingly, we are deducting the $500 value for the August 2003 rental cost. This results in a total of $3,900 in gifts Burns received for which he provides his own estimate.

We do not include, for purposes of disgorgement, a value for any of the items listed in Table C. As noted, these items include gifts of two kinds: (1) gifts for which the Division did not submit documentary evidence to support its estimated value of the gifts and for which Burns himself also offers no estimate, and (2) gifts that Burns requested and accepted on behalf of a senior manager at Fidelity, Lynch. We do not include the first type of gift in our disgorgement calculation because we do not find that the evidence supports with sufficient clarity a reasonable approximation of the value of these gifts, in light of the standard of review on summary disposition. We do not include the second type of gift in our calculation because, as noted, Lynch has already disgorged the value of the gifts he received in a separate proceeding.[45]

Totaling the value of the items Burns received as proven with documentary evidence or as estimated by Burns himself (i.e., as reflected in Tables A and B), we conclude that $141,822.50 reflects the total amount that Burns should disgorge.

Burns argues that disgorgement should not be calculated using the actual cost of an item paid by the broker (as reflected in Table A) but using the face value of gifts received, which Burns believes is a "matter of public record" and which Burns suggests would be substantially lower than the actual "inflated" cost paid by the brokers who purchased the items. Burns has cited several cases and laws in support of his argument, but none of these precedents control here. For example, Burns cites Massachusetts state law prohibiting ticket brokers from charging more than $2 over face value and some federal and state ethics rules requiring gift recipients to report the face value of gifts received; he also states that federal tax law limits ticket grantors to deducting only the face value of those tickets.[46] These statutes relate to public policy matters involving regulation of particular issues – ticket scalping, ethics disclosures of public officials, and collection of federal tax revenues – that are unrelated to the present question of how to

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45 *See supra* note 4.

46 Burns cites Mass. Gen. L. c.140 § 185A; IRS Pub. 463 (2005) at 10.

calculate disgorgement, which is intended to serve a remedial function in the context of securities law enforcement by depriving the wrongdoer of his unjust enrichment.[47]

Burns further argues that *United States v. Ostrander*[48] and *United States v. Milken*[49] establish that "the appropriate measure of value, for purposes of Section 17(e)(1), is based on the recipient's belief concerning the value of the compensation at issue." However, Burns misconstrues these cases. Both *Ostrander* and *Milken* hold that a person who received a gift and believed it to be of at least some benefit when he received it has thereby received "compensation" for purposes of Section 17(e)(1); these cases do not extend the relevance of the recipient's subjective belief to the question of how to value the gift when calculating disgorgement, and they do not compel the result that the face value of an item, even if known, is a more accurate measure of value than the actual cost paid to procure it.

The face value of an item may be a useful starting point from which to estimate the value of a gift of unknown cost, if necessary; but here, the record demonstrates the price paid to a disinterested third-party seller of the gifts.[50] To ignore the actual cost of an item, when known, would defeat the "effective enforcement of the federal securities laws, [which] requires that the SEC be able to make violations unprofitable."[51] This is especially true where, as here, the face value of the items in question did not reflect the fact that they were in high demand and short supply, making them all but impossible to procure at face value.

We find that the Division proved the value of the items listed above either by providing uncontroverted documentary evidence to demonstrate the actual price paid by the broker or by deferring to Burns' own admission of value. In that circumstance, there is no additional fact-

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[47] *See Brendan E. Murray*, Advisers Act Rel. No. 2809 (Nov. 21, 2008), 94 SEC Docket 11961, 11979 & n.47 (describing disgorgement as an "equitable remedy designed to deprive wrongdoers of unjust enrichment by returning them to where they would have been absent the violation and to deter others from violating the securities laws").

[48] 999 F. 2d 27, 31 (2d Cir. 1993).

[49] 759 F. Supp. 109, 120 (S.D.N.Y. 1990).

[50] *See First City Fin. Corp.*, 890 F.2d at 1232 (finding Commission's showing of respondents' actual profits on insider trading reasonably approximated disgorgement figure and noting that while "the line between restitution and penalty is unfortunately blurred, . . . the risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty").

[51] *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996).

finding that would refine the amount of disgorgement Burns properly owes. We therefore order Burns to disgorge $141,822.50, plus prejudgment interest.[52]

D. Civil Penalty

Investment Company Act Section 9(d) and Advisers Act Section 203(i) authorize the Commission to impose a civil money penalty where a respondent has willfully violated any provision of the federal securities laws and a penalty is in the public interest.[53] These acts establish a three-tiered system of civil penalties, each with a larger maximum penalty amount applicable to increasingly serious misconduct.[54] In determining whether a penalty is in the public interest, we may consider whether there was fraudulent misconduct, harm to others or unjust enrichment, whether the respondent had prior violations, and the need for deterrence, as well as such other matters as justice may require.[55]

As noted, Burns was unjustly enriched by accepting, and often requesting, numerous gifts of substantial value over the course of nearly three years. Burns' conduct is not alleged or shown to have been fraudulent, there was no demonstrated harm to others, and Burns' disciplinary history was unblemished before this proceeding. In light of the other sanctions already imposed, we find that a first-tier penalty of $4,000 for each of the ten brokerages from whom he accepted

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[52] Commission Rule of Practice 600(a), 17 C.F.R. § 201.600(a) (noting that "[p]rejudgment interest shall be due on any sum required to be paid pursuant to an order of disgorgement" and describing method of calculation of prejudgment interest due on sums ordered to be disgorged).

Burns argues that "the Staff's astronomical disgorgement demands are particularly unreasonable in view of certain other precedents," citing several disciplinary cases decided by NASD. We note that self-regulatory organizations' disciplinary decisions are not directly analogous to Commission administrative proceedings and that, in any event, it is well established that the appropriateness of a sanction "depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with the action taken in other proceedings." *Paz Sec., Inc.*, Exchange Act Rel. No. 57656 (April 11, 2008), 93 SEC Docket 5122, 5134, *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009) (citing *Butz v. Glover Livestock Comm'n Co.,* 411 U.S. 182, 187 (1973)).

[53] 15 U.S.C. §§ 80a-9(d), 80b-3(i).

[54] Violations committed by a natural person after February 2, 2001, but before February 14, 2005, have a maximum penalty per occurrence of $6,500 in the first tier; $60,000 in the second tier; and $120,000 in the third tier. *See* Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, ch. 10, sec. 31001, § 3701(a)(1); 28 U.S.C. § 2461 (effective Mar. 9, 2006); 17 C.F.R. §§ 201.1001, 201.1002.

[55] 15 U.S.C. §§ 80a-9(d)(3), 80b-3(i)(3).

gifts, for a total of $40,000, is an amount sufficient to deter Burns from future misconduct, and will also have a remedial effect of deterring others from engaging in the same misconduct.

E. Inability to Pay

Under Rule of Practice 630(a), we may, in our discretion, consider evidence of ability to pay in determining whether a respondent should be required to pay disgorgement, interest, or civil penalties.[56] Ability to pay, however, is only one factor that informs our determination and is not dispositive.[57] In particular, "[e]ven when a respondent demonstrates an inability to pay, we have discretion not to waive the penalty, [disgorgement, or interest,] particularly when the misconduct is sufficiently egregious."[58]

Burns represents that he has been unemployed as a result of this misconduct since FMR Co. terminated him in 2004. Burns also states that, in anticipation of having to pay financial sanctions as part of his good-faith efforts to settle these proceedings, he withdrew substantial sums from his retirement account and then sold his condominium in order to pay the taxes and penalties owed on those early-withdrawn funds. The bulk of his assets comprises the cash that he withdrew from his retirement account as well as funds still in that account. He represents that his net worth is approximately $277,823.

Burns has not adduced into the record documentation to support the representations he makes regarding his financial condition. Nonetheless, even accepting his statements as true, we find that Burns has not demonstrated that he is unable to pay the monetary sanctions that we order today. His purported net worth—more than $275,000—is, on its face, sufficient to pay the disgorgement, penalties, and interest at issue.[59] Moreover, Burns has stated that he intends to re-enter the industry when these proceedings are concluded, indicating that Burns may soon have an

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56 17 C.F.R. § 201.630(a).

57 *See, e.g., Brian A. Schmidt*, 55 S.E.C. 576, 597-98 (2002) (noting that, under Exchange Act Section 21B, ability to pay a penalty is but one factor to consider in determining whether a penalty is in the public interest); *see also, e.g., SEC v. Warren*, 534 F.3d 1368, 1370 (11th Cir. 2008) (per curiam) (stating that "[a]t most" a defendant's ability to pay is one factor to be considered in imposing a civil money penalty or disgorgement for violations of the federal securities laws).

58 *Philip A. Lehman*, Exchange Act Rel. No. 54660 (Oct. 27, 2006), 89 SEC Docket 536, 543.

59 *Cf. Thomas C. Bridge*, Exchange Act Rel. No. 60736 (Sept. 29, 2009), 96 SEC Docket 20805, 20848 (noting that a claimed net worth of $107,944 "arguably demonstrates that [respondent] has the means to pay a civil penalty" in the amount of $120,000 and finding that egregiousness of conduct outweighed arguments that respondents could not pay sanctions levied), *aff'd sub nom. Robles v. SEC*, 411 Fed. Appx. 337 (D.C. Cir. 2010).

income stream that would further improve his financial condition. In light of these considerations, and in light of the important public interest served by the sanctions imposed, we reject Burns' claim that he is unable to pay the sanctions ordered.[60]

An appropriate order will issue.[61]

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

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[60] Burns notes that "[f]air notice of the standards against which one is to be judged is a fundamental norm of administrative law," and argues that he "could not possibly have had fair warning that Section 17(e)(1) would be applied against [him] as advocated by the SEC Staff and adjudged in the Initial Decision." However, courts have found similar attacks on Section 17(e)(1) to be "without merit." *See, e.g.*, *Deutsch*, 451 F.2d at 114 ("Section 17(e)(1) clearly places men of reasonable intelligence on notice that affiliated persons cannot accept compensation in connection with the purchase or sale of property to or for their affiliated investment companies."). Moreover, we have repeatedly held that ignorance of the securities laws is not a defense to liability thereunder. *See Marc N. Geman*, 54 S.E.C. 1226, 1260 (2001), aff'd, 334 F.3d 1183 (10th Cir. 2003).

[61] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3260 / August 5, 2011

INVESTMENT COMPANY ACT OF 1940
Rel. No. 29746 / August 5, 2011

Admin. Proc. File No. 3-12978

In the Matter of

ROBERT L. BURNS

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Burns be, and hereby is, censured; and it is further

ORDERED that Burns cease and desist from committing or causing any violations or future violations of Section 17(e)(1) of the Investment Company Act of 1940; and it is further

ORDERED that Burns disgorge $141,822.50, plus prejudgment interest of $67,205.51, such prejudgment interested calculated beginning from October 1, 2004, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Burns pay a civil money penalty in the amount of $40,000.

Payment of the amount to be disgorged and the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, 100 F Street NE, Mail Stop 6042, Washington, DC 20549; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding. A copy of the cover letter and check shall be sent to Frank C. Huntington, Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro
Commissioner Walter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65044 / August 5, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14348

In the Matter of **JAMES R. SPURGER,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

On April 20, 2011, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against James R. Spurger ("Spurger" or "Respondent").

II.

In response to the institution of these administrative proceedings, Respondent has submitted an offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) 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. Respondent, 68, is a resident of Friendswood, Texas. During the time period relevant to the conduct alleged in the complaint and described in Section III.3. below, Respondent was the president of Navigators International Management Company, Ltd. ("Navigators"), a Bahamian corporation, or a consultant actively involved in Navigators' daily operations. Respondent and Navigators are not associated with, and have never applied for association or been associated with a broker or dealer registered with the Commission.

2. On March 28, 2011, a final judgment was entered by consent against Respondent permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Navigators International Management Co. Ltd., et al., Civil Action Number H-07-4518, in the United States District Court for the Southern District of Texas. The final judgment incorporates the consent.

3. The Commission's complaint alleged that from at least January 2005 through August 2007, Respondent, acting on Navigators' behalf, made use of the mails and the means of interstate commerce to effect, induce, and attempt to induce securities transactions with investors in the United States without being registered as a broker or dealer with the Commission. The complaint also alleged that Respondent offered and sold securities in unregistered transactions targeted at persons in the United States and engaged in other conduct that violated United States securities laws.

IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Spurger be, and hereby is:

barred from association with any broker or dealer.

Any application 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

Chairman Schapiro
Commissioner Walter
not participating

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65045 / August 5, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14347

In the Matter of **NAVIGATORS INTERNATIONAL MANAGEMENT CO., LTD.** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

On April 20, 2011, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Navigators International Management Co., Ltd. ("Navigators" or "Respondent").

II.

In response to the institution of these administrative 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 Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

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

1. Respondent is a Bahamian corporation headquartered in Nassau, The Bahamas. Respondent is not registered as, and never has been registered as, a broker or dealer with the Commission.

2. On March 28, 2011, a final judgment was entered by consent against Respondent permanently enjoining it from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Navigators International Management Co. Ltd., et al., Civil Action Number H-07-4518, in the United States District Court for the Southern District of Texas. The final judgment incorporates the consent.

3. The Commission's complaint alleged that from at least January 2005 through August 2007, Respondent made use of the mails and the means of interstate commerce to effect, induce, and attempt to induce securities transactions with investors in the United States without being registered as a broker or dealer with the Commission. The complaint also alleged that Respondent offered and sold securities in unregistered transactions targeted at persons in the United States and engaged in other conduct that violated United States securities laws.

IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Navigators be, and hereby is:

barred from association with any broker or dealer.

Any application 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. 65051 / August 5, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3312 / August 5, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14501

In the Matter of **STEVEN SCOPPETUOLO, 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 Steven Scoppetuolo ("Respondent" or "Scoppetuolo") 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 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. Scoppetuolo is a certified public accountant licensed to practice in the State of New Jersey. He served as Chief Financial Officer of World Fuel Services Corporation's ("World Fuel") Marine Segment from 2006 until September 2009.

2. World Fuel has, at all relevant times, been headquartered in Miami, Florida. At all relevant times, World Fuel's common stock has been quoted on the New York Stock Exchange, under the ticker symbol "INT," and its options are listed on the Chicago Board of Options Exchange and other exchanges.

3. On February 16, 2010, the Commission filed a complaint against Scoppetuolo in SEC v. Steven Scoppetuolo, et al. (Civil Action No. 10-CV-20475). On April 15, 2011, the Court entered an order permanently enjoining Scoppetuolo, by consent, from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933. The Court also imposed an officer-and-director bar and a civil penalty and disgorgement to be determined based upon the Commission's motion.

4. The Commission's complaint alleged, among other things, that Scoppetuolo engaged in illegal insider trading in the securities of his employer, World Fuel. Scoppetuolo tipped his friend, Robert Tocci, and broker, Sarang Ahuja, about World Fuel's worse-than-expected earnings in advance of World Fuel's May and August 2007 earnings announcements. Before the announcements, Tocci and Ahuja purchased put options and Tocci sold short World Fuel securities. After the announcements, Tocci and Ahuja sold their put options and Tocci covered his short position for profits.

IV.

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 229, 230, 239, 240, 249, 270, and 274

[Release Nos. 33-9250; 34-65052; IC-29748]

TECHNICAL AMENDMENTS TO COMMISSION RULES AND FORMS RELATED TO THE FASB'S ACCOUNTING STANDARDS CODIFICATION

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; technical amendments.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting technical amendments to various rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. These revisions are necessary to conform those rules and forms to the FASB Accounting Standards Codification™ ("FASB Codification").[1] The technical amendments include revision of certain rules in Regulation S-X, certain items in Regulation S-K, and various rules and forms prescribed under the Securities Act, Exchange Act and Investment Company Act.

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

FOR FURTHER INFORMATION CONTACT: Jenifer Minke-Girard, Senior Associate Chief Accountant, or Annemarie Ettinger, Senior Special Counsel, at (202) 551-5300, Office of the Chief Accountant, or Angela Crane, Associate Chief Accountant, at (202) 551-3400, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are adopting technical amendments to each of the following provisions of Regulation S-X,[2] Regulation S-K,[3] and the rules and forms under the

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[1] "FASB Accounting Standards Codification" is a registered trademark of the Financial Accounting Foundation.

[2] 17 CFR 210.

Securities Act of 1933[4] (the "Securities Act"), the Securities Exchange Act of 1934[5] (the "Exchange Act"), and the Investment Company Act of 1940[6] (the "Investment Company Act"):

- Rules 1-02, 4-01, 4-08, 4-10, and 10-01 of Regulation S-X.[7]
- Items 101, 201, 302, 303, 305, 402, 503, 601, and 1204 of Regulation S-K.[8]
- Securities Act Rule 175.[9]
- Securities Act Forms S-4 and 1-A.[10]
- Exchange Act Rules 3b-6 and 17h-1T.[11]
- Exchange Act Forms 20-F, 40-F, 8-K, and 17-H.[12]
- Investment Company Act Rule 3a-8.[13]
- Investment Company Act Forms N-1A, N-3, N-4, and N-6.[14]

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[3] 17 CFR 229.

[4] 15 U.S.C. 77a et seq. Additionally, the Commission has authorized the staff to issue technical amendments to Industry Guides 3 and 7 to conform the guides to the FASB Codification. The Industry Guides serve as expressions of the policies and practices of the Division of Corporation Finance. They are of assistance to issuers, their counsel, and others preparing registration statements and reports, as well as to the Commission's staff. The Industry Guides are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved these interpretations. See Release No. 33-6384 (Mar. 16, 1982) [47 FR 11476].

[5] 15 U.S.C. 78a et seq.

[6] 15 U.S.C. 80a-1 et seq.

[7] 17 CFR 210.1-02, 210.4-01, 210.4-08, 210.4-10, and 210.10-01.

[8] 17 CFR 229.101, 229.201, 229.302, 229.303, 229.305, 229.402, 229.601, and 229.1204.

[9] 17 CFR 230.175.

[10] 17 CFR 239.25 and 239.90.

[11] 17 CFR 240.3b-6 and 240.17h-1T.

[12] 17 CFR 249.220f, 249.240f, 249.308, and 249.328T.

[13] 17 CFR 270.3a-8.

[14] 17 CFR 239.15A and 274.11A; 17 CFR 239.17a and 274.11b; 17 CFR 239.17b and 274.11c; and 17 CFR 239.17c and 274.11d.

I. Background

Section 108 of the Sarbanes-Oxley Act of 2002[15] (the "Sarbanes-Oxley Act") amended Section 19(b) of the Securities Act[16] to provide that the Commission may recognize, as generally accepted for purposes of the securities laws, any accounting principles established by a standard-setting body that meets specified criteria. 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, satisfied the criteria for an accounting standard-setting body under the Sarbanes-Oxley Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" for purposes of the federal securities laws.[17]

On June 30, 2009, the FASB issued FASB Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162 ("Statement No. 168"), to establish the FASB Codification as the source of authoritative non-Commission accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. generally accepted accounting principles ("U.S. GAAP"). Statement No. 168 became effective for financial statements issued for interim and annual periods ending after September 15, 2009. The FASB Codification reorganizes existing U.S. accounting and reporting standards issued by the FASB and other

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[15] 15 U.S.C. 7201 et seq.

[16] 15 U.S.C. 77s(b).

[17] See Commission Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Release No. 33-8221 (April 25, 2003) [68 FR 23333].

related private-sector standard setters. All guidance contained in the FASB Codification carries an equal level of authority.[18]

The FASB Codification affects those Commission rules, regulations, releases, and staff bulletins (collectively referred to in this release as "Commission rules and staff guidance") that refer to specific FASB standards or other private sector standard-setter literature under U.S. GAAP, because such references are now superseded by the FASB Codification. As is discussed further below, on August 18, 2009, the Commission issued interpretive guidance[19] to avoid confusion on the part of issuers, auditors, investors, and other users of financial statements about the use of U.S. GAAP references in Commission rules and staff guidance.

II. Discussion

Many parts of Commission rules and staff guidance include direct references to specific standards under U.S. GAAP. For example, Regulation S-X – which, together with the Commission's Financial Reporting Releases, sets forth the form and content of and requirements for financial statements required to be filed with the Commission[20] – includes references to specific standards under U.S. GAAP.[21] In addition, some parts of Commission rules and staff guidance outside of the financial statement context include references to specific standards under U.S. GAAP, such as in Item 402 of Regulation S-K regarding disclosure of executive compensation.[22]

[18] The FASB Codification is available at http://asc.fasb.org/home.

[19] Release No. 33-9062A (Aug. 18, 2009) [74 FR 42772].

[20] See 17 CFR 210.1-01.

[21] See, e.g., Rule 1-02(u) of Regulation S-X [17 CFR 210.1-02(u)], which defines the term "related parties" by reference to FASB Statement of Financial Accounting Standards No. 57, Related Party Disclosures.

[22] See 17 CFR 229.402.

In its August 18, 2009 interpretive release, the Commission noted that given the possible confusion between Commission rules and staff guidance, on the one hand, and the FASB's Codification, on the other hand, effective immediately, references in Commission rules and staff guidance to specific standards under U.S. GAAP should be understood to mean the corresponding reference in the FASB Codification. In the August 18, 2009 release, the Commission stated that it intended to embark on a longer term rulemaking and updating initiative to revise comprehensively specific references to specific standards under U.S. GAAP in the Commission's rules and staff guidance. This release is a result of that initiative with respect to the Commission's rules and forms.[23]

Most of the technical amendments in this release result from a straightforward conversion of the prior U.S. GAAP reference to the corresponding reference in the FASB Codification. For a few specific references, the specific U.S. GAAP standard referenced in the Commission rule or form was superseded by the FASB prior to the establishment of the FASB Codification. In these instances, the particular term referenced in the Commission rule or form is no longer used in U.S. GAAP, or has a meaning different than under the prior referenced standard. In these instances, these amendments either delete the prior U.S. GAAP reference without replacement where it is no longer needed, or incorporates directly into the Commission rule or form the definition that had been used in the now-superseded standard in U.S. GAAP, as appropriate. All of the changes are technical in nature and none of the changes are intended to represent a substantive change in the underlying rules or forms.

[23] References to U.S. GAAP in Commission staff guidance in the codification of Staff Accounting Bulletins have been updated as a result of SAB No. 114 issued on March 7, 2011, available at http://www.sec.gov/interps/account/sab114.pdf. In addition, the Commission is adopting a technical amendment to the heading of Part 210 of the Code of Federal Regulations to remove a reference to the Public Utility Holding Company Act of 1935, which was repealed by the Energy Policy Act of 2005. Pub. L. No. 109-58 § 1263, 119 Stat. 624, 974 (2005).

III. Certain Findings

Under the Administrative Procedure Act, a notice of proposed rulemaking is not required when the agency, for good cause, finds that notice and public comment are impracticable, unnecessary, or contrary to the public interest.[24] These amendments are technical changes to eliminate obsolete terminology and revise reporting and disclosure requirements as necessary to achieve consistency between the Commission's compliance requirements and the FASB Codification. Because no one is likely to want to comment on such non-substantive, technical amendments, the Commission finds that it is unnecessary to publish notice of these amendments.[25]

The Administrative Procedure Act also requires publication of a rule at least 30 days before its effective date unless the agency finds otherwise for good cause.[26] Because the amendments are non-substantive, and no affected parties would need time to learn of the changes and modify their practices, the Commission finds there is good cause for the amendments to take effect on [insert date of publication in the Federal Register].

IV. Consideration of Competitive Effects of Amendments

Section 23(a)(2) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the competitive effects of such rules, if any, and to refrain from adopting a rule that would impose a burden on competition not necessary or appropriate in

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[24] 5 U.S.C. 553(b).

[25] For similar reasons, the amendments do not require analysis under the Regulatory Flexibility Act or analysis of major rule status under the Small Business Regulatory Enforcement Fairness Act. See 5 U.S.C. 601(2) (for purposes of Regulatory Flexibility Act analysis, the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking); and 5 U.S.C. 804(3)(C) (for purposes of Congressional review of agency rulemaking, the term "rule" does not include any rule of agency organization, procedure or practice that does not substantially affect the rights or obligations of non-agency parties).

[26] See 5 U.S.C. 553(d)(3).

furtherance of the purposes of the Exchange Act.[27] Because these amendments merely make technical changes to update references to applicable paragraphs, subtopics, or topics in the FASB Codification, we do not anticipate any competitive advantages or disadvantages will be created.

V. Statutory Basis and Text of Amendments

We are adopting these technical amendments pursuant to Sections 6, 7, 10, and 19 of the Securities Act,[28] Sections 3, 10, 12, 13, 14, 15, 17, and 23 of the Exchange Act,[29] and Sections 8, 20(a), 24, 30, and 38 of the Investment Company Act.[30]

List of Subjects in 17 CFR Part 210

Accountants, Accounting, Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Parts 229, 239, and 249

Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Part 230

Advertising, Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Parts 270 and 274

Investment Companies, Reporting and recordkeeping requirements, Securities.

Text of Amendments

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

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[27] 15 U.S.C. 78w(a)(2).

[28] 15 U.S.C. 77f, 77g, 77j, and 77s(a).

[29] 15 U.S.C. 78c, 78j, 78l, 78m, 78n, 78o, 78q, and 78w.

[30] 15 U.S.C. 80a-8, 80a-20, 80a-24, 80a-29, and 80a-37.

PART 210 - FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for Part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77nn(25), 77nn(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202, and 7262, unless otherwise noted.

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2. The part heading is revised to read as shown above.

3. In § 210.1-02 amend paragraph (u) by removing “the Glossary to Statement of Financial Accounting Standards No. 57, "Related Party Disclosures."” and adding in its place “the FASB ASC Master Glossary.”.

4. In § 210.4-01:

a. Amend paragraph (a)(3)(i) by removing “Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ("Statement No. 123R")” and adding in its place “FASB ASC Topic 718, Compensation – Stock Compensation” and by removing “Statement No. 123R” and adding in its place “FASB ASC Topic 718”.

b. Amend paragraph (a)(3)(ii) by removing “both Statement No. 123R and Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (October 1995),” and adding in its place “FASB ASC Topic 718 and prior authoritative guidance”.

5. In § 210.4-08:

a. Amend paragraph (h)(3) by removing "Statement of Financial Accounting Standards 109, Accounting for Income Taxes" and adding in its place "FASB ASC Topic 740, Income Taxes".

b. Amend Instruction 1(i) to the Instructions to Paragraph (n) by removing "Financial Accounting Standards Board ("FASB"), Statement of Financial Accounting Standards No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments," ("FAS 119") paragraphs 5-7, (October 1994)" and adding in its place "FASB ASC Master Glossary".

c. Amend Instruction 2 to the Instructions to Paragraph (n) by removing "has the same meaning as defined by generally accepted accounting principles (see, e.g., FAS 119, paragraph 9a (October 1994))" and adding in its place "means dealing and other trading activities measured at fair value with gains and losses recognized in earnings".

d. Amend Instruction 3 of the Instructions to Paragraph (n) by removing "(see, e.g., FASB, Statement of Financial Accounting Standards No. 80, "Accounting for Futures Contracts," paragraph 9, (August 1984))".

6. In § 210.4-10 amend paragraph (b) by removing "Statement of Financial Accounting Standards No. 19, as amended" and adding in its place "FASB ASC Topic 932, Extractive Activities – Oil and Gas".

7. In § 210.10-01:

a. Amend paragraph (a)(7) by removing "Statement of Financial Accounting Standards No. 7, "Accounting and Reporting by Development Stage Enterprises"" and adding in its place "FASB ASC Topic 915, Development Stage Entities,".

b. Amend paragraph (b)(5) by removing "disposed of any significant segment of its business (as defined in paragraph 13 of Accounting Principles Board Opinion No. 30)" and adding in its place "reported a discontinued operation (as required by FASB ASC Subtopic 205-20, Presentation of Financial Statements – Discontinued Operations)".

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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

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

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 777iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78n-1, 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.

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9. In § 229.101 amend Instruction 2 of the Instructions to Item 101 by removing "SFAS No. 131" and adding in its place "FASB ASC Topic 280, Segment Reporting,".

10. In § 229.201 amend Instruction 1 of the Instructions to Paragraph (d) by removing "Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, or any successor standard" and replacing with "FASB ASC Topic 718, Compensation – Stock Compensation, and FASB ASC Subtopic 505-50, Equity - Equity-Based Payments to Non-Employees".

11. In § 229.302:

a. Amend paragraph (b) by removing "paragraphs 9-34 of Statement of Financial Accounting Standards ("SFAS") No. 69, "Disclosures about Oil and Gas Producing Activities."

If such oil and gas producing activities are regarded as significant under one or more of the tests set forth in paragraph 8 of SFAS No. 69." and adding in its place "FASB ASC Topic 932, Extractive Activities – Oil and Gas, if such oil and gas producing activities are regarded as significant under one or more of the tests set forth in FASB ASC Subtopic 932-235, Extractive Activities – Oil and Gas – Notes to Financial Statements, for "Significant Activities."".

b. Amend Instruction 1 of the Instructions to paragraph (b) by removing "SFAS No. 69" each time it appears and adding in its place "FASB ASC Subtopic 932-235".

12. In § 229.303:

a. Amend paragraph (a)(4)(ii)(A) by removing "paragraph 3 of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (November 2002) ("FIN 45"), as may be modified or supplemented, and that is not excluded from the initial recognition and measurement provisions of FIN 45 pursuant to paragraphs 6 or 7 of that Interpretation" and adding in its place "FASB ASC paragraph 460-10-15-4 (Guarantees Topic), as may be modified or supplemented, and that is not excluded from the initial recognition and measurement provisions of FASB ASC paragraphs 460-10-15-7, 460-10-25-1, and 460-10-30-1".

b. Amend paragraph (a)(4)(ii)(C) by removing "FASB Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (June 1998), pursuant to paragraph 11(a) of that Statement" and adding in its place "FASB ASC Topic 815, Derivatives and Hedging, pursuant to FASB ASC subparagraph 815-10-15-74(a)".

c. Amend paragraph (a)(4)(ii)(D) by removing "as referenced in FASB Interpretation No. 46, Consolidation of Variable Interest Entities (January 2003)" and adding in its place "as defined in the FASB ASC Master Glossary".

d. Amend paragraph (a)(5)(ii)(A) by removing "FASB Statement of Financial Accounting Standards No. 47 Disclosure of Long-Term Obligations (March 1981)" and adding in its place "FASB ASC paragraph 470-10-50-1 (Debt Topic)".

e. Amend paragraph (a)(5)(ii)(B) by removing "FASB Statement of Financial Accounting Standards No. 13 Accounting for Leases (November 1976)" and adding in its place "FASB ASC Topic 840, Leases".

f. Amend paragraph (a)(5)(ii)(C) by removing "FASB Statement of Financial Accounting Standards No. 13 Accounting for Leases (November 1976)" and adding in its place "FASB ASC Topic 840".

g. Amend Instruction 8 of the Instructions to paragraph 303(a) by removing "Statement of Financial Accounting Standards No. 89, "Financial Reporting and Changing Prices"" and adding in its place "FASB ASC Topic 255, Changing Prices,".

h. Amend Instruction 9 of the Instructions to paragraph 303(a) by removing "SFAS No. 89, "Financial Reporting and Changing Prices,"" and adding in its place "FASB ASC Topic 255".

13. In § 229.305:

a. Amend Instruction 1.C. of the Instructions to paragraph 305(a) by removing "FASB, Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation", ("FAS 52") paragraph 20 (December 1981)" and adding in its place "FASB ASC Master Glossary".

b. Amend Instruction 2.B.vi. of the Instructions to paragraph 305(a) by removing "FAS 52 paragraph 20 (December 1981)" and adding in its place "FASB ASC paragraph 830-20-35-3 (Foreign Currency Matters Topic)".

c. Amend Instruction 2.E. of the Instructions to paragraph 305(a) by removing "(see, e.g., FAS 52 Appendix E for a definition of currency swap)".

d. Amend Instruction 3.B. of the Instructions to paragraph 305(a) by removing "FASB, Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," ("FAS 5") paragraph 3 (March 1975)" and adding in its place "FASB ASC Master Glossary".

e. Amend Instruction 3.C. of the Instructions to paragraph 305(a) by removing "generally AICPA, Statement of Position 94-6, "Disclosure of Certain Significant Risks and Uncertainties," ("SOP 94-6") at paragraph 7 (December 30, 1994)" and adding in its place "FASB ASC Master Glossary".

f. Amend Instruction 3.E. of the Instructions to paragraph 305(a) by removing "FAS 52" and adding in its place "FASB ASC Topic 830, Foreign Currency Matters".

g. Amend Instruction 4.B. of the Instructions to paragraph 305(a) by removing "FAS 5, paragraph 3 (March 1975)" and adding in its place "FASB ASC Master Glossary".

h. Amend Instruction 4.C. of the Instructions to paragraph 305(a) by removing "generally SOP 94-6, at paragraph 7 (December 30, 1994)" and adding in its place "FASB ASC Master Glossary".

i. Amend Instruction 4.D. of the Instructions to paragraph 305(a) by removing "FAS 52" and adding in its place "FASB ASC Topic 830, Foreign Currency Matters".

j. Amend Instruction 3.A. of the General Instructions to paragraphs 305(a) and 305(b) by removing "FASB, Statement of Financial Accounting Standards No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments," ("FAS 119") paragraphs 5-7 (October 1994)" and adding in its place "FASB ASC Master Glossary".

k. Amend Instruction 3.B. of the General Instructions to paragraphs 305(a) and 305(b) by removing "FASB, Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments," ("FAS 107") paragraphs 3 and 8 (December 1991)" and adding in its place "FASB ASC paragraph 825-10-50-8 (Financial Instruments Topic)".

l. Amend Instruction 3.C.ii. of the General Instructions to paragraphs 305(a) and 305(b) by removing "FAS 107, paragraph 8 (December 1991)" and adding in its place "FASB ASC paragraph 825-10-50-8".

m. Amend Instruction 5.C. of the General Instructions to paragraphs 305(a) and 305(b) by removing "FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts" (March 1992)" and adding in its place "FASB ASC Subtopic 210-20, Balance Sheet – Offsetting".

n. Amend Instruction 5.E. of the General Instructions to paragraphs 305(a) and 305(b) by removing "generally SOP 94-6, at paragraph 7 (December 30, 1994)" and adding in its place "FASB ASC Master Glossary".

o. Amend Instruction 5.F. of the General Instructions to paragraphs 305(a) and 305(b) by removing "FAS 5, paragraph 3 (March 1975)" and adding in its place "FASB ASC Master Glossary".

p. Amend Instruction 7 of the General Instructions to paragraphs 305(a) and 305(b) by removing "has the same meaning as defined by generally accepted accounting principles (see, e.g., FAS 119, paragraph 9a (October 1994))" and adding in its place "means dealing and other trading activities measured at fair value with gains and losses recognized in earnings", and by removing "(see, e.g., FASB, Statement of Financial Accounting Standards No. 80, "Accounting for Futures Contracts," paragraph 9, (August 1984))".

14. In § 229.402:

a. Amend paragraph (a)(6)(iii) by removing "Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, as modified or supplemented ("FAS 123R")" and adding in its place "FASB ASC Topic 718, Compensation – Stock Compensation".

b. Amend paragraphs (a)(6)(iv), (c)(2)(ix)(C), (d)(2)(viii), (e)(1)(iii), (k)(2)(vii)(C), (m)(5)(iv), (n)(2)(ix)(C), and (r)(2)(vii)(C) by removing "FAS 123R" each time it appears and adding in its place "FASB ASC Topic 718".

c. Amend the Instruction to Item 402(k)(2)(iii) and (iv) by removing "FAS 123R" and adding in its place "FASB ASC Topic 718".

d. Amend paragraph (m)(5)(iii) by removing "Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, as modified or supplemented ("FAS 123R")" and adding in its place "FASB ASC Topic 718".

15. In § 229.503 amend paragraph 1.(C) of the Instructions to paragraph 503(d) by removing "SFAS 71" and adding in its place "FASB ASC Topic 980, Regulated Operations,".

16. In § 229.601 amend paragraph (b)(11) by removing "on both primary and fully diluted basis" and by removing "even though the amounts of per share earnings on the fully diluted bases are not required to be presented in the income statement under the provisions of Accounting Principles Board Opinion No. 15. That Opinion provides that any reduction of less than 3% need not be considered as dilution (see footnote to paragraph 14 of the Opinion) and that a computation on the fully diluted basis which results in improvement of earnings per share

not be taken into account (see paragraph 40 of the Opinion)" and adding in its place "on both a basic and diluted basis".

17. In § 229.1204:

a. Amend Instruction 4 to Item 1204 by removing "SFAS 69" and adding in its place "FASB ASC paragraph 932-235-50-24 (Extractive Activities – Oil and Gas Topic)".

b. Amend Instruction 5 to Item 1204 by removing "SFAS 69" and adding in its place "FASB ASC Topic 932, Extractive Activities – Oil and Gas".

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PART 230 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1933

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

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

* * * * *

19. In § 230.175 amend paragraph (b)(2)(ii) by removing "paragraphs 30-34 of Statement of Financial Accounting Standards No. 69" and adding in its place "FASB ASC paragraphs 932-235-50-29 through 932-235-50-36 (Extractive Activities – Oil and Gas Topic)".

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PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

20. 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, and 80a-37, unless otherwise noted.

* * * * *

21. In Form S-4 (referenced in § 239.25):

Note: The text of Form S-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

a. Amend paragraph (b)(3) of Item 10 by removing "where one or more business combinations accounted for by the pooling of interest method of accounting have been consummated" and adding in its place "where a combination under common control has been consummated".

b. Amend paragraph (c)(1)(iii) of Item 12 by removing "consummation of one or more business combinations accounted for by the pooling of interest method of accounting" and adding in its place "combination under common control".

22. In Form 1-A (referenced in § 239.90):

Note: The text of Form 1-A does not, and this amendment will not, appear in the Code of Federal Regulations.

a. Amend the INSTRUCTION to the Cover Page for Offering Circular Model A by removing "Statement of Financial Accounting Standards No. 7 (June 1, 1975)." and adding in its place "the FASB ASC Master Glossary for a "development stage entity."".

b. Amend paragraph (4)(c)(ii) to Part F/S by removing "pooling of interests" and adding in its place "combination under common control".

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

23. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78<u>ll</u>, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 <u>et</u> <u>seq</u>.; 18 U.S.C. 1350; 12 U.S.C. 5221(e)(3); and 7 U.S.C. 2(c)(2)(E), unless otherwise noted.

* * * * *

24. In § 240.3b-6 amend paragraph (b)(2)(ii) by removing "paragraphs 30-34 of Statement of Financial Accounting Standards No. 69" and adding in its place "FASB ASC paragraphs 932-235-50-29 through 932-235-50-36 (Extractive Activities - Oil and Gas Topic)".

25. In § 240.17h-1T amend paragraph (a)(1)(vii) by removing the parenthetical phrase "(as those terms are used in Statement of Financial Accounting Standards No. 105)" and removing "(as that term is used in Statement of Financial Accounting Standards No. 105)" and adding in its place "(defined as the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract)".

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

26. The authority citation for Part 249 continues to read, in part, as follows:

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

* * * * *

27. In Form 20-F (referenced in § 249.220f):

Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

a. Amend paragraph (a) of Item 5.E.2 by removing "paragraph 3 of FASB Interpretation No. 45, <u>Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others</u> (November 2002) ("FIN 45"), as may be modified or supplemented, excluding the types of guarantee contracts described in paragraphs 6 and 7 of FIN 45" and adding in its place "FASB ASC paragraph 460-10-15-4 (Guarantees Topic), as may be modified or supplemented, excluding the types of guarantee contracts described in FASB ASC paragraphs 460-10-15-7, 460-10-25-1, and 460-10-30-1".

b. Amend paragraph (d) of Item 5.E.2 by removing "referenced in FASB Interpretation No. 46, Consolidation of Variable Interest Entities (January 2003)" and adding in its place "defined in the FASB ASC Master Glossary".

c. Amend Instruction 1.C. of the Instructions to Item 11(a) by removing "FASB, Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation", ("FAS 52") paragraph 20 (December 1981)" and adding in its place "FASB ASC Master Glossary".

d. Amend Instruction 2.B.vi. of the Instructions to Item 11(a) by removing "FAS 52 paragraph 20 (December 1981)" and adding in its place "FASB ASC paragraph 830-20-35-3 (Foreign Currency Matters Topic)".

e. Amend Instruction 2.E. of the Instructions to Item 11(a) by removing "(see, e.g., FAS 52 Appendix E for a definition of currency swap)".

f. Amend Instruction 3.B. of the Instructions to Item 11(a) by removing "FASB, Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," ("FAS 5") paragraph 3 (March 1975)" and adding in its place "FASB ASC Master Glossary".

g. Amend Instruction 3.C. of the Instructions to Item 11(a) by removing "generally AICPA, Statement of Position 946, "Disclosure of Certain Significant Risks and Uncertainties," ("SOP 94-6") at paragraph 7 (December 30, 1994)" and adding in its place "FASB ASC Master Glossary".

h. Amend Instruction 3.E. of the Instructions to Item 11(a) by removing "FAS 52" and adding in its place "FASB ASC Topic 830, Foreign Currency Matters".

i. Amend Instruction 4.B. of the Instructions to Item 11(a) by removing "FAS 5, paragraph 3 (March 1975)" and adding in its place "FASB ASC Master Glossary".

j. Amend Instruction 4.C. of the Instructions to Item 11(a) by removing "generally SOP 94-6, at paragraph 7 (December 30, 1994)" and adding in its place "FASB ASC Master Glossary".

k. Amend Instruction 4.D. of the Instructions to Item 11(a) by removing "FAS 52" and adding in its place "FASB ASC Topic 830, Foreign Currency Matters".

l. Amend Instruction 3.A. of the General Instructions to Items 11(a) and 11(b) by removing "FASB, Statement of Financial Accounting Standards No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments," ("FAS 119") paragraphs 5-7 (October 1994)" and adding in its place "FASB ASC Master Glossary".

m. Amend Instruction 3.B. of the General Instructions to Items 11(a) and 11(b) by removing "FASB, Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments," ("FAS 107") paragraphs 3 and 8 (December 1991)" and adding in its place "FASB ASC paragraph 825-10-50-8 (Financial Instruments Topic)".

n. Amend Instruction 3.C.ii. of the General Instructions to Items 11(a) and 11(b) by removing "FAS 107, paragraph 8 (December 1991)" and adding in its place "FASB ASC paragraph 825-10-50-8".

o. Amend Instruction 5.C. of the General Instructions to Items 11(a) and 11(b) by removing "FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts"

(March 1992)" and adding in its place "FASB ASC Subtopic 210-20, Balance Sheet – Offsetting".

p. Amend Instruction 5.E. of the General Instructions to Items 11(a) and 11(b) by removing "generally SOP 946, at paragraph 7 (December 30, 1994)" and adding in its place "FASB ASC Master Glossary".

q. Amend Instruction 5.F. of the General Instructions to Items 11(a) and 11(b) by removing "FAS 5, paragraph 3 (March 1975)" and adding in its place "FASB ASC Master Glossary".

r. Amend Instruction 7 of the General Instructions to Items 11(a) and 11(b) by removing "has the same meaning as defined by generally accepted accounting principles (see, e.g., FAS 119, paragraph 9a (October 1994))" and adding in its place "means dealing and other trading activities measured at fair value with gains and losses recognized in earnings" and by removing "(see, e.g., FASB, Statement of Financial Accounting Standards No. 80, "Accounting for Futures Contracts," paragraph 9, (August 1984))".

s. Amend Instruction 3 of the Instructions to Item 17 by removing "SFAS No. 131" the first time it appears and adding in its place "FASB ASC Topic 280, Segment Reporting" and by removing "SFAS No. 131" the second time it appears and adding in its place "FASB ASC Topic 280".

t. Amend paragraph 2 of the Instruction to Item 18 by removing "FASB Statement of Accounting Standards No. 69, "Disclosures about Oil and Gas Producing Activities,"" and adding in its place "FASB ASC Topic 932, Extractive Activities – Oil and Gas,".

28. In Form 40-F (referenced in § 249.240f):

Note: The text of Form 40-F does not, and this amendment will not, appear in the Code of Federal Regulations.

a. Amend paragraph (11)(ii)(A) in General Instruction B by removing "paragraph 3 of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (November 2002) ("FIN 45"), as may be modified or supplemented, excluding the types of guarantee contracts described in paragraphs 6 and 7 of FIN 45" and adding in its place "FASB ASC paragraph 460-10-15-4 (Guarantees Topic), as may be modified or supplemented, excluding the types of guarantee contracts described in FASB ASC paragraphs 460-10-15-7, 460-10-25-1, and 460-10-30-1".

b. Amend paragraph (11)(ii)(D) in General Instruction B by removing "referenced in FASB Interpretation No. 46, Consolidation of Variable Interest Entities (January 2003)" and adding in its place "defined in the FASB ASC Master Glossary".

29. In Form 8-K (referenced in § 249.308):

Note: The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

a. Amend paragraph (e) of Item 2.03 by removing "Accounting Research Bulletin No. 43, Chapter 3A, Working Capital" and adding in its place "FASB ASC paragraph 210-10-45-3 (Balance Sheet Topic)".

b. Amend paragraph (c) of Item 2.04 by removing "FASB Statement of Financial Accounting Standards No. 5 Accounting for Contingencies (SFAS No. 5)" and adding in its place "FASB ASC Section 450-20-25, Contingencies – Loss Contingencies – Recognition,".

c. Amend Instruction 4 of Item 2.04 by removing "SFAS No. 5" and adding in its place "FASB ASC Section 450-20-25".

d. Amend the first paragraph of Item 2.05 by removing "paragraph 8 of FASB Statement of Financial Accounting Standards No. 146 Accounting for Costs Associated with

Exit or Disposal Activities (SFAS No. 146)" and adding in its place "FASB ASC paragraph 420-10-25-4 (Exit or Disposal Cost Obligations Topic)".

e. Amend paragraph (a) of Item 4.02 by removing "Accounting Principles Board Opinion No. 20" and adding in its place "FASB ASC Topic 250, Accounting Changes and Error Corrections".

30. In Form 17-H (referenced in § 249.328T) amend Item II.K. of Part II by removing "as defined in Statement of Financial Accounting Standards No. 105".

Note: The text of Form 17-H does not, and this amendment will not, appear in the Code of Federal Regulations.

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PART 270 – RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

31. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

* * * * *

32. Amend paragraph (b)(9) of § 270.3a-8 by removing "expenses as defined in FASB Statement of Financial Accounting Standards No. 2, Accounting for Research and Development Costs" and adding in its place "costs as defined in FASB ASC Topic 730, Research and Development".

* * * * *

PART 274 - FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

33. The authority citation for Part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

34. In Form N-1A (referenced in §§ 239.15A and 274.11A):

Note: The text of Form N-1A does not, and this amendment will not, appear in the Code of Federal Regulations.

a. Amend Instruction 3(c)(ii) of the Instructions to Item 3 by removing "Accounting Principles Board Opinion No. 30" and adding in its place "FASB ASC Subtopic 225-20, Income Statement – Extraordinary and Unusual Items".

b. Amend Instruction 2(a)(ii) of the Instructions to paragraph (d)(1) of Item 27 by removing "Accounting Principles Board Opinion No. 30" and adding in its place "FASB ASC Subtopic 225-20, Income Statement – Extraordinary and Unusual Items".

35. In Form N-3 (referenced in §§ 239.17a and 274.11b) amend Instruction 15.(a) of the General Instructions to paragraph (a) of Item 3 by removing "Accounting Principles Board Opinion No. 30" and adding in its place "FASB ASC Subtopic 225-20, Income Statement – Extraordinary and Unusual Items".

Note: The text of Form N-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

36. In Form N-4 (referenced in §§ 239.17b and 274.11c) amend Instruction 17.(b) of the General Instructions to paragraph (a) of Item 3 by removing "Accounting Principles Board Opinion No. 30" and adding in its place "FASB ASC Subtopic 225-20, Income Statement – Extraordinary and Unusual Items".

Note: The text of Form N-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

37. In Form N-6 (referenced in §§ 239.17c and 274.11d) amend Instruction 4.(c) of the Instructions to Item 3 by removing "Accounting Principles Board Opinion No. 30" and adding in its place "FASB ASC Subtopic 225-20, Income Statement – Extraordinary and Unusual Items".

Note: The text of Form N-6 does not, and this amendment will not, appear in the Code of Federal Regulations.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: August 8, 2011

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 230

[Release No. 33-9251; File No. S7-31-11]

RIN 3235-AL20

COVERED SECURITIES PURSUANT TO SECTION 18 OF THE SECURITIES ACT OF 1933

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") proposes for comment an amendment to Rule 146 under Section 18 of the Securities Act of 1933 ("Securities Act"), as amended, to designate certain securities on BATS Exchange, Inc. ("BATS" or "Exchange") as covered securities for purposes of Section 18 of the Securities Act. Covered securities under Section 18 of the Securities Act are exempt from state law registration requirements.

DATES: Comments should be received on or before [insert date 30 days after publication in the Federal Register].

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-31-11 on the subject line.
- 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 S7-31-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for 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. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: David R. Dimitrious, Senior Special Counsel, (202) 551-5131, Ronesha Butler, Special Counsel, (202) 551-5629 or Carl Tugberk, Special Counsel, (202) 551-6049, Division of Trading and Markets ("Division"), Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

I. Introduction

In 1996, Congress amended Section 18 of the Securities Act to exempt from state registration requirements securities listed, or authorized for listing, on the New York Stock Exchange LLC ("NYSE"), the American Stock Exchange LLC ("Amex") (now known as NYSE Amex LLC),[1] or the National Market System of The NASDAQ Stock Market LLC ("Nasdaq/NGM")[2] (collectively, the "Named Markets"), or any national securities exchange designated by the Commission to have substantially similar listing standards to those of the Named Markets.[3] More specifically, Section 18(a) of the Securities Act provides that "no law, rule, regulation, or order, or other administrative action of any State . . . requiring, or with respect to, registration or qualification of securities . . . shall directly or indirectly apply to a security that – (A) is a covered

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1 On October 1, 2008, NYSE Euronext acquired The Amex Membership Corporation ("AMC") pursuant to an Agreement and Plan of Merger, dated January 17, 2008 (the "Merger"). In connection with the Merger, NYSE Amex's predecessor, the Amex, a subsidiary of AMC, became a subsidiary of NYSE Euronext called NYSE Alternext US LLC ("NYSE Alternext"). See Securities Exchange Act Release No. 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008) (SR-NYSE-2008-60 and SR-Amex 2008-62) (approving the Merger). In 2009, the Exchange changed its name from NYSE Alternext to NYSE Amex LLC ("NYSE Amex"). See Securities Exchange Act Release No. 59575 (March 13, 2009), 74 FR 11803 (March 19, 2009) (SR-NYSEALTR-2009-24) (approving the name change).

2 As of July 1, 2006, the National Market System of The NASDAQ Stock Market LLC is known as the Nasdaq Global Market ("NGM"). See Securities Exchange Act Release Nos. 53799 (May 12, 2006), 71 FR 29195 (May 19, 2006) and 54071 (June 29, 2006), 71 FR 38922 (July 10, 2006).

3 See National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (October 11, 1996).

security."[4] Covered securities are defined in Section 18(b)(1) of the Securities Act to include those securities listed, or authorized for listing, on the Named Markets, or securities listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule are "substantially similar" to those of the Named Markets ("Covered Securities").[5]

Pursuant to Section 18(b)(1)(B) of the Securities Act, the Commission adopted Rule 146.[6] Rule 146(b) lists those national securities exchanges, or segments or tiers thereof, that the Commission has determined to have listing standards substantially similar to those of the Named Markets and thus securities listed on such exchanges are deemed Covered Securities.[7] BATS has filed a proposed rule change for the listing of

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4 15 U.S.C. 77r(a).

5 15 U.S.C. 77r(b)(1)(A) and (B). In addition, securities of the same issuer that are equal in seniority or senior to a security listed on a Named Market or national securities exchange designated by the Commission as having substantially similar listing standards to a Named Market are covered securities for purposes of Section 18 of the Securities Act. 15 U.S.C. 77r(b)(1)(C).

6 Securities Exchange Act Release No. 39542 (January 13, 1998), 63 FR 3032 (January 21, 1998) (determining that the listing standards of the Chicago Board Options Exchange, Incorporated ("CBOE"), Tier 1 of the Pacific Exchange, Inc. ("PCX") (now known as NYSE Arca, Inc.), and Tier 1 of the Philadelphia Stock Exchange, Inc. ("Phlx") (now known as NASDAQ OMX PHLX LLC) were substantially similar to those of the Named Markets and that securities listed pursuant to those standards would be deemed Covered Securities for purposes of Section 18 of the Securities Act). In 2004, the Commission amended Rule 146(b) to designate options listed on the International Securities Exchange, Inc. ("ISE") (now known as the International Securities Exchange, LLC) as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 8442 (July 14, 2004), 69 FR 43295 (July 20, 2004). In 2007, the Commission amended Rule 146(b) to designate securities listed on the Nasdaq Capital Market ("NCM") as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 8791 (April 18, 2007), 72 FR 20410 (April 24, 2007).

7 17 CFR 230.146(b).

securities on BATS[8] and has petitioned the Commission to amend Rule 146(b) to designate such securities as Covered Securities for the purpose of Section 18 of the Securities Act.[9] If the Commission were to approve the proposed listing standards and make this determination, then securities listed on BATS would be exempt from state law registration requirements.[10] Additionally, should the Commission approve BATS' proposed listing standards and the securities listed, or authorized for listing, on BATS were designated as Covered Securities under Rule 146(b)(1), then BATS' listing standards would be subject to Rule 146(b)(2) under the Securities Act. Rule 146(b)(2) conditions the designation of securities as Covered Securities under Rule 146(b)(1) on the identified exchange's listing standards continuing to be substantially similar to those of the Named Markets. Thus, under Rule 146(b)(2), the designation of certain securities as Covered Securities would be conditioned on BATS maintaining listing standards for its equity securities that are substantially similar to those of the Named Markets.

II. Background

In 1998, the CBOE, PCX (now known as NYSE Arca, Inc.), Phlx,[11] and the Chicago Stock Exchange, Inc. ("CHX") petitioned the Commission to adopt a rule

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8 See Securities Exchange Act Release No. 64546 (May 25, 2011), 76 FR 31660 (June 1, 2011) (proposing qualitative and quantitative listing requirements and standards for securities).

9 See letter from Eric Swanson, Senior Vice President and General Counsel, BATS, to Elizabeth M. Murphy, Secretary, Commission, dated May 26, 2011 (File No. 4-632) ("BATS Petition").

10 15 U.S.C. 77r.

11 On July 24, 2008, The NASDAQ OMX Group, Inc. acquired Phlx and renamed it "NASDAQ OMX PHLX LLC." See Securities Exchange Act Release Nos. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (SR-Phlx-2008-31); and 58183 (July 17, 2008), 73 FR 42850 (July 23, 2008) (SR-NASDAQ-2008-035).

determining that specified portions of the exchanges' listing standards were substantially similar to the listing standards of the Named Markets.[12] In response to the petitions, and after extensive review of the petitioners' listing standards, the Commission adopted Rule 146(b), determining that the listing standards of the CBOE, Tier 1 of the PCX, and Tier 1 of the Phlx were substantially similar to those of the Named Markets and that securities listed pursuant to those standards would be deemed Covered Securities.[13] In 2004, ISE petitioned the Commission to amend Rule 146(b) to determine that its listing standards for securities listed on ISE are substantially similar to those of the Named Markets and, accordingly, that securities listed pursuant to such listing standards are Covered Securities for purposes of Section 18(b) of the Securities Act.[14] The Commission subsequently amended Rule 146(b) to designate options listed on ISE as Covered Securities.[15] In 2007, Nasdaq petitioned the Commission to amend Rule 146(b) to determine that listing standards for securities listed on the NCM are substantially similar

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See also Securities Exchange Act Release No. 62783 (August 27, 2010), 75 FR 54204 (September 3, 2010) (SR-Phlx-2010-104).

12 See letter from David P. Semak, Vice President, Regulation, PCX, to Arthur Levitt, Jr., Chairman, Commission, dated November 15, 1996; letter from Alger B. Chapman, Chairman, CBOE, to Jonathan G. Katz, Secretary, Commission, dated November 18, 1996; letter from J. Craig Long, Esq., Foley & Lardner, Counsel to CHX, to Jonathan G. Katz, Secretary, Commission, dated February 4, 1997; and letter from Michele R. Weisbaum, Vice President and Associate General Counsel, Phlx, to Jonathan G. Katz, Secretary, Commission, dated March 31, 1997.

13 Securities Exchange Act Release No. 39542, supra note 6. The Commission did not include Tier 1 of the CHX in Rule 146 because of "concerns regarding the CHX's listing and maintenance procedures." Id. at 3032.

14 See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Jonathan G. Katz, Secretary, Commission, dated October 9, 2003.

15 Securities Act Release No. 8442 (July 14, 2004), 69 FR 43295 (July 20, 2004).

to those of the Named Markets and, accordingly, that securities listed pursuant to such listing standards are Covered Securities.[16] The Commission subsequently amended Rule 146(b) to designate securities listed on the NCM as Covered Securities.[17]

BATS has petitioned the Commission to amend Rule 146(b) and determine that its proposed listing standards for securities listed on BATS are substantially similar to those of the Named Markets, and that such securities are Covered Securities under Section 18(b) of the Securities Act.[18]

III. Discussion

Under Section 18(b)(1)(B) of the Securities Act,[19] the Commission has the authority to determine that the listing standards of an exchange, or tier or segment thereof, are substantially similar with those of the NYSE, NYSE Amex, or Nasdaq/NGM. The Commission initially has compared BATS' proposed listing standards for all securities with one of the Named Markets. If the proposed listing standards in a particular category were not substantially similar to the standards of that market, the Commission compared BATS' proposed standards to one of the other two markets.[20] In addition, as it has done previously, the Commission has interpreted the "substantially

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16 See letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Nancy M. Morris, Secretary, Commission, dated March 1, 2006 (File No. 4-513).

17 See Securities Act Release No. 8791, supra note 6.

18 See BATS Petition, supra note 9.

19 15 U.S.C. 77r(b)(1)(B).

20 This approach is consistent with the approach that the Commission has previously taken. See Securities Act Release No. 7494 (January 13, 1998), 63 FR 3032 (January 21, 1998).

similar" standard to require listing standards at least as comprehensive as those of the Named Markets.[21] If a petitioner's listing standards are higher than the Named Markets, then the Commission may still determine that the petitioner's listing standards are substantially similar to those of the Named Markets.[22] Finally, the Commission notes that differences in language or approach would not necessarily lead to a determination that the listing standards of the petitioner are not substantially similar to those of any Named Market.[23]

The Commission has reviewed proposed listing standards for securities to be listed and traded on BATS and, for the reasons discussed below, preliminarily believes that the proposed standards overall are substantially similar to those of a Named Market.[24]

A. Qualitative Listing Standards

BATS' proposed qualitative listing standards for both the Tier I and Tier II securities are substantively identical to the qualitative listing standards for Nasdaq/NGM

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21 See id.

22 See Securities Act Release No. 8791, supra note 6.

23 Id.

24 See generally proposed BATS Chapter XIV; Securities Exchange Act Release No. 64546, supra note 8, 76 FR 31660. In making its preliminary determination of substantial similarity, as discussed in detail below, the Commission generally compared BATS' proposed qualitative listing standards for both Tier I and Tier II securities with Nasdaq/NGM's qualitative listing standards, BATS' proposed quantitative listing standards for Tier I securities with Nasdaq/NGM's quantitative listing standards, and BATS' proposed quantitative listing standards for Tier II securities with NYSE Amex's quantitative listing standards.

securities.[25] Therefore, the Commission preliminarily believes that BATS' qualitative listing standards for Tier I and Tier II securities are substantially similar to a Named Market.

The Commission requests comment on whether BATS' proposed qualitative listing standards for Tier I and Tier II are "substantially similar" to Nasdaq/NGM's listing standards.

B. Tier I Securities Quantitative Listing Standards

The Commission believes that BATS' proposed initial and continued listing standards for its Tier I Securities are substantively identical to the initial and continued listing standards for securities listed on Nasdaq/NGM.[26] Therefore, the Commission preliminarily believes that BATS' quantitative listing standards for Tier I Securities are substantially similar to a Named Market.

The Commission requests comment on whether BATS' proposed Tier I Securities quantitative listing rules are "substantially similar" to Nasdaq/NGM's listing rules.

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25 Such qualitative listing standards relate to, among other things, the number of independent directors required, conflicts of interest, composition of the audit committee, executive compensation, shareholder meeting requirements, voting rights, quorum, code of conduct, proxies, shareholder approval of certain corporate actions, and the annual and interim reports requirements. Compare proposed BATS Rules 14.6 and 14.10 with Nasdaq Rule 5250 and Rule 5600 Series.

26 Compare proposed BATS Rules 14.4(a) and 14.8 with Nasdaq Rule 5225(a) and Nasdaq Rule 5400 Series (providing for identical rules concerning initial listing and maintenance standards for units, primary equity securities, preferred stock and secondary classes of common stock, rights, warrants and convertible debt on BATS and the Nasdaq/NGM).

C. Tier II Securities Quantitative Listing Standards

1. Primary Equity Securities

The Commission compared BATS' proposed listing standards for primary equity securities listed on Tier II of the Exchange to the listing standards of NYSE Amex.[27] The Commission preliminarily believes that BATS' proposed initial listing standards for primary equity securities listed on Tier II of the Exchange are substantially similar to those of NYSE Amex's common stock listing standards.[28] Specifically, BATS' proposed requirements relating to bid price,[29] round lot holders,[30] shares held by the public,[31] and

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27 See generally Sections 101 and 102 of the NYSE Amex Company Guide and proposed BATS Rule 14.9.

28 BATS' proposed used of "primary equity securities" and NYSE Amex's use of "common stock" is simply a difference in nomenclature, as BATS' proposed listing standards define "primary equity security" as a company's first class of common stock. See proposed BATS Rule 14.1(a)(21).

29 BATS' proposed listing standards would require a minimum bid price of $4 per share for initial listing and $1 per share for continued listing while NYSE Amex requires a minimum bid price of $2-3 per share depending on the issuer for initial listing and will consider delisting if the price per share is "low." Compare proposed BATS Rule 14.9(b)(1)(A) with Section 102 of the NYSE Amex Company Guide. The Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets; the Commission may determine that a petitioner's standards are substantially similar if they are higher, and differences in language or approach of the listing standards are not dispositive. See supra notes 21-23 and accompanying text.

30 While BATS' proposed listing standards would require at least 300 round lot holders, NYSE Amex's listing standards require 400 or 800 public shareholders (depending upon the number of shares held by the public), or 300 or 600 public shareholders for its alternate listing standards. The Commission preliminarily does not believe this difference would preclude a determination of substantial similarity between the standards. Additionally, BATS' proposed listing standards are identical to the listing standards of NCM, which the Commission previously found to be substantially similar to a Named Market. See Securities Act Release 8791, supra note 6 (determining that NCM listing standards, which are identical to BATS' proposed listing standards for primary equity securities on Tier II of the

required number of registered and active market makers[32] are substantially similar to NYSE Amex requirements. Additionally, BATS' proposed equity,[33] market value,[34] and net income[35] standards are also substantially similar to NYSE Amex standards.

Exchange, are substantially similar to these same Amex standards). With respect to NCM having alternative listing standards for the number of round lot holders, the Commission noted that this difference did not preclude a determination of substantial similarity between the standards. See Securities Act Release 8791, supra note 6, 72 FR at 20412; Securities Act Release No. 8754 (November 22, 2006), 71 FR 67762 (November 22, 2006) (proposing that the Commission amend Rule 146(b) to designate securities listed on the NCM as covered securities for purposes of Section 18(b) of the Securities Act).

31 BATS' proposed listing standards would require a minimum of 1,000,000 publicly held shares while NYSE Amex requires a minimum of 500,000. . Compare proposed BATS Rule 14.9(b)(1)(B) with Section 102(a) of the NYSE Amex Company Guide. The Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets; the Commission may determine that a petitioner's standards are substantially similar if they are higher, and differences in language or approach of the listing standards are not dispositive. See supra notes 21-23 and accompanying text.

32 BATS' proposed listing requirements would require at least three registered and active market makers while NYSE Amex requires one specialist to be assigned. Compare proposed BATS Rule 14.9(b)(1)(D) with Section 202(e) of the NYSE Amex Company Guide. The Commission may still determine that the petitioner's listing standards are substantially similar to those of the Named Markets if a petitioner's listing standards are higher than the Named Markets. See Securities Act Release No. 8791, supra note 6.

33 BATS' proposed listing standard would require a company to have stockholder equity of at least \$5 million, a market value of publicly held shares of at least \$15 million, and a two-year operating history. See proposed BATS Rule 14.9(b)(2)(A). NYSE Amex requires stockholder equity of at least \$4 million, a market value of publicly held shares of at least \$15 million, and a two-year operating history.

34 BATS' proposed listing standards would require a market value of listed securities of at least \$50 million and a market value of publicly held shares of at least \$15 million, which is the same as required by NYSE Amex. Compare proposed BATS Rule 14.9(b)(2)(B) with Section 101(c)(2)-(3) of the NYSE Amex Company Guide.

In addition to the above initial listing requirements, BATS would require that American Depositary Receipts ("ADRs") comply with an additional criterion. Specifically, BATS would require there be at least 400,000 ADRs issued for such securities to be initially listed on BATS.[36] However, NYSE Amex does not have specific requirements for ADRs in addition to its initial listing standards for primary equity securities.[37] As noted above, the Commission may still determine that the petitioner's listing standards are similar to those of the Named Markets if BATS' proposed listing standards are higher than the Named Markets.[38] The Commission preliminarily believes that BATS' proposed listing requirements for ADRs are substantially similar to those of NYSE Amex.

The Commission also preliminarily believes that the proposed continued listing requirements for primary equity securities listed on Tier II of the Exchange, while not identical, are substantially similar to those of NYSE Amex.[39] NYSE Amex's delisting

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35 BATS' proposed listing standards would require net income from continuing operations of at least $750,000, which is the same as required by NYSE Amex. Compare proposed BATS Rule 14.9(b)(2)(C) with Section 101(d)(1) of the NYSE Amex Company Guide.

36 See proposed BATS Rule 14.9(b)(1)(E). This proposed requirement is identical to NCM. See Nasdaq Rule 5505(a)(5); see generally Securities Act Release 8791, supra note 6 (determining that NCM listing standards, which are identical to BATS' proposed standards for primary equity securities on Tier II of the Exchange, are substantially similar to the Amex standards).

37 See Section 102 of the NYSE Amex Company Guide. See also Section 110 of the NYSE Amex Company Guide.

38 See Securities Act Release No. 8791, supra note 6.

39 See generally Securities Act Release 8791, supra note 6 (determining that NCM continued listing standards, which are identical to BATS' proposed continued listing standards for primary equity securities on Tier II of the Exchange, are substantially similar to the Amex standards).

criteria are triggered by poor financial conditions or operating results of the issuer.[40] Specifically, NYSE Amex will consider delisting an equity issue if: (i) stockholders' equity is less than $2 million and such issuer has sustained losses from continuing operations and/or net losses in two of its three most recent fiscal years; (ii) stockholders' equity is less than $4 million and such issuer has sustained losses from continuing operations and/or net losses in three of its four most recent fiscal years; (iii) stockholders' equity is less than $6 million if such issuer has sustained losses from continuing operations and/or net losses in its five most recent fiscal years; or (iv) the issuer has sustained losses which are so substantial in relation to its overall operations or its existing financial resources, or its financial condition has become so impaired that it appears questionable, in the opinion of the exchange, as to whether such company will be able to continue operations and/or meet its obligations as they mature.[41]

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40 See generally Sections 1001 through 1006 of the NYSE Amex Company Guide.

41 See Section 1003(a) of the NYSE Amex Company Guide. While not identical to NYSE Amex, BATS, as noted below, also has a shareholder equity standard. See infra note 42 and accompanying text. NYSE Amex, however, will not normally consider suspending dealing in (i) through (iii) noted above if the issuer is in compliance with the following: (1) total market value of market capitalization of at least $50,000,000; or total assets and revenue of $50,000,000 each in its last fiscal year, or in tow of its last three fiscal years; and (2) the issuer has at least 1,100,000 shares publicly held, a value of publicly held shares of at least $15,000,000 and 400 round lot holders. Id.

NYSE Amex also will consider delisting if: (i) an issuer has sold or otherwise disposed of its principal operating assets or has ceased to be an operating company or has discontinued a substantial portion of its operations or business; (ii) if substantial liquidation of the issuer has been made; or (iii) if advice has been received, deemed by the Exchange to be authoritative, that the security is without value, or in the case of a common stock, such stock has been selling for a substantial period of time at a low price. See Section 1003(c) and (f)(v) of the NYSE Amex Company Guide.

Although BATS would not have the same continued listing provisions for Tier II, BATS also would look at the financial condition and operating results of the issuer in order to determine whether to delist an issuer. BATS' continued listing standards for Tier II securities would require compliance with either a (1) shareholder equity, (2) market value of listed securities or (3) net income standard. Specifically, for continued listing, BATS would require shareholder's equity of at least $2.5 million, market value of listed securities of at least $35 million, or net income of $500,000 from continuing operations in the past fiscal year or two out of three past fiscal years.[42] Further, BATS would require an issuer to have (i) a minimum bid price for continued listing of $1 per share,[43] (ii) at least two registered and active market makers, (iii) 300 public holders, and (iv) a minimum number of publicly held shares of at least 500,000 shares with a market value of at least $1 million.[44] The Commission preliminarily believes that the differences in the maintenance criteria for common stock listed on NYSE Amex and as proposed on

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42 Proposed BATS Rule 14.9(e)(2)(A)-(C). NYSE Amex focuses on a shareholder equity standard for continued listing. BATS' proposed shareholder equity standard would require at least $2.5 million shareholders' equity compared to NYSE Amex's lowest shareholder equity standard of $2 million, if the NYSE Amex issuer has sustained losses from continuing operations and/or net losses in two of its three most fiscal years. <u>Compare</u> proposed BATS Rule 14.9(e)(2)(A)-(C) <u>with</u> Section 1003(a) of the NYSE Amex Company Guide.

43 <u>See</u> proposed BATS Rule 14.9(e)(1)(B). Amex will consider delisting if the price per share is "low." <u>See</u> Section 1003(f)(v) of the Amex Company Guide. <u>See also</u> Securities Act Release 8791, <u>supra</u> note 6 (noting the same regarding the NCM and Amex bid price standards).

44 Proposed BATS Rule 14.9(e)(1)(A)-(E). NYSE Amex will consider delisting the common stock of an issuer if the aggregate market value of such publicly held shares is less than $1 million for more than 90 consecutive days, the number of publicly held shares is less than 200,000 shares, or the number of its public stockholders is less than 300. <u>See</u> Section 1003(b) of the NYSE Amex Company Guide.

BATS for Tier II Securities are not significant and that, taken as a whole, the criteria are substantially similar.[45]

The Commission requests comment on whether BATS' proposed listing standards for primary equity securities on Tier II are "substantially similar" to NYSE Amex standards.

2. Preferred Stock and Secondary Classes of Common Stock

The Commission has compared the proposed listing standards of preferred stock and secondary classes of common stock on Tier II of the Exchange to the Nasdaq/NGM standards and preliminarily believes that BATS' standards are substantially similar to those of Nasdaq/NGM. A secondary class of common stock is a class of common stock of an issuer that has another class of common stock listed on an exchange.[46] The Commission preliminarily believes that BATS' proposed initial and continued listing standards with respect to the number of round lot holders,[47] bid price,[48] number of

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[45] The Commission has interpreted the substantially similar standard to require listing standards at least as comprehensive as those of the Named Markets, and differences in language or approach of the listing standards are not dispositive. See supra notes 21-23 and accompanying text. See also Securities Act Release 8791, supra note 6 (determining that NCM continued listing standards, which are identical to BATS' proposed continued listing standards for primary equity securities on Tier II of the Exchange, are substantially similar to the Amex standards).

[46] See Securities Act Release No. 8791, supra note 6, at 20411.

[47] BATS' proposed initial listing standard would require 100 round lot holders, as Nasdaq/NGM requires. Compare proposed BATS Rule 14.9(c) with Nasdaq Rule 5510. Similarly, BATS' proposed continued listing standard would require 100 round lot holders. The Nasdaq/NGM continued listing standard requires 100 round lot holders. Compare proposed BATS Rule 14.9(f) with Nasdaq Rule 5460(a)(4).

[48] While BATS' proposed bid price requirement for initial listing is $4 and the Nasdaq/NGM requirement is $5, the Commission preliminarily does not believe

publicly held shares,[49] market value of publicly held shares,[50] and number of market makers[51] are substantially similar to the Nasdaq/NGM standards.[52]

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this difference is significant. Compare proposed BATS Rule 14.9(c)(1)(A) with Nasdaq Rule 5510(a)(1). See also Securities Act Release No. 8791, supra note 6, at 20412 n. 28 (determining that an NCM bid requirement, which is identical to BATS' proposed bid requirement, was substantially similar to the Nasdaq/NGM requirement). Both BATS' proposed standard and Nasdaq/NGM's existing standard require a $1 bid price for continued listing. Compare proposed BATS Rule 14.9(f)(1) with Nasdaq Rule 5460(a)(3).

49 BATS' proposed standard would require 200,000 publicly held shares for initial listing, and 100,000 publicly held shares for continued listing, which is the same as Nasdaq/NGM requires. Compare proposed BATS Rule 14.9(c)(1)(C) and 14.9(f)(1)(c) with Nasdaq Rules 5415(a)(1) and 5460(a)(1).

50 BATS' proposed standard for initial listing of preferred stock or a secondary class of common stock would require a market value of publicly held shares of at least $3.5 million. Nasdaq/NGM requires a market value of publicly held shares of at least $4 million. Compare proposed BATS Rule 14.9(c)(1)(D) with Nasdaq Rule 5415(a)(2). BATS proposed standard for continued listing would require a market value of publicly held shares of at least $1 million. Nasdaq/NGM requires a market value of publicly held shares of at least $1 million for continued listing. Compare proposed BATS Rule 14.9(f)(1)(D) with Nasdaq Rule 5460(a)(1). The Commission preliminarily believes BATS' proposed initial and continued listing standards for preferred stock and secondary classes of common stock are substantially similar to Nasdaq/NGM. See also Securities Act Release No. 8791, supra note 6, at 20411-12. (determining that NCM listing standards, which are identical to BATS' proposed listing standards for preferred stock and secondary classes of common stock, are substantially similar to the Nasdaq/NGM standards).

51 BATS proposed standard for initial listing would require at least three registered and active market makers, while its continued listing standard would require at least two registered and active market makers. Nasdaq/NGM requires the same. Compare proposed BATS Rule 14.9(c)(1)(E) with Nasdaq Rule 5415(a)(2).

52 The Commission notes that these proposed requirements would apply to instances when the common stock or common stock equivalent security of the issuer were listed on BATS as a Tier II Security or otherwise were a Covered Security. If the common stock or common stock equivalent is not listed as a Tier II Security or is a Covered Security, then the security would be required to meet the initial primary equity listing requirements for Tier II noted above. Nasdaq/NGM contains a similar requirement. Compare proposed BATS Rule 14.9(f)(2) with Nasdaq Rule 5460(b).

The Commission requests comment on whether the BATS proposed secondary classes of common stock and preferred stock rules are "substantially similar" to Nasdaq/NGM's rules.

3. Warrants

The Commission has compared BATS' proposed standards for warrants to Nasdaq/NGM's standards, and preliminarily believes that the BATS proposed standards are substantially similar to the Nasdaq/NGM standards. BATS' proposed initial listing standards would require that 400,000 warrants be outstanding for initial listing, and that there be at least three registered and active market makers and 400 round lot holders.[53] Nasdaq/NGM's standards are identical except that Nasdaq/NGM requires 450,000 warrants to be outstanding.[54] Though not identical with respect to the number of warrants outstanding standard, the Commission preliminarily believes these proposed initial listing standards are substantially similar to the Nasdaq/NGM standards.[55] Further, the proposed BATS standards would require the issuer's underlying security to be listed on the Exchange or be a Covered Security.[56] The Commission notes that Nasdaq/NGM has a similar standard that the underlying security be listed on Nasdaq/NGM or be a

53 See proposed BATS Rule 14.9(d)(1)(A), (C) and (D).

54 See Nasdaq Rule 5410(a), (c) and (d).

55 See also Securities Act Release 8791, supra note 6 (determining that NCM initial listing standards, which are identical to BATS' proposed standards for warrants on Tier II of the Exchange, are substantially similar to the Amex standards).

56 See BATS proposed Rule 14.9(d)(1)(B).

Covered Security and preliminarily believes that BATS' proposed standard is substantially similar to Nasdaq/NGM.[57]

The Commission also preliminarily believes that BATS' proposed continuing listing requirements for warrants that there be two registered and active market makers (one of which may be a market maker entering a stabilizing bid) and that the underlying security remain listed on the Exchange or be a Covered Security are substantially similar to that of Nasdaq/NGM.[58]

The Commission requests comment on whether BATS' proposed listing standards for warrants are "substantially similar" to Nasdaq/NGM's listing standards.

4. Index Warrants

For index warrants traded on BATS, BATS has proposed the same standards (both initial and continuing) that apply to index warrants traded on Nasdaq/NGM.[59] Therefore, the Commission preliminarily believes that the proposed listing standards for index warrants traded on BATS are substantially similar to the standards applicable to index warrants traded on the Nasdaq/NGM market.

The Commission requests comment on whether BATS proposed listing standards for index warrants are "substantially similar" to Nasdaq/NGM's listing standards.

5. Convertible Debt

The Commission has compared BATS' proposed listing standards for convertible debt to NYSE Amex's listing standards for debt. The Commission preliminarily believes

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57 See Nasdaq Rule 5410(b).

58 Compare proposed BATS' Rule 14.9(g)(1) with Nasdaq Rule 5455(1) and (2).

59 Compare proposed BATS' Rule 14.9(d)(3) with Nasdaq Rule 5725.

that BATS' proposed initial listing standards regarding the threshold principal amount outstanding,[60] the availability of current last sale information,[61] and number of market makers[62] are substantially similar to NYSE Amex standards.[63] In addition to the

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60 The BATS proposed rule would require a principal amount outstanding of at least \$10 million for initial listing and \$5 million for continued listing. See proposed BATS Rule 14.9(d)(2)(A) and 14.9(g)(2)(A). NYSE Amex requires a principal amount outstanding of at least \$5 million for initial listing and will consider delisting if the principal amount outstanding is less than \$400,000 or if the issuer is not able to meet its obligations on the listed debt security. See Sections 104 and 1003 of the NYSE Amex Company Guide. As the Commission noted in a prior release, while these requirements are not identical, the Commission believes that both standards are designed to ensure the continued liquidity of the debt security, and thus are substantially similar. See Securities Act Release 8791, supra note 6, at 20412 (finding that an identical NCM listing standard was substantially similar to the Amex standard).

61 Both BATS' proposed standard and NYSE Amex include an initial listing requirement that there be current last sale information available in the United States with respect to the underlying security into which the bond or debenture is convertible. Compare proposed BATS Rule 14.9(d)(2)(B) with Section 104 of the NYSE Amex Company Guide. Additionally, Section 1003(e) of the NYSE Amex Company Guide states that convertible bonds will be reviewed when the underlying security is delisted and will be delisted when the underlying security is no longer the subject of real-time reporting in the United States. BATS' continued listing standards for a convertible debt security also require that current last sale information be available in the United States with respect to the underlying security, whereas NYSE Amex does not. Compare proposed BATS Rule 14.9(g)(2)(C) with Section 1003(e) of the NYSE Amex Company Guide.

62 BATS' proposed standard would require at least three registered and active market makers for initial listing and two registered and active market makers for continued listing (one of which may be a market maker entering a stabilizing bid), whereas NYSE Amex requires one specialist to be assigned. Compare proposed BATS Rule 14.9(d)(1)(C) with NYSE Amex Rule 104.

63 NYSE Amex will not list a convertible debt issue containing a provision which gives an issuer discretion to reduce the conversion price unless the issuer establishes a minimum 10-day period within which such price reduction will be in effect. See Section 104 of the NYSE Amex Company Guide. The Commission preliminarily believes that omission of such a provision does not impact its determination. See Securities Act Release Nos. 39542, supra note 6 (finding PCX listing standards to be substantially similar to Amex even with the absence of this provision); 8791, supra note 6, at 20412 (finding NCM's listing standard, which is

requirements noted above, BATS' proposed listing standards would require that one of four additional conditions be met for listing of convertible debt. Specifically, BATS proposes that it would not list a convertible debt security unless one of the following conditions were met: (i) the issuer of the debt security also has equity securities listed on the Exchange, NYSE Amex, the NYSE, or Nasdaq/NGM; (ii) an issuer of equity securities listed on the Exchange, NYSE Amex, the NYSE, or Nasdaq/NGM directly or indirectly owns a majority interest in, or is under common control with, the issuer of the debt security, or has guaranteed the debt security; (iii) a nationally recognized securities rating organization (an "NRSRO") has assigned a current rating to the debt security that is no lower than an S&P Corporation "B" rating or equivalent rating by another NRSRO; or (iv) if no NRSRO has assigned a rating to the issue, an NRSRO has currently assigned an investment grade rating to an immediately senior issue or a rating that is no lower than an S&P Corporation "B" rating, or an equivalent rating by another NRSRO, to a pari passu or junior issue.[64] The Commission preliminarily believes that these other conditions proposed by BATS for listing of convertible debt are substantially similar to NYSE Amex standards.[65]

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identical to BATS' proposed listing standard for convertible debt, is substantially similar to Amex even with the absence of this provision).

64 These standards are identical to the initial listing standard for convertible debt securities on NYSE Amex and NCM). Compare proposed BATS Rule 14.9(d)(2)(D)(iv) with Section 104(A)-(E) of the NYSE Amex Company Guide and Nasdaq Rule 5515(b)(4).

65 Id.

The Commission requests comment on whether the BATS proposed convertible debt listing rules are "substantially similar" to NYSE Amex's listing standards for debt securities.

6. Units

The listing requirements for units on Tier II of the Exchange, NYSE Amex, and Nasdaq/NGM are all the same, as each evaluates the initial and continued listing of a unit by looking to its components.[66] If all of the components of a unit individually meet the standards for listing, then the unit would meet the standards for listing.[67] Because the components for units proposed by BATS are substantially similar to those of a Named Market, as discussed above, the Commission preliminarily believes that BATS' proposed listing standards for units to be listed on Tier II of the Exchange are substantially similar to a Named Market.[68]

The Commission requests comment on whether BATS' proposed listing standards for units on Tier II of the Exchange are "substantially similar" to NYSE Amex requirements.

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66 A unit is a type of security consisting of two or more different types of securities (e.g., a combination of common stocks and warrants). See, e.g., Securities Exchange Act Release No. 48464 (September 9, 2003), 68 FR 54250 (September 16, 2003) (order approving NYSE Amex proposed rule change to amend Sections 101 and 1003 of the NYSE Amex Company Guide to clarify the listing requirements applicable to units).

67 See generally proposed BATS Rule 14.4, Section 101(f) of the NYSE Amex Company Guide, and Nasdaq Rule 5225.

68 See Securities Exchange Act Release No. 64546, supra note 8, 76 FR 31660 at 31664.

D. Other Securities Including Exchange Traded Funds, Portfolio Depository Receipts and Index Fund Shares

In addition to the proposed listing standards for Tier I and Tier II securities and the analyses of such standards to the Named Markets discussed above, the Commission notes that BATS has proposed listing standards for other securities, including exchange traded funds, portfolio depository receipts, and index fund shares. The Commission also notes that BATS' proposed standards for these securities are identical to those of Nasdaq/NGM.[69]

E. Other Changes

Sections (b)(1) and (b)(2) of Rule 146 use the term "Amex" to refer to the American Stock Exchange LLC. As noted above, on October 1, 2008, NYSE Euronext acquired Amex and renamed it NYSE Alternext.[70] Further, in 2009, NYSE Alternext was renamed NYSE Amex LLC.[71] Additionally, Section (b)(1) of Rule 146 uses the term "the Philadelphia Stock Exchange, Inc." As noted above, on July 24, 2008, The NASDAQ OMX Group, Inc. acquired Phlx and renamed it "NASDAQ OMX PHLX LLC."[72] The proposed rule change includes changes to Rule 146(b) to account for these name changes.

F. Comments

To date, the Commission has not received any comment letters on the Petition.

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69 Compare proposed BATS Rule 14.11 with Nasdaq Rule 5700 Series.

70 See Securities Exchange Act Release No. 58673, supra note 1.

71 See Securities Exchange Act Release No. 59575, supra note 1.

72 See Securities Exchange Act Release Nos. 58179, 58183, and 62783, supra note 11.

IV. Solicitation of Comments

The Commission seeks comment generally on the desirability of amending Rule 146(b) to include securities listed, or authorized for listing, of BATS. As discussed above, based on its review of BATS' proposed listing standards, the Commission preliminarily believes that the proposed initial and continued listing standards for BATS are substantially similar to those of the NYSE Amex or Nasdaq/NGM. The Commission seeks comments on its preliminary analysis.

The Commission also invites commenters to provide views and data as to the costs, benefits, and effects associated with the proposed amendments. In addition to the questions posed above, commenters are welcome to offer their views on any other matter raised by the proposed amendment to Rule 146(b), including the application of rule 146(b)(2). Finally, the Commission requests comment on whether it could use a different methodology to determine whether BATS' proposed listing standards are "substantially similar" to those of the Named Markets.

V. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 does not apply because the proposed amendment to Rule 146(b) does not impose recordkeeping or information collection requirements or other collection of information, which require the approval of the Office of Management and Budget under 44 U.S.C. 3501 et seq.

VI. Economic Analysis

A. Introduction

Section 2(b) of the Securities Act[73] requires us, when engaging in rulemaking

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73 15 U.S.C. 77b(b).

where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. We have considered, and discuss below, the effects of the proposed amendment to Securities Act Rule 146, with regard to BATS' proposed listing standards to designate certain securities that would be listed on BATS as Covered Securities, on efficiency, competition, and capital formation, as well as the benefits and costs associated with the proposed rulemaking.

Congress amended Section 18 of the Securities Act to exempt covered securities from state registration requirements. These securities are listed on the Named Markets or any other national securities exchange determined by the Commission to have "substantially similar" listing standards to those of the Named Markets ("Designated Markets").[74] The Commission proposes to determine (if the Commission were to approve the proposed listing standards filed by BATS) that the listing standards for securities listed on BATS are substantially similar to those of a Named Market, specifically Nasdaq/NGM or NYSE Amex. Securities listed, or authorized for listing, on BATS therefore would be exempt from state law registration requirements.

There are three Named Markets (NYSE, NYSE Amex, and Nasdaq/NGM) and currently five Designated Markets (Tier I of NYSE Arca, Tier I of the Philadelphia Stock Exchange, CBOE, ISE, and Nasdaq/NCM). NYSE and Nasdaq/NGM are currently the largest exchanges in terms of number of securities listed. As of April 19, 2011, in terms of securities listed, NYSE lists 3,255, Nasdaq/NGM lists 2,854, NYSE Arca lists 1,213,

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[74] See 15 U.S.C. 77r(b)(1)(B).

and NYSE Amex lists 544.[75]

The direct economic effect of the proposed rule would be to exempt issuers that list, or are authorized to list, on BATS from the requirements of state registration. Instead, these issuers would be required to comply with BATS' proposed listing standards and the federal securities laws, rules and regulations with respect to the registration and sale of securities. The requirements of state registration typically include: (i) paperwork and labor hours necessary to comply with state registration requirements, (ii) meeting the disclosure standards, and (iii) in some states, meeting certain minimum merit requirements to make public offerings.[76]

An indirect effect of the proposed rule would be that, by removing the requirements of state registration for issuers that list, or are authorized to list, on BATS – the same privilege granted to other Covered Securities – the rule could improve BATS' ability to compete effectively with other exchanges. Therefore, an important economic effect of the rule could be to engender greater competition in the market for listing services.

Exchanges generally compete in multiple areas, which include the market for

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75 These listed securities include exchange traded funds and multiple securities from the same issuer.

76 A commentator noted that the purpose of such review is "to prevent 'unfair' and 'oppressive' offerings of securities," and, as of 2011, merit review is employed in about 30 states. See Jeffrey B. Bartell & A.A. Sommer, Jr., Blue Sky Registration, in SECURITIES LAW TECHNIQUES (Matthew Bender ed., 2011). Typical elements of merit review include: offering expenses, including underwriter's compensation, rights of security holders, historical ability to service debt or pay dividends, financial condition of the issuer, cheap stock held by insiders, the quantity of securities subject to options and warrants, self-dealing and other conflicts of interest, and the price at which the securities will be offered. See id. Some merit regulation would be imposed on these issuers through application of exchange listing standards.

listing, the market for trading, and the market for order-flow. This proposed rule and BATS' proposed listing standards[77] relate primarily to the market for listing, although the proposed rule (should it be adopted) and the entry of a new participant in the listings market could impact other markets as well.[78] In the market for listing, exchanges compete for issuers to list on their exchanges, so that the exchange may collect listing fees. Domestic exchanges face listing competition from other domestic exchanges and from foreign exchanges.[79] The benefit of listing for issuers generally is to gain greater access to capital through measures designed to help promote quality certification and visibility to public investors, which will generally result in a reduction in the cost of raising capital for these issuers. This access to capital may be further enhanced through listing on particular exchanges, which could affect the level of investors' trust in a listed company's governance structure and the fairness of trading in the company's securities (through the perceived effectiveness of exchanges' conduct rules and surveillance of

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77 See Securities Exchange Act Release No. 64546, supra note 8.

78 See, e.g., Thierry Foucault and Christine A. Parlour, Competition for Listing, 35 RAND J. ECON. 329 (2004) (describing how listing fees and trading costs both affect firms' incentives to list with one exchange versus another).

79 It has been noted that NYSE and the London Stock Exchange, for example, compete for listings of firms in third countries, in particular from emerging economies. See Thomas J. Chemmanur & Paolo Fulghieri, Competition and Cooperation Among Exchanges: A Theory of Cross-Listing and Endogenous Listing Standards, 82 J. FIN. ECON. 455, 456 (2006). See generally Craig Doidge, Andrew Karolyi, and René Stulz, Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices Over Time, JOURNAL OF FINANCIAL ECONOMICS 91, 253-277 (2009); Craig Doidge, Andrew Karolyi, and René Stulz, Why Do Foreign Firms Leave U.S. Equity Markets?, JOURNAL OF FINANCE 65, 1507-1553 (2010); Caglio, Cecilia, Hanley, Kathleen Weiss and Marietta-Westberg, Jennifer, Going Public Abroad: The Role of International Markets for IPOs (March 16, 2010), available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572949. Additionally, differences in regulatory regimes may impact listing decisions.

trading as well as other services and regulatory functions).

Exchanges may try to compete for issuers by reducing listing fees or by improving the quality of services they offer, or both. The cost of listing for an issuer includes listing fees and the cost of complying with listing standards. In principle, this means exchanges can compete by reducing listing fees, by relaxing the listing standards issuers must meet, or by offering several trading segments with different listing standards on each, though such standards must be determined to be substantially similar to a Named Market in order to get the benefit of the Securities Act Section 18(b)(1)(B) exemption from state registration requirements. Any concern that exchanges may try to compete by lowering the listing standards to attract issuers (and hence enter in a "race-to-the-bottom") is mitigated by the fact that (1) listing standards affect exchanges' reputations among investors, which, in turn, impacts their attractiveness to issuers, (2) any proposed listing standards or proposed changes to existing listing standards must be filed with the Commission pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act") and must meet its requirements to become effective,[80] and (3) lower listing standards that are not substantially similar to those of a Named Market will not have the benefit of the exemption from state registration requirements.[81]

The competition among exchanges for listings is only partially based on price.

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80 Any revision to exchange listing standards must be done in accordance with Section 19(b) of the Exchange Act and Rule 19b-4 thereunder. Any Commission approval of a listing standard revision is conditioned upon a finding by the Commission that the revision is consistent with the requirements of the Exchange Act and rules thereunder. See 15 U.S.C. 78s.

81 See Chemmanur & Fulghieri, supra note 79, at 458.

Exchanges also compete in various other areas, which contribute to the quality of the service listed issuers receive, including, but not limited to, provision of trade statistics, regulatory and surveillance services, access to new technology, attractive trading mechanisms, and marketing services.

One important dimension of competition is brand name.[82] Issuers place high value on being listed on certain exchanges because investors may more readily trust those exchanges, which may, in turn, reduce the cost of raising capital for those issuers. As a result, NYSE and Nasdaq/NGM, which are already the two largest exchanges in terms of securities listed, may be able to charge listing fees that are above marginal cost—that is, what it would cost them to list additional issuers—and higher than other competing exchanges; therefore, certain exchanges may earn economic rent from these higher listing premiums (the amount of fee difference certain exchanges can charge, above a competitor's price, because of its brand name). In addition to brand name recognition, the market for listing exhibits positive network externalities: issuers may prefer to be listed on exchanges where many other issuers are listed and where there are more intermediaries trading because of increased liquidity and visibility.[83] This indicates that,

82 See generally Clement G. Krouse, Brand Name as a Barrier to Entry: The Rea Lemon Case, 51 SOUTHERN ECON. J. 495 (1984) (describing the effect of brand name on competition in markets with incomplete information); see also Tibor Scitovsky, Ignorance as a Source of Oligopoly Power, 40 AMER. ECON. REV. 48, 49 (1950) ("An ignorant buyer . . . is unable to judge the quality of the products he buys by their intrinsic merit. Unable to appraise products by objective standards, he is forced to base his judgment on indices of quality, such as . . . general reputation of the producing firms.").

83 See, e.g., Carmine Di Nola, Competition and Integration Among Stock Exchanges in Europe: Network Effects, Implicit Mergers and Remote Access, 7 EUROPEAN FIN. MAN. 39 (2001)("Firms may derive more utility in being listed on exchanges where there are more intermediaries as they give more liquidity to the market.").

all else being equal, large exchanges (in terms of listings) will tend to be favored over smaller ones. In theory, this preference may persist to some extent even if large exchanges were to offer slightly inferior services than their smaller counterparts because the advantages of being listed on a large exchange, where there are many issuers and intermediaries, might outweigh the cost of being offered slightly inferior services. Because of these brand name effects and positive externalities, the market for listings to some extent exhibits certain barriers to entry for new entrants to the listing markets, such as BATS.[84]

B. Benefits, Including the Impact on Efficiency, Competition, and Capital Formation

By proposing to exempt securities listed, or authorized for listing, on BATS from state law registration requirements, the Commission expects that issuers seeking to list securities on BATS could have the benefit of reduced regulatory compliance burdens, as compliance with state blue sky law requirements would not be required. One benefit of this proposal would be to eliminate these compliance burdens with respect to securities listed, or authorized for listing, on BATS. The Commission expects that the proposed rule could also improve efficiency by eliminating duplicative registration costs for issuers and improving liquidity by allowing for greater market access to issuers who have not been listed previously.

84 Brand name recognition is frequently recognized as a barrier to entry mainly because consumers do not have all the information regarding product quality and thus tend to rely on brand names as a proxy for quality. See, e.g., Brand Name as a Barrier to Entry: The Rea Lemon Case, 51 S. ECON. J. 495 (1984); Tibor Scitovsky, Ignorance as a Source of Oligopoly Power, 40 AMER. ECON. REV. 48 (1950). Network externalities are also recognized as a barrier to entry. See, e.g., Gregory J. Weden, Network Effects and Conditions of Entry: Lessons from the Microsoft Case, 69 Antitrust L.J. 87 (2001); Douglas A. Melamed, Network Industries and Antitrust, 23 HARV. J. L. & PUB. POL'Y 147 (1999).

To the extent that state merit reviews may have inhibited certain smaller businesses from making public offerings,[85] an exemption from state registration requirements could facilitate capital formation.

The Commission preliminarily believes that the proposed amendment to Rule 146(b) should permit BATS to better compete for listings with other markets whose listed securities already are exempt from state law registration requirements. This result could enhance competition, thus benefiting market participants and the public.

Specifically, BATS currently intends to enter the listing market with generally lower fees than incumbent exchanges in order to compete with them.[86] In response to BATS' proposed entry, although recognizing the significant barriers to entry noted

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85 A number of scholarly articles have expressed concerns over the possibility for blue sky merit regulation to hinder capital formation. See, e.g., Martin Fojas, Ay Dios NSMIA!: Proof of a Private Offering Exemption Should Not Be a Precondition for Preempting Blue Sky Law Under the National Securities Markets Improvement Act, 74 BROOKLYN L. REV. 477 (2009); Rutheford B. Campbell, Jr., Blue Sky Laws and the Recent Congressional Preemption Failure, 22 J. CORP. L. 175 (1997); Brian J. Fahrney, State Blue Sky Laws: A Stronger Case for Federal Pre-Emption Due to Increasing Internationalization of Securities Markets, Comment, 86 NW. U. L. REV. 753 (1991-92); Roberta S. Karmel, Blue-Sky Merit Regulation: Benefit to Investors or Burden on Commerce, 53 BROOK. L. REV. 106 (1987-88). While the concerns are numerous, other studies have shown some positive effect of merit regulation. See Jay T. Brandi, The Silverlining in Blue Sky Laws: The Effect of Merit Regulation on Common Stock Returns and Market Efficiency, 12 J. Corp. L. 713 (1986-87) (reporting that merit regulation can have a positive effect on investor returns); Ashwini K. Agrawal, "The Impact of Investor Protection Law on Corporate Policy: Evidence from the Blue Sky Laws," working paper (2009) (reporting that the passage of investor protection statutes causes firms to pay out greater dividends, issue more equity, and grow in size), available at http://ssrn.com/abstract=1442224. Some merit regulation would be imposed on these issuers through application of exchange listing standards.

86 See Securities Exchange Act Release No. 64546, supra note 8, 76 FR at 31666 & n. 27-28 (representing that BATS' proposed pricing, while not necessarily cheaper for all issuers at all other markets, is roughly equivalent to or less than the price issuers would pay at other exchanges, including NGM and NCM).

above, the incumbent exchanges might choose to reduce their listing fees to match or come closer to those proposed by BATS. Incumbent exchanges might also enhance the other services they provide to their currently listed issuers (e.g., regulatory and surveillance services, access to new technology, attractive trading mechanisms, marketing services) as a way to counteract BATS' proposed lower listing fees.

Additional competition in the market for listings could enable some issuers, both public and private, that have (1) either not listed on any exchange or (2) have listed on an exchange but have chosen not to list on certain exchanges because of the costs of listing there, to list on any Named or Designated Market due to the potential for lower listing fees across all exchanges. This potentially could result in a lower cost of capital for those issuers that previously had not listed on an exchange and could benefit the current investors in such issuers in the form of higher company value arising from the reduced cost of capital and increased liquidity. If currently unlisted firms were able to list because of lower listing fees, this could also improve efficiency and capital formation since future investors in these issuers would have easier access to invest in them and to further diversify their investment portfolios.

Those issuers that are currently listed on any exchange, including the Named Markets, and that remain listed there, would potentially benefit from any reduced listing fees; however, because any such benefit would come at the expense of the exchange on which they are listed in the form of potentially reduced profit, this aggregate effect would be a transfer from one group of investors (exchange shareholders) to another group of investors (listed issuer shareholders).

Additionally, some issuers currently listed on other Named or Designated Markets could potentially switch their listings to BATS, thus potentially lowering their listing costs (provided the Named or Designated Markets did not reduce their listing fees). The size of any such potential benefit would depend on how large any cost savings due to listing on BATS would be in comparison to the cost of giving up any valuable services that the other exchanges might provide that BATS might not. In addition, the behavior of these issuers would depend heavily on the extent to which these other exchanges respond to BATS' proposed entry by making themselves more competitive to the issuers.

C. Costs, Including the Impact on Efficiency, Competition, and Capital Formation

The proposed amendment would eliminate state registration requirements for securities listed, or authorized for listing, on BATS. In principle, there could be certain economic costs to investors through the loss of benefits of state registration and oversight. For example, by listing on BATS, issuers would no longer be required to comply with certain states' blue sky laws, which could mandate more detailed disclosure than BATS' proposed listing standards and the requirements imposed pursuant to the federal securities laws, rules, and regulations. In such circumstances, investors could lose the benefit of the additional information. Additionally, to the extent blue sky laws result in additional enforcement protections in the form of another regulator policing issuer activity, then investors from these states could incur costs when issuers choose to list on BATS. Some commentators have also expressed a concern that the exemption from blue sky laws could prompt riskier public offerings.[87]

From the perspective of competition in the market for listing, the Commission

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87 See, e.g., Brandi, supra note 85.

notes that there could be a concern that, to the extent the market for exchange services exhibits network effects, as explained above, there could be a loss in efficiency as a result of having a greater number of networks, if one or more of the existing large exchanges (in terms of listings) shrinks in size. However, the Commission also notes that the overall efficiency effect would depend on the precise fragmentation of the exchanges. It is possible, for instance, that, through specialization of exchanges, there could be an efficiency gain from having more distinct exchanges, each of which specializes in listing issuers from certain types of industries.

The Commission acknowledges that these costs are difficult to quantify. The Commission believes that Congress contemplated these costs in relation to the economic benefits of exempting Covered Securities from state regulation. The Commission, however, is considering the costs of the proposed amendment to Rule 146(b) and requests commenters to provide views and supporting information as to the costs and benefits associated with this proposal. The proposed rule otherwise imposes no recordkeeping or compliance burdens, but would provide a limited purpose exemption under the federal securities laws.

Overall, the Commission believes the proposed amendment to Rule 146(b) should not impair efficiency, competition, and capital formation.

D. Request for Comment

We request comment on the costs and benefits associated with this rule amendment, including identification and assessments of any costs and benefits not discussed in this analysis. We solicit comments on the usefulness of the rule amendment to investors, reporting persons, registrants, and the marketplace at large. We encourage commentators to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits, as well as any costs and benefits not already defined. We also request qualitative feedback on the nature of the benefits and costs described above. Additionally, we request comment on the extent of any costs that may be attributable to any loss of protections that currently are afforded by the state registration process, such as any merit-based requirements imposed by states on issuers.

VII. Regulatory Flexibility Act Certification

Section 603(a) of the Regulatory Flexibility Act[88] requires the Commission to undertake an initial regulatory flexibility analysis of the proposed amendment to Rule 146 on small entities, unless the Commission certifies that the proposed amendment, if adopted, would not have a significant economic impact on a substantial number of small entities.[89] For purposes of Commission rulemaking in connection with the Regulatory Flexibility Act, an issuer is a small business if its "total assets on the last day of its most recent fiscal year were $5 million or less."[90]

The Commission believes that the proposal to amend Rule 146(b) would not affect a substantial number of small entities because, as proposed by BATS, to list its securities on BATS, an issuer's aggregate market value of publicly held shares would be required to be at least $5 million. If an entity's market value of publicly held shares were at least $5 million, it is reasonable to believe that its assets generally would be worth more than $5 million. Therefore, an entity seeking to list securities as proposed by BATS

88 5 U.S.C. 603(a).

89 5 U.S.C. 605(b).

90 17 CFR 230.157. See also 17 CFR 240.0-10(a).

in its proposed listing standards generally would have assets with a market value of more than $5 million and thus would not be a small entity.

Accordingly, the Commission hereby certifies, pursuant to Section 605(b) of the Regulatory Flexibility Act,[91] that amending Rule 146(b) as proposed would not have a significant economic impact on a substantial number of small entities. The Commission encourages written comments regarding this certification. The Commission solicits comment as to whether the proposed amendment to Rule 146(b) could have an effect that has not been considered. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

VIII. Small Business Regulatory Enforcement Fairness Act of 1996

For purposes of the Small Business Enforcement Fairness Act of 1996, a rule is "major" if it results or is likely to result in:

(i) an annual effect on the economy of $100 million or more;

(ii) a major increase in costs or prices for consumers or individual industries; or

(iii) significant adverse effects on competition, investment, or innovation.[92]

The Commission requests comment regarding the potential impact of the proposed amendment on the economy on an annual basis. Commenters should provide empirical data to support their views to the extent possible.

IX. Statutory Authority and Text of the Proposed Rule

The Commission is proposing an amendment to Rule 146 pursuant to the

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91 5 U.S.C. 605(b).

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

Securities Act of 1933,[93] particularly Sections 18(b)(1)(B) and 19(a).[94]

List of Subjects in 17 CFR Part 230

Securities.

For the reasons set forth in the preamble, the Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

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

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

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

* * * * *

2. Revise Section 230.146(b)(1) and (b)(2) to read as follows:

§ 230.146 Rules under section 18 of the Act.

* * * * *

(b) * * *

(1) For purposes of Section 18(b) of the Act (15 U.S.C. 77r), the Commission finds that the following national securities exchanges, or segments or tiers thereof, have listing standards that are substantially similar to those of the New York Stock Exchange ("NYSE"), the NYSE Amex LLC ("NYSE Amex"), or the National Market System of the Nasdaq Stock Market ("Nasdaq/NGM"), and that securities listed, or authorized for listing, on such exchanges shall be deemed covered securities:

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93 15 U.S.C. 77a et seq.

94 15 U.S.C. 77r(b)(1)(B) and 77s(a).

(i) Tier I of the NYSE Arca, Inc.;

(ii) Tier I of the NASDAQ OMX PHLX LLC;

(iii) The Chicago Board Options Exchange, Incorporated;

(iv) Options listed on the International Securities Exchange, LLC;

(v) The Nasdaq Capital Market; and

(vi) BATS Exchange, Inc.

(2) The designation of securities in paragraphs (b)(1)(i) through (vi) of this section as covered securities is conditioned on such exchanges' listing standards (or segments or tiers thereof) continuing to be substantially similar to those of the NYSE, NYSE Amex, or Nasdaq/NGM.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 8, 2011

Commissioner Casey
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 29749 / August 8, 2011

In the Matter of

J.P. MORGAN SECURITIES LLC
338 Madison Avenue
New York, NY 10179

BEAR STEARNS ASSET MANAGEMENT INC.
BEAR STEARNS HEALTH INNOVENTURES MANAGEMENT, L.L.C.
BSCGP INC.
270 Park Avenue
New York, NY 10017

CONSTELLATION GROWTH CAPITAL LLC
49 West 57th Street, 32nd Floor
New York, NY 10019

CONSTELLATION VENTURES MANAGEMENT II, LLC
270 Park Avenue
New York, NY 10017

HIGHBRIDGE CAPITAL MANAGEMENT, LLC
49 West 57th Street, 32nd Floor
New York, NY 10019

JF INTERNATIONAL MANAGEMENT INC.
21st Floor, Chater House
8 Connaught Road Central
Hong Kong

JPMORGAN ASSET MANAGEMENT (UK) LIMITED
125 London Wall
London, UK, EC2Y5AJ

JPMORGAN DISTRIBUTION SERVICES, INC.
1111 Polaris Parkway
Columbus, OH 43240

J.P. MORGAN INSTITUTIONAL INVESTMENTS, INC.)
J.P. MORGAN INVESTMENT MANAGEMENT INC.)
J.P. MORGAN LATIN AMERICA MANAGEMENT COMPANY, LLC)
J.P. MORGAN PARTNERS, LLC)
J.P. MORGAN PRIVATE INVESTMENTS INC.)
270 Park Avenue)
New York, NY 10017)
)
OEP CO-INVESTORS MANAGEMENT II, LTD.)
OEP CO-INVESTORS MANAGEMENT III, LTD.)
320 Park Avenue, 18th Floor)
New York, NY 10022)
)
SECURITY CAPITAL RESEARCH & MANAGEMENT INCORPORATED)
10 South Dearborn Street, Suite 1400)
Chicago, IL 60603)
)
SIXTY WALL STREET GP CORPORATION)
SIXTY WALL STREET MANAGEMENT COMPANY, LLC)
270 Park Avenue)
New York, NY 10017)
)
TECHNOLOGY COINVESTORS MANAGEMENT, LLC)
270 Park Avenue)
New York, NY 10017)
)
(812-13919))

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

J.P. Morgan Securities LLC ("JPMS"), Bear Stearns Asset Management Inc., Bear Stearns Health Innoventures Management, L.L.C., BSCGP Inc., Constellation Growth Capital LLC, Constellation Ventures Management II, LLC, Highbridge Capital Management, LLC, JF International Management Inc., JPMorgan Asset Management (UK) Limited, JPMorgan Distribution Services, Inc., J.P. Morgan Institutional Investments, Inc., J.P. Morgan Investment Management Inc., J.P. Morgan Latin America Management Company, LLC, J.P. Morgan Partners, LLC, J.P. Morgan Private Investments Inc., OEP Co-Investors Management II, Ltd., OEP Co-Investors Management III, Ltd., Security Capital Research & Management Incorporated, Sixty Wall Street GP Corporation, Sixty Wall Street Management Company, LLC, and Technology Coinvestors Management, LLC (collectively, "Applicants") filed an application on July 7, 2011, and an amendment to the application on July 11, 2011, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which JPMS is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the

Act with respect to an injunction entered by the United States District Court for the District of New Jersey on July 8, 2011.

On July 11, 2011, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 29719) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the conduct of the Applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application, as amended and filed by J.P. Morgan Securities LLC, et al. (File No. 812-13919) that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, as amended, entered by the United States District Court for the District of New Jersey on July 8, 2011.

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. 65096 / August 10, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14502

In the Matter of D.G. Jewellery of Canada Ltd. (n/k/a D.G. Jewelry, Inc.), Daine Industries, Inc. (n/k/a Oasis Travel Group, Inc.), Del Cerro Enterprises, Inc., Denstone Minerals Ltd., Diadem Resources Ltd., Digicomm Services, Inc. (f/k/a NEMO Enterprises, Inc.), Digital Courier International Corp., Digital Star Inc., Dimples Group Inc., Dominion Bridge Corp., and DSI Datotech Systems 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 D.G. Jewellery of Canada Ltd. (n/k/a D.G. Jewelry, Inc.), Daine Industries, Inc. (n/k/a Oasis Travel Group, Inc.), Del Cerro Enterprises, Inc., Denstone Minerals Ltd., Diadem Resources Ltd., Digicomm Services, Inc. (f/k/a NEMO Enterprises, Inc.), Digital Courier International Corp., Digital Star Inc., Dimples Group Inc., Dominion Bridge Corp., and DSI Datotech Systems Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. D.G. Jewellery of Canada Ltd. (n/k/a D.G. Jewelry, Inc.) (CIK Nos. 1061318 and 1029631) 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). D.G. Jewellery is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended June 30, 2002, which reported a net loss of over $11.6 million for the prior six months. On October 10, 2002, the Ontario Superior Court of Justice appointed an Interim Receiver for D.G. Jewellery, who took possession of all D.G. Jewellery's assets.

2. Daine Industries, Inc. (n/k/a Oasis Travel Group, Inc.) (CIK No. 824845) is a void Delaware corporation located in Edmonton, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Daine Industries is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended September 30, 2002, which reported a net loss of over $5,000 for the prior three months.

3. Del Cerro Enterprises, Inc. (CIK No. 1114708) is a revoked Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Del Cerro Enterprises 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 over $1,700 for the prior six months.

4. Denstone Minerals Ltd. (CIK No. 1052421) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Denstone Minerals is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR/A registration statement on February 2, 1998, which reported a net loss of over $1,400 (Canadian) for the three-month period ended May 31, 1997.

5. Diadem Resources Ltd. (CIK No. 1027599) 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). Diadem Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended May 31, 1998, which reported a net loss of over $1.8 million (Canadian) for the prior twelve months.

6. Digicomm Services, Inc. (f/k/a NEMO Enterprises, Inc.) (CIK No. 1117459) is a dissolved Colorado corporation located in West Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Digicomm Services is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2002, which reported a net loss of $415 for the prior three months.

7. Digital Courier International Corp. (CIK No. 1017460) is an Alberta corporation located in Burnaby, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Digital Courier International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F registration statement on July 31, 1997, which reported a net loss of over $7 million (Canadian) for the six-month period ended March 31, 1997.

8. Digital Star Inc. (CIK No. 1096764) is a British Virgin Islands corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Digital Star is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended September 30, 2000, which reported a net loss of over $23,000 for the prior twelve months.

9. Dimples Group Inc. (CIK No. 891071) is a British Columbia corporation located in Markham, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dimples Group 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, 1993, which reported a net loss of over $4.8 million for the prior twelve months.

10. Dominion Bridge Corp. (CIK No. 854859) is a void Delaware company located in Lachine, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dominion Bridge is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 1998, which reported a net loss of over $12.5 million for the prior six months.

11. DSI Datotech Systems Inc. (CIK No. 1062434) is a British Columbia corporation located in Montreal, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DSI Datotech Systems 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 October 31, 2001, which reported a net loss of over $3 million for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

12. 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.

13. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports. Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

14. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65097 / August 10, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14503

In the Matter of Santa Cruz Gold, Inc., SCNV Acquisition Corp., Scoot.com PLC (n/k/a Coe Group PLC), SCS Solars Computing Systems, Inc., Secured Communication Canada 95, Inc., and Select Software Tools, PLC, 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 Santa Cruz Gold, Inc., SCNV Acquisition Corp., Scoot.com PLC (n/k/a Coe Group PLC), SCS Solars Computing Systems, Inc., Secured Communication Canada 95, Inc., and Select Software Tools, PLC.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Santa Cruz Gold, Inc. (CIK No. 1031713) 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). Santa Cruz Gold is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1998, which reported a net loss of over $24.8 million for the prior twelve months.

2. SCNV Acquisition Corp. (CIK No. 1051934) is a void Delaware corporation located in Omer, Israel with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SCNV Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2000, which reported a net loss of over $848,000 for the prior six months.

3. Scoot.com PLC (n/k/a Coe Group PLC) (CIK No. 1031633) is a United Kingdom company located in Oxford, United Kingdom with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Scoot.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended September 30, 1999, which reported a net loss of over $33.9 million for the prior twelve months.

4. SCS Solars Computing Systems, Inc. (CIK No. 1102037) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SCS Solars 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 November 30, 2000.

5. Secured Communication Canada 95, Inc. (CIK No. 877831) is a British Columbia corporation located in Etobicoke, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Secured Communication Canada 95 is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1996, which reported a net loss of over $6.8 million (Canadian) for the prior twelve months.

6. Select Software Tools PLC (CIK No. 1018154) is a United Kingdom corporation located in Gloucestershire, United Kingdom with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Select Software Tools 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 $8 million for the prior twelve 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

Elizabeth M. Murphy
Secretary

Chairman Schapiro
not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65117 / August 11, 2011

Admin. Proc. File No. 3-14317

In the Matter of the Application of KENT D. SWEAT and INTERMOUNTAIN FINANCIAL SERVICES, INC. 2636 S. Old Settlers Road Heber City, UT 84032 For Review of Disciplinary Action Taken by FINRA	ORDER DENYING MOTION FOR RECONSIDERATION (CORRECTED)

Kent D. Sweat, a FINRA-registered general securities representative and principal, and Intermountain Financial Services, Inc. ("IFS"), a FINRA member firm of which Sweat is the President and Chief Compliance Officer (Sweat and IFS, collectively, "Applicants"), move for reconsideration of our June 10, 2011 order dismissing Applicants' petition for review for failure to file a brief pursuant to Rule of Practice 180(c).[1] Applicants' motion, which Sweat submitted, states, in its entirety, that "[a]ccording to rule 470, I am requesting reconsideration of my appeal, which was denied because of my failure to file documents due to illness. P.S. Enclosed is your order dismissing my appeal."

We analyze Applicants' motion for reconsideration under Rule of Practice 470.[2] Reconsideration is an extraordinary remedy "designed to correct manifest errors of law or fact, or to permit the presentation of newly discovered evidence."[3] Motions for reconsideration,

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1 17 C.F.R. § 201.180(c).

2 17 C.F.R. § 201.470.

3 *Perpetual Sec., Inc.*, Securities Exchange Act Rel. No. 56962 (Dec. 13, 2007),
(continued...)

therefore, are granted only in exceptional cases. Applicants' motion does not establish a basis for reconsideration here.

I.

This matter involves Applicants' repeated failures to file documents or provide other information to regulatory authorities. Applicants' underlying appeal sought review of FINRA's finding that Applicants failed to respond to FINRA requests for information. According to the FINRA hearing panel, FINRA repeatedly attempted to obtain information concerning IFS's net capital position during routine examinations of the firm.[4] FINRA scheduled an examination with Applicants for June 7, 2010, but delayed the examination at Applicants' request until September 20, 2010 due to Sweat's travel plans for a family reunion. Sweat then informed FINRA that he would also be away on the rescheduled examination date. FINRA again agreed to postpone the examination, this time until September 27, 2010, but on September 23, 2010, Sweat informed FINRA that he was attending a wedding in Atlanta, was not feeling well, and was not sure whether he would be able to assist in the examination on September 27. When examiners arrived at IFS's offices, located in Sweat's home in Heber City, Utah, Sweat stated that he was not feeling well and could not participate in the scheduled examination.

FINRA staff subsequently requested that IFS provide financial books and records by September 28, 2010 pursuant to Rule 8210.[5] A FINRA examiner testified at Applicants' disciplinary hearing that FINRA needed the information to assess whether IFS maintained sufficient net capital after paying a settlement related to an earlier FINRA disciplinary proceeding. FINRA asserted that Sweat provided some documents on September 28, but that the response was incomplete. As a result, on October 5, 2010, FINRA issued another Rule 8210

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3 (...continued)
92 SEC Docket 472, 473; *see also Laminaire Corp.*, Exchange Act Rel. No. 56789 (Nov. 15, 2007), 91 SEC Docket 3221, 3223; *Feeley & Wilcox Asset Mgmt. Corp.*, 56 S.E.C. 1264, 1265 (2003).

4 Applicants do not dispute the findings contained in the hearing panel's March 25, 2011 decision. Instead, Sweat wrote in Applicants' notice of appeal to the Commission only that "[a]t the time of the [information] request I had suffered health complications associated with diabetes which prohibited me from providing the requested information" and that he intended to provide FINRA with the requested information by June 25, 2011. The record provides no indication that he ever did do.

5 FINRA Rule 8210 requires members and persons associated with a member to "provide information orally [or] in writing . . . with respect to any matter involved in . . . [a FINRA] examination." Rule 8210 further states that FINRA staff shall have the right to "inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in . . . [a FINRA] examination."

request for Applicants to bring the information to FINRA's Denver office by October 19, 2010. When Applicants failed to do so, FINRA made another Rule 8210 request for the same information, setting October 27, 2010 as the due date, but Applicants again failed to respond to this request. FINRA's Department of Enforcement then issued a Notice, pursuant to Rule 9552, stating that Applicants would be suspended in twenty-one days unless they complied with the request for information.[6]

On November 19, 2010, Applicants requested an expedited hearing, which stayed the suspensions until FINRA decided Applicants' appeal. A hearing was conducted by telephone on January 10, 2011, and FINRA issued its decision on March 25, 2011. In the decision, FINRA found, and Applicants do not deny, that Applicants failed to provide IFS's financial books and records to FINRA examiners, pursuant to requests made under Rule 8210. FINRA further found that Sweat's assertion about the effects his medical condition had on his ability to participate in the pending examination was not a defense and did not otherwise excuse Applicants from providing the requested information.

FINRA suspended Sweat from associating with a FINRA member firm in any capacity and suspended IFS from FINRA membership, with the suspensions to remain in effect until Applicants fully complied with FINRA's requests for information. FINRA further found that, if Applicants did not comply with the information requests within three months, Sweat's suspension would automatically convert into a bar and IFS's suspension would automatically convert into an expulsion. FINRA also ordered that Applicants, jointly and severally, pay costs of $2,216.85 associated with the proceeding.

II.

On April 1, 2011, Applicants filed an appeal with the Commission and requested a stay of their suspensions. Applicants' stay request, submitted by Sweat, did not dispute that Applicants failed to provide information. The request instead stated only that, "[a]t the time of the request I had suffered health complications associated with diabetes which prohibited me from providing the requested information. I am committed to providing the information to FINRA. Even though my health still remains a concern, I will gather the requested information and provide it to FINRA before their requested date of June 25, 2011." The Commission, pursuant to delegated authority, denied Applicants' stay request, finding, among other things, that there did not appear to be a strong likelihood that Applicants would succeed on appeal nor did Applicants appear likely to suffer irreparable harm given that the suspensions could end anytime before June 25, 2011 if Applicants complied with FINRA's requests to provide information before that date.

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6 FINRA Rule 9552 provides that if a member or associated person fails to provide any information requested under FINRA's Rules, FINRA staff may provide written notice specifying the nature of the failure and stating that a failure to take corrective action within twenty-one days after service of the notice will result in a suspension.

The Commission subsequently issued a briefing order stating that Applicants' brief was due on May 23, 2011 and that, pursuant to Rule of Practice 180(c), failure to file a brief could result in dismissal of the proceeding. The Commission did not receive a brief from Applicants and accordingly dismissed their appeal on June 10, 2011. Applicants now ask the Commission to reconsider that dismissal because, they claim, their failure to file a brief was "due to illness."

We see no basis for reconsidering our dismissal of Applicants' petition for review. As noted earlier, reconsideration is an extraordinary remedy "designed to correct manifest errors of law or fact, or to permit the presentation of newly discovered evidence."[7] Applicants' motion fails to provide such grounds for reconsideration. Applicants provide no explanation for Sweat's alleged illness or how that illness affected Applicants' ability to file a brief in this matter. Applicants also filed their motion for reconsideration eleven days after the deadline for filing such motions without seeking an extension of time,[8] and the record provides no indication that Applicants have yet complied with FINRA's requests for information. Applicants' repeated failures to comply with regulatory requests for information and documents "indicate[] a risk to the regulatory system -- and the markets and investors it protects."[9]

Accordingly, IT IS ORDERED that the request of Kent D. Sweat and Intermountain Financial Services, Inc. for reconsideration be, and hereby is, DENIED.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

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7 *Perpetual Sec.*, 92 SEC Docket at 473.

8 Commission Rule of Practice 470(b) (stating that motions for reconsideration "shall be filed within 10 days after service of the order complained of").

9 *Morton Bruce Erenstein*, Exchange Act Rel. No. 56768 (Nov. 8, 2007), 91 SEC Docket 3114, 3128 (noting that a registered representative's failure to heed repeated warnings about his failure to respond to an information request "requir[ed] a sanction that will impress upon Erenstein the seriousness of his conduct and deter him from similar future misconduct"), *petition denied*, 316 F. App'x 865 (11th Cir. Sept. 16, 2008); *see also Paz Sec., Inc.*, Exchange Act Rel. No. 57656 (Apr. 11, 2008), 93 SEC Docket 5122 (sustaining NASD's imposition of a bar for applicants' failure to respond to repeated information requests), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

Chairman Schapiro
not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65118 / August 12, 2011

Admin. Proc. File No. 3-13998

In the Matter of

COBALIS CORPORATION
c/o Warren Nemiroff, Esq.
The Law Offices of Warren Nemiroff
120 S. El. Camino Drive, Ste. 206
Beverly Hills, CA 90212

ORDER DENYING MOTION FOR RECONSIDERATION

I.

On July 6, 2011, we issued an order and opinion (the "Opinion") revoking the registration of all classes of the registered securities of Cobalis Corporation (the "Company").[1] We found that the Company had violated Section 13(a) of the Securities Exchange Act of 1934[2] and Exchange Act Rules 13a-1 and 13a-13[3] by failing to file annual or quarterly reports for any period after December 31, 2007. The Opinion concluded that the protection of investors required revocation pursuant to Exchange Act Section 12(j).[4]

II.

On July 18, 2011, the Company filed a "Status Report and Response to the Opinion of the Commission." In that filing, the Company acknowledges its "failure to file periodic reports with the Commission, dating 2007 to present," but "report[s] that perhaps a decision has been made

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1 *Cobalis Corporation*, Securities Exchange Act Rel. No. 64813 (July 6, 2011), __ SEC Docket __.

2 15 U.S.C. § 78m(a).

3 17 C.F.R. §§ 240.13a-1, 13a-13.

4 15 U.S.C. § 78l(j).

that will place the company in a position to satisfy reporting requirements as much as humanly possible." As a result, the Company "recommend[s] that the matter of final revocation be tabled for one final 75 day period."[5]

We have construed the July 18, 2011 filing as a motion for reconsideration of the Opinion (the "Motion"), which we review under our Rule of Practice 470.[6] Under that rule, a motion for reconsideration "shall briefly and specifically state the matters of record alleged to have been erroneously decided, the grounds relied upon, and the relief sought."[7] Motions for reconsideration are granted only in exceptional cases where necessary "to correct manifest errors of law or fact, or to permit the presentation of newly discovered evidence."[8] They may not be used "to reiterate arguments previously made or to cite authority previously available."[9] Moreover, we will only accept additional evidence that "the movant could not have known about or adduced before entry" of the Opinion.[10] The Motion does not meet these rigorous standards for reconsideration.

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5 The Motion suggests that the Company misapprehends whether a "final order" revoking the registration of the Company's securities has been issued. On July 6, 2011, in connection with issuance of our opinion in this case, we ordered "that the registration of all classes of the registered securities of Cobalis Corporation . . . be, and it hereby is, revoked pursuant to Exchange Act Section 12(j)."

6 17 C.F.R. § 201.470.

7 *Id.*

8 *Barr Fin. Group, Inc.*, Investment Advisers Act Rel. No. 2202 (Dec 3, 2003), 81 SEC Docket 2911, 2912; *see also KPMG Peat Marwick LLP*, Order Denying Request for Reconsideration, 55 S.E.C. 1, 3 n.7 (2001) (stating that our analysis under Rule 470 is informed by the federal court practice of rejecting motions for reconsideration absent manifest errors of law or fact or newly discovered evidence, and finding that respondent was "foreclosed from resurrecting" an argument that had not been properly raised before the Commission previously); *Rockies Fund, Inc.*, Exchange Act Rel. No. 56344 (Aug. 31, 2007), 91 SEC Docket 1418, 1420 (rejecting a motion for reconsideration "based on a reworking of arguments and facts previously considered and rejected by the Commission and the Court of Appeals" as "an inappropriate attempt to avoid the finality of the Commission's administrative process").

9 *Manuel P. Asensio*, Exchange Act Rel. No. 62645 (Aug. 4, 2010), 99 SEC Docket 30990, 30991.

10 *Perpetual Sec.*, Exchange Act Rel. No. 56962 (Dec. 13, 2007), 92 SEC Docket 472, 473 & n.2 (quoting *Feeley & Willcox Asset Mgmt. Corp.*, 56 S.E.C. 1264, 1269 n.18 (2003)).

The Motion acknowledges the Company's longstanding failure to file required Exchange Act reports, and relies primarily on arguments previously considered and rejected in the Opinion. For instance, the Company argues that financial information for the periods from December 31, 2007 through March 31, 2009 will "continue[] to be beyond the ability of accountants and auditors to opine . . . until the present litigation [with a shareholder] is decided, which may not be until mid or late 2012." However, the Opinion rejected the Company's attempts to attribute its filing delinquencies to a third party or this ongoing litigation, stating that "the only matters relevant to a 12(j) proceeding" are "the fact of [an issuer's] failure to file its quarterly or annual reports" and "its present inability to cure these deficiencies." We further explained that "explanations for delinquent filings do not render such violations 'excusable.'"

The Motion states that the Company "now has accountants working on unaudited numbers" for financial periods beginning from March 31, 2009 "that will be ready for submission . . . on, or around, August 5th," and that "[i]t should then take another 30-45 days to audit the same." However, the Opinion considered the Company's previous repeated assurances regarding purportedly imminent filings, and the Company's failures to meet these self-imposed deadlines. The Motion appears to continue this pattern of assurances which, together with other factors addressed in the Opinion, "cast[] serious doubt on [the Company's] ability to prepare and file the delinquent reports and significantly undermine[] the credibility of its assurances against further violations." In any case, as the Opinion noted, "[e]ven when delinquent filings are made prior to our decision on appeal," we decline to:

> reward those issuers who fail to file required periodic reports when due over an extended period of time, become the subject of Exchange Act Section 12(j) revocation proceedings, and then, on the eve of hearings before the law judge or . . . on appeal, make last-minute filings in an effort to bring themselves current with their reporting obligations, while prolonging indefinitely the period during which public investors would be without accurate, complete, and timely reports . . . to make informed investment decisions.[11]

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[11] Quoting *Nature's Sunshine Products, Inc.*, Exchange Act Rel. No. 59268 (Jan. 21, 2009), 95 SEC Docket 13488, 13501.

The Company also states in its filing that its "financial records and tax returns" prior to December 2007 "probably mischaracterized significant outlays and expenditures." Such assertions do not constitute the kind of "newly discovered evidence" justifying reconsideration, but merely further confirm our doubts about the Company's ability to return to regulatory compliance.

Under the circumstances, we see no basis for altering our earlier conclusion that revocation of the Company's registration is necessary for the protection of investors, particularly in light of the public interest in finality in our administrative proceedings.[12]

Therefore, IT IS ORDERED that the motion for reconsideration filed by Cobalis Corporation be, and it hereby is, denied.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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[12] As we noted in the Opinion, the Company can file a Form 10 to re-register its securities if it is subsequently able to meet the applicable reporting requirements, notwithstanding its earlier revocation.

Commissioner Casey not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65124 / August 12, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14069

In the Matter of Timothy M. Gautney, Robert A. Bellia, Jr., and Erik S. Blum, Respondents.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO ROBERT A. BELLIA, JR.

I.

On September 27, 2010, the Securities and Exchange Commission ("Commission") initiated proceedings pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Robert A. Bellia ("Bellia" 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 Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 as to Robert A. Bellia Jr., as set forth below.

III.

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

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

1. These proceedings arise out of an investigation into the churning activities of registered representatives ("RRs") affiliated with Aura Financial Services, Inc. ("Aura"). Aura was a Birmingham, Alabama-based corporation which was registered with the Commission as a broker-dealer from February 1997 until February 2010.

2. Robert A. Bellia, Jr., 40, of Wantagh, New York, was a registered representative associated with Aura from June 2007 until August 2009. Bellia also owned Aura's branch office in Islandia, New York and served as its branch manager until January 2009. From August 1993 until he became registered with Aura in June 2007, Bellia had been associated with twelve other broker-dealers. During his entire career at Aura, Bellia was under heightened supervision due to FINRA disciplinary history for failing to supervise registered representatives at another broker-dealer.

3. Between at least January 2008 and December 2008 in Aura's former Islandia, New York branch office, two former RRs largely depleted the funds in seven of their customers' accounts through improper churning.[2] Bellia was responsible for supervising these two RRs.

4. Courts commonly use two metrics to determine whether an account has been churned: the account's "annualized turnover ratio" and its "cost to equity ratio," which is also known as its "break even percentage." An annualized turnover ratio is the number of times per year a customer's securities are replaced by new securities. It is calculated by determining the aggregate amount of purchases in an account over a given period, calculating the ratio of those aggregate purchases to the account's average net equity during that period, and then annualizing that ratio. A turnover rate that exceeds six is presumptive of churning. A cost to equity ratio or break even analysis determines the rate of return that an account has to earn on an annual basis just to cover transaction costs, and thus "break even." Trading practices that require an account to earn returns in excess of 20% just to break even are indicative of possible churning.

5. One RR ("RR1") supervised by Bellia churned the accounts of five Aura customers in violation of Section 10(b) and Rule 10b-5 of the Exchange Act. These customers had annualized turnover rates, as reflected in quarterly reports sent to Bellia, of 20 to 94 and cost to equity ratios of 87% to 2058%. Another Islandia representative ("RR2") churned the accounts of two Aura customers in violation of Section 10(b) and Rule 10b-5 of the Exchange Act. These customers had annualized turnover rates, as reflected in quarterly reports sent to Bellia, of 40 and 59 and cost to equity ratios of 144% and 418%, respectively.

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2 Churning is the excessive buying and selling of securities in a customer's account by a broker, for the purpose of generating commissions and without regard to the customer's investment objectives or interest or with the intent to defraud. For churning to occur, the broker must exercise control over the investment decisions in the account, either through a formal written discretionary agreement or otherwise, such as through the customer routinely accepting the broker's recommendations without question.

6. These seven customers opened and funded their accounts after being cold-called by, or otherwise introduced to, the RRs. They had their accounts aggressively traded, though none indicated to Aura an investment objective or risk tolerance supporting that trading. None of the seven customers had an understanding of the total transaction costs they were incurring by trading through Aura.

7. Aura's Written Supervisory Procedures ("WSP"), dated 2007-2008, and in effect during the time of the churning by the two RRs, stated, among other things, that an annualized turnover ratio greater than six:

> warrant[s] immediate attention and further review of a larger sample size, if applicable. The D[esignated] P[rincipal] should take immediate steps to determine that such trading activity is acceptable to the customer (acknowledgment by customer in writing may be sought), and conforms to the customer's objectives. Otherwise, steps may be taken to close the trading activity in the customer's accounts.

8. At least each quarter, Aura's Compliance Department provided Bellia with excerpts of a report containing annualized turnover ratios, break even ratios, and other account metrics for the largest commission producing accounts from his branch. Aura's active account letter procedure, which was unwritten, required Bellia to send such letters to all customers whose accounts had turnover ratios greater than six.

9. The active account letters, entitled "Intent to Maintain Active Account," did not explain why Aura was sending the letters to the customers and they were not sent along with cover letters. The body of the form letters did not identify the respective accounts as actively traded or that they had recently shown a certain number of trades or a certain amount of turnover, but stated that "certain clients may wish to engage in more frequent trading in their accounts." The letters included a general disclosure of the risks associated with "frequent" trading and numerous blanks for the customer to complete concerning numbers of trades over the past year, anticipated trades in the future year, investment objective, risk exposure, and other financial information. After the customer filled in the blanks, the firm's procedures contemplated that the customer would sign the letter and return it to the Aura branch where his account was located. If information in the returned active account letter did not indicate changes from the customer's original application, the returned active account letter was maintained at the branch office. According to Aura's Chief Compliance Officer, branch managers were supposed to call, or have an RR call, customers and send out additional active account letters if customers did not return their letters.

10. Bellia failed reasonably to supervise RR1, from January 2008 through December 2008, and RR2, from April 2008 through August 2008, while they were registered with Aura and subject to Bellia's supervision in Aura's Islandia, New York branch office. The level of trading in the accounts of RR1's customers and RR2's customers was not merely indicative of potential churning, but was extreme.

11. While Bellia supervised RR1 and RR2, during at least each quarter of 2008, Bellia received excerpts of reports from Aura's Compliance Department containing, among other account information, annualized turnover ratios and break even ratios for the largest commission producing accounts from his branch. These reports included the names of RR1 and RR2's churning victims, all of whom had at least double digit annualized turnover rates. The turnover rates listed were far in excess of the turnover rate of six that Aura's WSPs cautioned warranted immediate attention and review by the supervisor.

12. As reflected in the quarterly reports for 2008, RR1's victims had annualized turnover rates of 20 to 94 and cost to equity ratios of 87% to 2058%. With each successive quarter of 2008, RR1's victims grew in number or their turnover rates and cost to equity ratios increased in value. One of RR1's victims appeared on the report sent to Bellia in the first quarter with a turnover rate of 20 and a cost to equity ratio of 87%. In the second quarter, that victim's turnover rate increased to 43 and his cost to equity ratio increased to 188. In the third quarter, two of RR1's victims appeared on the report with turnover rates up to 59 and cost to equity ratios up to 2050%. By the fourth quarter, five of RR1's victims appeared on the report, with turnover rates up to 94 and cost to equity ratios up to 2058%. RR2's victims appeared on the report for the second quarter with annualized turnover rates of 40 and 59 and cost to equity ratios of 144% and 418%, respectively.[3]

13. Pursuant to Aura's Active Account Letter procedure, Bellia was required to send Active Account Letters to all customers with turnover rates exceeding six. Despite such requirements, and, notwithstanding that RR1 was under heightened supervision, Bellia and Aura were only able to produce Active Account Letters for two of RR1's five customers and for none of RR2's two customers. Bellia did not keep a log or otherwise track whether the letters were returned. When the letters did not come back, Bellia's practice was to direct the RRs to contact the customers. Bellia failed to take any steps to modify his practice in the face of repeated red flags of excessive trading in the RRs' customer accounts.

14. The failure to contact RR1's customers is particularly egregious because RR1 was on heightened supervision due to his disciplinary history. Additionally, RR1 had been the subject of six complaints from Aura customers during the relevant period. Two of the Aura customer complaints alleged churning and the other four alleged that customers had not in fact signed paperwork for their accounts. RR1 also was discharged from broker-dealers in 2002 and 2005, both times for unauthorized trading, and was permitted to resign from a broker-dealer in 2006 for unauthorized use of a sales script.

15. Bellia was aware of RR1's disciplinary history and was required to follow the firm's heightened supervisory procedures for RR1. Bellia testified that the heightened supervisory procedures he was required to perform included reviewing all of RR1's incoming and outgoing

[3] RR2 was voluntarily terminated from Aura in August 2008 for reasons purportedly unrelated to churning.

correspondence, reviewing all of RR1's trade tickets, and checking RR1's orders for suitability. It is unclear whether Bellia actually performed those extra procedures. Had he done so, additional red flags of RR1's churning would have been apparent. For example, if Bellia had been reviewing RR1's trade tickets and checking RR1's orders for suitability, then red flags of discrepancies between the objectives and risk tolerances of at least three of RR1's churning victims likely would have been apparent. Three of RR1's churning victims are reflected on the active account reports with investment objectives of capital appreciation and moderate risk tolerances.

16. Before coming to Aura in March 2008, RR2 had been associated with seventeen other broker-dealers since 2000, including prior tenures at Aura for two months in 2007 and six months in 2005. RR2's known history showed thirteen customer complaints, including two from Aura customers during the relevant period. One Aura customer complaint claimed damages of $69,000 from unauthorized trading; the other complaint claimed failure to follow customer instructions and settled for $12,500. In 2006, FINRA fined RR2 $15,000 and suspended him for ninety days for unauthorized trading while he was employed at another firm. Between 2006 and when he joined Aura for two months in May 2007, RR2 was either discharged or permitted to resign from three other broker-dealers for various reasons.

17. If Bellia had reasonably followed up on the red flags of high trading in the customer accounts of RR1 and RR2 or if he had diligently followed the heightened supervisory procedures for RR1, it is likely that he would have prevented or detected the RRs' violations of Section 10(b) and Rule 10b-5 of the Exchange Act.

18. As a result of the conduct described above, Bellia failed reasonably to supervise the RRs within the meaning of Section 15(b)(4)(E) of the Exchange Act, as incorporated by reference in Section 15(b)(6) of the Exchange Act.

19. Bellia has submitted a sworn Statement of Financial Condition dates November 17, 2010 and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 15(b)(6) of the Exchange Act, Bellia shall be, and hereby is barred from association in any capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

B. Bellia shall 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.

C. Bellia shall pay disgorgement of $5,959 and prejudgment interest of $901.40, but that payment of such amount is waived and the Commission foregoes the imposition of a civil penalty based upon Respondent's sworn representations in his Statement of Financial Condition dated November 17, 2010 and other documents submitted to the Commission.

D. The Division of Enforcement may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest should not be ordered; (3) contest the amount of disgorgement and interest to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

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. 65123 / August 12, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14504

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Daniel Cohen ("Cohen" 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 at least early 2008 through approximately August 2008, Cohen managed two sales offices in California that offered and sold securities issued by Delta Onshore Management, LLC. As the manager of these offices, he directed employees to sell the above-described securities, and he personally offered and sold them as well. In so doing, he participated at key points in the distribution of those securities and received compensation related to the transactions. No registration statement was filed with the Commission or in effect at the time of Respondent's offers or sales of the above-referenced securities; nor were the transactions exempt from registration. Further, Respondent was not registered with the Commission as a broker or dealer. Cohen, 35 years old, is a resident of Calabasas, California.

2. On March 22, 2011, a permanent injunction was entered by consent against Cohen, permanently enjoining him from future violations of Sections 5(a), and 5(c) of the Securities Act of 1933, and Section 15(a)(1) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Delta Onshore Management, LLC, et al., Civil Action Number 08-1278-MLB, in the United States District Court for the District of Kansas.

3. The Commission's complaint alleged that, in connection with the offering of the above-referenced securities, the named defendants collectively raised approximately $2.8 million from investors nationwide, over half of whom were 60 years old or older. The complaint alleged that the promoters hired sales agents, such as Respondent, to market the offering, and falsely advised the sales agents that they had acquired two drilling rigs that were "ready to go to work" earning annual returns of 25% to 36%. The sales agents marketed the securities by including this false information in their sales pitches to investors. In fact, at the time of the offering, the Delta Onshore venture had not acquired any drilling rigs, and investors received none of the promised returns.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940, Respondent Cohen 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; and 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.

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Walter
not participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 29753 / August 15, 2011

In the Matter of	)
	)
BAC HOME LOANS SERVICING, LP 6400 Legacy Drive Plano, TX 75024	)
	)
BOFA ADVISORS, LLC BOFA DISTRIBUTORS, INC. BANK OF AMERICA CAPITAL ADVISORS LLC 100 Federal Street Boston, MA 02110	)
	)
KECALP INC. MERRILL LYNCH VENTURES, LLC MERRILL LYNCH GLOBAL PRIVATE EQUITY INC. 767 Fifth Avenue, 7th Floor New York, NY 10153	)
	)
(812-13910)	)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

BAC Home Loans Servicing, LP ("HLS"), BofA Advisors, LLC, BofA Distributors, Inc., Bank of America Capital Advisors LLC, KECALP Inc., Merrill Lynch Ventures, LLC and Merrill Lynch Global Private Equity Inc. (collectively, "Applicants") filed an application on May 27, 2011 and amended it on June 1, 2011, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which HLS is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the United States District Court for the Central District of California on May 31, 2011.

On June 1, 2011, the Commission issued a temporary conditional order exempting Applicants from section 9(a) of the Act with respect to the above-referenced injunction until the

Commission took final action on an application for a permanent order or, if earlier, July 29, 2011 (Investment Company Act Release No. 29688). On July 18, 2011, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 29726) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the conduct of Applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by HLS et al. (File No. 812-13910), as amended, that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the United States District Court for the Central District of California on May 31, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 17, 2011

In the Matter of **Auriga Laboratories, Inc.,** **Curon Medical, Inc.,** **Goldstate Corp.,** **OneWorld Systems, Inc., and** **PracticeXpert, 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 Auriga Laboratories, Inc. because it has not filed any periodic reports since the period ended March 31, 2008.

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of OneWorld Systems, Inc. because it has not filed any periodic reports since the period ended December 31, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of PracticeXpert, Inc. because it has not filed any periodic reports since the period ended June 30, 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. EDT on August 17, 2011, through 11:59 p.m. EDT on August 30, 2011.

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. 65145 / August 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14506

In the Matter of Auriga Laboratories, Inc., Curon Medical, Inc., Goldstate Corp., OneWorld Systems, Inc., and PracticeXpert, 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 Auriga Laboratories, Inc., Curon Medical, Inc., Goldstate Corp., OneWorld Systems, Inc., and PracticeXpert, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Auriga Laboratories, Inc. ("ARGA") [1] (CIK No. 1072313) is a void Delaware corporation located in Camarillo, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ARGA is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2008, which reported a net loss of $1,265,267 for the prior three months. As of August 15, 2011, the common stock of ARGA was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

[1]The short form of each issuer's name is also its stock symbol.

2. Curon Medical, Inc. ("CRNM") (CIK No. 1114365) is a void Delaware corporation located in Fremont, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CRNM is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2006. On November 17, 2006, CRNM filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, which was still pending as of August 15, 2011. As of August 15, 2011, the common stock of CRNM was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Goldstate Corp. ("GDTT") (CIK No. 1050248) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GDTT 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 $29,483 for the prior three months. As of August 15, 2011, the common stock of GDTT was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. OneWorld Systems, Inc. ("OWLD") (CIK No. 875983) is a dissolved Delaware corporation located in Sunnyvale, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OWLD is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 1999, which reported a net loss of $8,057,000 for the prior nine months. As of August 15, 2011, the common stock of OWLD was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. PracticeXpert, Inc. ("PXPT") (CIK No. 1113679) is a revoked Nevada corporation located in Calabasas, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PXPT 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 $3,173,076 for the prior six months. As of August 15, 2011, the common stock of PXPT 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

6. 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.

7. 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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-65148; File No. S7-02-11]

RIN 3235-AK89

SUSPENSION OF THE DUTY TO FILE REPORTS FOR CLASSES OF ASSET-BACKED SECURITIES UNDER SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: Section 942(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminated the automatic suspension of the duty to file under Section 15(d) of the Securities Exchange Act of 1934 for asset-backed securities issuers and granted the Commission the authority to issue rules providing for the suspension or termination of such duty. We are adopting rules to provide certain thresholds for suspension of the reporting obligations for asset-backed securities issuers. We are also amending our rules relating to the Exchange Act reporting obligations of asset-backed securities issuers in light of these statutory changes.

EFFECTIVE DATE: **[insert date 30 days after publication in the Federal Register]**

FOR FURTHER INFORMATION CONTACT: Steven Hearne, Special Counsel, in the Office of Rulemaking, at (202) 551-3430 or Kathy Hsu, Chief, Office of Structured Finance, Division of Corporation Finance, at (202) 551-3850, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are adopting amendments to Rules 12h-3, 12h-6, and 15d-22[1] and Form 15[2] under the Securities Exchange Act of 1934 ("Exchange Act").[3]

I. Background and Overview of the Amendments

Section 942(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act")[4] eliminated the automatic suspension of the duty to file under Section 15(d)[5] of the Exchange Act for asset-backed securities ("ABS") issuers and granted the Commission the authority to issue rules providing for the suspension or termination of such duty. We proposed amendments on January 6, 2011 to provide for the suspension of reporting obligations for ABS issuers under certain circumstances and to revise our rules in light of the amendment of Exchange Act Section 15(d).[6] In this release, we are adopting the rule amendments with some changes to reflect comments we received on the proposed amendments.

Exchange Act Section 15(d) generally requires an issuer with a registration statement that has become effective pursuant to the Securities Act of 1933[7] ("Securities Act") to file ongoing Exchange Act reports with the Commission. Prior to enactment of the Act, Exchange Act Section 15(d) provided that for issuers without a class of securities registered

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1 17 CFR 240.12h-3, 17 CFR 240.12h-6, and 17 CFR 240.15d-22.

2 17 CFR 249.323.

3 15 U.S.C. 78a et seq.

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

5 15 U.S.C. 78o(d).

6 Suspension of the Duty to File Reports for Classes of Asset-Backed Securities Under Section 15(d) of the Securities Exchange Act of 1934, Release No. 34-63652 (Jan. 6, 2011) [76 FR 2049] (the "Proposing Release").

7 15 U.S.C. 77a et seq.

under the Exchange Act the duty to file ongoing reports is automatically suspended as to any fiscal year, other than the fiscal year within which the registration statement for the securities became effective, if the securities of each class to which the registration statement relates are held of record by less than 300 persons. As a result, the reporting obligations of ABS issuers,[8] other than those with master trust structures,[9] were generally suspended after the ABS issuer filed one annual report on Form 10-K because the number of record holders was below, often significantly below, the 300 record holder threshold.[10]

The Act removed any class of ABS from the automatic suspension provided in Exchange Act Section 15(d) by inserting the phrase, "other than any class of asset-backed securities." Consequently, ABS issuers no longer automatically suspend reporting under Exchange Act Section 15(d). Instead, the Act granted the Commission authority to "provide for the suspension or termination of the duty to file under this subsection for any class of asset-backed security, on such terms and conditions and for such period or periods as the

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8 ABS offerings are typically registered on shelf registration statements and each ABS offering is typically sold in a separate "takedown" off of the shelf. In 2004, the Commission adopted Exchange Act Rule 15d-22 relating to ABS reporting under Exchange Act Section 15(d). Exchange Act Rule 15d-22 codified the staff position regarding the starting and suspension dates for any reporting obligation with respect to a takedown of ABS and clarified that a new takedown for a new ABS offering off the same shelf registration statement did not necessitate continued reporting for a class of securities from a prior takedown that was otherwise eligible to suspend reporting. See Asset-Backed Securities, Release No. 33-8518 (Dec. 22, 2004) [70 FR 1506] (the "ABS Adopting Release").

9 In a securitization using a master trust structure, the ABS transaction contemplates future issuances of ABS backed by the same, but expanded, asset pool that consists of revolving assets. Pre-existing and newly issued securities would therefore be backed by the same expanded asset pool. Thus, given their continued issuance, master trust ABS issuers typically continue to report, even after the first annual report is filed.

10 One source noted that in a survey of 100 randomly selected asset-backed transactions, the number of record holders provided in reports on Form 15 ranged from two to more than 70. The survey did not consider beneficial owner numbers. See Committee on Capital Markets Regulation, The Global Financial Crisis: A Plan for Regulatory Reform, May 2009, at fn. 349.

Commission deems necessary or appropriate in the public interest or for the protection of investors."[11]

We proposed new Exchange Act Rule 15d-22(b) to provide for suspension of the reporting obligations for a given class of ABS pursuant to Exchange Act Section 15(d) under certain limited circumstances. In addition, we proposed to update Exchange Act Rule 15d-22 to indicate when annual and other reports need to be filed and when starting and suspension dates are determined with respect to a takedown.

We received seven comment letters in response to the proposed amendments.[12] These letters came from four professional associations, a law firm, an individual and an institutional investor. We have reviewed and considered all of the comments that we received on the proposed amendments. Most commentators supported the Commission's goal of providing full and transparent disclosure to investors in ABS. Comments on the proposal were mixed. Two commentators supported the proposed standard without revisions.[13] Other commentators suggested revisions to the proposed standard, which are described below.[14] Further, two commentators recommended permitting commercial mortgage-backed securities to suspend reporting after one year.[15] The adopted rules reflect

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11 15 U.S.C. 78o(d)(2).

12 The public comments we received are available on our website at http://www.sec.gov/comments/s7-02-11/s70211.shtml. See letters from the American Securitization Forum ("ASF"), Chris Barnard ("Barnard"), Cleary, Gottlieb, Steen, & Hamilton LLP ("Cleary"), CRE Finance Council ("CREFC"), Investment Company Institute ("ICI"), MetLife, Inc. ("MetLife"), and Mortgage Bankers Association ("MBA").

13 See letters from ICI and Barnard.

14 See letters from ASF, Cleary and Metlife.

15 See letters from CREFC and MBA. These commentators recommended that such securities be permitted to suspend reporting under the old Section 15(d) standard, which previously allowed issuers of securities to suspend Exchange Act reporting typically after the first year of reporting. In support of differential treatment, the commentators pointed to the "Annex A" initial disclosure package and the "Investor Reporting Package" used in the commercial mortgage-backed securities market, suggesting these materials, along with certain "best practices" projects, provide most, if not all, of the information

changes made in response to comments. We explain our revisions with respect to each proposed rule amendment in more detail throughout this release.

II. Discussion of the Amendments

As indicated above, Exchange Act Section 15(d), as amended by the Act, establishes an ongoing reporting obligation for each class of ABS for which an issuer has filed a registration statement that has become effective pursuant to the Securities Act. Exchange Act Section 15(d) also grants the Commission authority to provide for the suspension or termination of the duty to file. We are adopting amendments with changes made in response to comments to provide limited relief from these reporting obligations in a manner that we believe is appropriate in the public interest and consistent with the protection of investors. In addition, we are adopting rule and form amendments, substantially as proposed, to update our rules relating to ABS takedowns under a shelf registration statement.

A. Suspension of Exchange Act Section 15(d) Reporting Obligation

1. Proposed Amendments

In the Proposing Release, we proposed amended Exchange Act Rule 15d-22(b) to provide for suspension of the reporting obligations for a given class of ABS pursuant to Exchange Act Section 15(d) under certain limited circumstances.[16] As revised by the Act, Exchange Act Section 15(d) no longer provides for the automatic suspension of the duty to file periodic and other reports for issuers of a class of ABS. Without action by the Commission, ABS issuers that have filed a registration statement that has become effective

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that would be required to be included in the Section 15(d) reports, and such materials are required to be provided to investors on a timely basis under the Investor Reporting Package standards.

16 See the Proposing Release supra note 6.

pursuant to the Securities Act or that have conducted a takedown off of a shelf registration statement, would be obligated to continue to file such reports for the life of the security.

In the Proposing Release, we noted that post-issuance reporting of information by an ABS issuer provides investors and the market with transparency regarding many aspects of the ongoing performance of the securities and the servicer in complying with servicing criteria and that such transparency is valuable in evaluating transaction performance and making ongoing investment decisions. We also indicated our belief that the benefits of ongoing reporting to investors and the market where there are only affiliated holders of the ABS are limited and would not justify the burden of reporting by those issuers. Consequently, we proposed amended Exchange Act Rule 15d-22(b), which would provide that the reporting obligation regarding any class of ABS is suspended for any fiscal year, other than the fiscal year within which the registration statement became effective, if, at the beginning of the fiscal year there are no longer any securities of such class held by non-affiliates of the depositor that were sold in the registered transaction. We also proposed to amend Form 15 to add a checkbox for ABS issuers to indicate that they are relying on proposed Exchange Act Rule 15d-22(b) to suspend their reporting obligation alerting the market and the Commission of the change in reporting status.

2. Comments on the Proposed Amendments

Commentators generally supported an amendment that would provide for the suspension of the reporting obligation for ABS.[17] The commentators expressed varying levels of support for the Commission's proposed Exchange Act Rule 15d-22(b):

[17] See letters from ASF, Barnard, Cleary, CREFC, ICI, MetLife, and MBA.

- Two commentators supported the proposal without changes;[18]
- One commentator recommended a more stringent standard;[19]
- One commentator expressed general support for the proposal subject to specific comments on the language of the proposal;[20]
- One commentator suggested expanding the set of circumstances when ABS issuers may suspend reporting;[21] and
- Two commentators suggested allowing suspension for commercial mortgage-backed securities issuers after one year in keeping with the Section 15(d) standard as it existed prior to the adoption of Section 942(a) of the Act amending Exchange Act Section 15(d).[22]

The proposed rule would have required an issuer to assess whether there were any securities held by non-affiliates of the depositor at the beginning of the fiscal year. One commentator recommended accelerating the timing of when an issuer may assess whether it may suspend reporting to enable an issuer to suspend reporting once there are no non-affiliated holders or in the alternative, monthly.[23] In addition, this commentator

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18 See letters from Barnard and ICI.

19 See letter from MetLife recommending permitting suspension "only if (a) ABS of a particular class are no longer held by non-affiliates of the depositor and (b) the transaction has matured (i.e. the collateral has been liquidated from the trust or otherwise been fully amortized) or been redeemed or called by the servicer."

20 See letter from ASF recommending various changes to the proposed language discussed in more detail below.

21 See letter from Cleary recommending permitting suspension or termination of reporting in two additional circumstances: (1) where an ABS is backed by a sufficient concentration of obligations of an entity (e.g., repackagings) and reference information under Item 1100(c)(2) of Regulation AB (17 CFR 229.1100(c)(2)) is unavailable and (2) where investors voted for termination after a period of public reporting.

22 See letters from CREFC and MBA.

23 See letter from ASF.

recommended that the Commission amend the proposed rule to clarify that, at such time as none of an issuer's registered ABS remain outstanding, the issuer may immediately cease ongoing Exchange Act reporting.[24] In contrast, some commentators supported the timing of the assessment,[25] and one commentator recommended requiring an issuer to re-assess its reporting obligation, including after suspension, every six months and further recommended including an anti-avoidance provision.[26]

Some commentators recommended specific revisions to the proposed text of the rule. The proposed rule would have provided that the issuer may not suspend reporting in the "fiscal year within which the registration statement became effective." One commentator recommended that the Commission revise the language to instead refer to the "fiscal year within which the takedown occurred" to provide additional clarity on the application of the rule as it relates to shelf offerings.[27] In addition, the proposed rule would provide for suspension of reporting obligations in any fiscal year when there "are no longer any securities of such class held by non-affiliates of the depositor." Two commentators noted that ABS are often held of record by a custodian or broker on behalf of underlying beneficial owners and suggested that the test should look to the underlying beneficial owners of the securities.[28] In addition, one commentator recommended using the term "are not" rather than saying there "are no longer" any securities of such class held by non-affiliates of the

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24 Id.

25 See letters from Barnard and ICI.

26 See letter from MetLife. MetLife expressed concern that there are possible scenarios where a depositor or its affiliates could potentially acquire all registered ABS securities of a particular class that were not held by such entities prior to the Section 15(d) re-assessment determination date and then re-sell such securities to non-affiliates in secondary transactions during the course of the fiscal year.

27 See letter from ASF.

28 See letters from ASF and MetLife.

depositor that were sold in the registered transaction to avoid any implication that the ABS must have been previously held by one or more non-affiliates.[29]

3. Final Rule

After considering the comments, we are adopting amendments to our rules to provide for suspension of the reporting obligations for a given class of ABS pursuant to Exchange Act Section 15(d) as proposed with some changes as recommended by commentators. As adopted, Exchange Act Rule 15d-22(b) provides that the duty to file annual and other reports under Section 15(d) is suspended:

- As to any semi-annual fiscal period, if, at the beginning of the semi-annual fiscal period, other than a period in the fiscal year within which the registration statement became effective or, for shelf offerings, the takedown occurred, there are no ABS of such class that were sold in a registered transaction held by non-affiliates of the depositor and a certification on Form 15 has been filed;[30] or
- When there are no ABS of such class that were sold in a registered transaction still outstanding, immediately upon the filing with the Commission of a certification on Form 15 if the issuer has filed all required reports for the most recent three fiscal years.[31]

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29 See letter from ASF.

30 The final rule clarifies that the issuer must make its determination as of the beginning of the semi-annual fiscal period and file a certification on Form 15 in the semi-annual fiscal period within which the issuer suspends its reporting obligation.

31 The final rule, consistent with Exchange Act Rule 12h-3, also states that if the certification on Form 15 is withdrawn or denied, the issuer is obligated, within 60 days, to file all reports that would have been required if such certification had not been filed. The final rule provides conditions for the immediate suspension of reporting that are not required when the issuer suspends reporting after its semi-annual assessment that may help to reduce confusion or gaps in reporting upon immediate suspension and are consistent with the conditions established under Exchange Act Rule 12h-3.

In addition, the final rule amends Form 15 to add a checkbox for ABS issuers to indicate that they are relying on Exchange Act Rule 15d-22(b) to suspend their reporting obligation and adds two Notes to paragraph (b). Note 1 indicates that securities held of record by a broker, dealer, bank or nominee shall be considered as held by the separate accounts for which the securities are held. Note 2 includes an anti-avoidance provision, as described below.

In response to comments, Exchange Act Rule 15d-22(b) has been changed from the proposal in the following ways:

- The final rule provides for the timing of the suspension of the duty to file to be tested at the beginning of the semi-annual fiscal period rather than annually as proposed. The semi-annual assessment provided in the final rule requires an issuer to assess whether it is required to report more often than the proposed rule. The increased frequency of the required assessment seeks to alleviate concerns regarding reporting and information gaps that could occur with annual assessments by making it harder to evade the reporting requirements as well as reduce costs imposed by requiring reporting for the remainder of the year when the ABS are held solely by affiliates of the depositor.[32] We do not believe more frequent assessments to allow suspension are appropriate because if conducted more frequently, these assessments might result in an ABS issuer frequently changing its reporting status and thereby result in less continuity in its annual and other reports and the creation of disclosure gaps that could be detrimental to investors' ability to evaluate ABS performance and make ongoing investment decisions.

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32 See letters from ASF and MetLife. The final rule requires ABS issuers, like other issuers that must comply with Section 15(d), to assess periodically whether they may suspend their duty to file. Pursuant to Section 15(d) and our rules, issuers may be permitted to suspend their duty to file after one assessment, but may be required to recommence reporting after a subsequent assessment.

- The final rule provides that an issuer of ABS may not suspend reporting "in the fiscal year within which the registration statement became effective, or, for offerings conducted pursuant to §230.415(a)(1)(vii) or §230.415(a)(1)(x), the takedown for the offering occurred." The language was revised in response to comments to provide additional clarity on the application of the rule as it relates to shelf offerings.[33]
- The final rule uses the term "there are no asset-backed securities" rather than the proposed "there are no longer any asset-backed securities" to avoid any implication that the ABS must have been held by one or more non-affiliates.[34]
- The final rule specifically provides for the immediate suspension upon filing of a Form 15 of the duty to file when there are no ABS of a class that were sold in a registered transaction still outstanding subject to conditions that are consistent with similar conditions in Exchange Act Rule 12h-3.[35] As requested, the final rule makes clear that an issuer may immediately suspend reporting when the securities have been retired or fully paid. In providing for immediate suspension in our rules, we have also added obligations that are consistent with similar conditions in Exchange Act Rule 12h-3 and may help reduce possible confusion or gaps in reporting that could occur with an immediate suspension of reporting.
- The final rule adds a Note to paragraph (b) of Exchange Act Rule 15d-22 clarifying that securities held of record by a broker, dealer, bank or nominee for any of them for the accounts of customers are considered held by the separate accounts for which they are held. Thus, if an investment bank is an ABS issuer and holds securities in its

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33 See letter from ASF.

34 See letter from ASF.

35 See letter from ASF.

name for the benefit of other non-affiliated investors, it cannot suspend reporting. Conversely, if an unaffiliated bank or broker holds ABS for affiliates of the ABS issuer, the unaffiliated status of the broker or bank will not preclude suspension of reporting.[36]

- The final rule adds a Note to paragraph (b) of Exchange Act Rule 15d-22(b) providing that an issuer may not suspend reporting if securities are acquired and resold by affiliates as part of a plan or scheme to evade the reporting obligations of Section 15(d).[37]

The proposal and the final rules that we are adopting today sought to provide for the suspension of the reporting obligation for a given class of ABS under limited circumstances. Two commentators requested that commercial mortgage-backed securities issuers be permitted to suspend reporting based on the use of their industry reporting standards.[38] We are not adopting those recommendations because we believe that there are benefits to investors and the market of uniform disclosure standards provided by Regulation AB and public access to such uniform disclosure, and that such an approach is more consistent with Exchange Act Section 15(d), as amended by the Act. In addition, we are not adopting another commentator's recommendations to permit suspension of reporting for repackaging ABS where reference issuers stop reporting or to permit suspension where requested by a majority of holders.[39] We are not adopting the recommendation regarding repackaging transactions because the concentration of the significant obligor in the asset pool makes the

36 See letter from ASF and MetLife.

37 See letter from MetLife and note 26. This change should address the concern described by MetLife.

38 See letters from CREFC and MBA.

39 See letter from Cleary.

information material. The need for the information about the underlying issuer in the reports for the ABS does not change due to a change in the reporting status of the underlying issuer.[40] In addition, we are not adopting the recommendation to permit suspension where requested by a majority of investors because any such suspension would limit the information available to investors and the marketplace for ABS with non-affiliated holders and could result in a reduction of the minority holders ability to sell and the price at which they may be able to sell their securities.

B. Revisions to Existing Exchange Act Rule Provisions

In light of the statutory changes to Exchange Act Section 15(d), we proposed to revise Exchange Act Rule 15d-22 to indicate when annual and other reports need to be filed and when starting and suspension dates are determined with respect to a takedown. We also proposed to amend Exchange Act Rule 12h-3(b)(1) to conform the rule to the language of amended Exchange Act Section 15(d) and to add a clarifying note.

1. Proposed Amendments

We proposed to amend Exchange Act Rule 15d-22 to retain the approach relating to separate takedowns in current Exchange Act Rules 15d-22(a) and 15d-22(b) in a revised Exchange Act Rule 15d-22(a). Under the amendments we proposed, Exchange Act Rule 15d-22(a)(1) would provide that with respect to an offering of ABS sold off the shelf pursuant to Securities Act Rule 415(a)(1)(x),[41] the requirement to file annual and other reports pursuant to Exchange Act Section 15(d) regarding a class of securities commences upon the first bona fide sale in a takedown of securities under the registration statement.

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40 See the ABS Adopting Release at 1554.

41 17 CFR 230.415(a)(1)(x).

Under the amendments we proposed, Exchange Act Rule 15d-22(a)(2) would establish that the requirement to file annual and other reports pursuant to Exchange Act Section 15(d) regarding a class of securities is determined separately for each takedown of securities under the registration statement. Exchange Act Rule 15d-22(c) would remain substantially unchanged, except for minor revisions to reflect the amendments discussed above. Finally, under the amendments we proposed, Exchange Act Rule 12h-3(b)(1) would exclude ABS from the classes of securities eligible for suspension (tracking the language of the Exchange Act) and a note would be added to Exchange Act Rule 12h-3 to direct ABS issuers to Exchange Act Rule 15d-22 for the requirements regarding suspension of reporting for ABS.

2. Comments on the Proposed Amendments

Commentators expressed general support, and no commentators provided specific comment on these proposed revisions.[42]

3. Final Rule

After further consideration, we are adopting the amendments to our rules relating to when annual and other reports need to be filed and when starting and suspension dates are determined with respect to a takedown substantially as proposed.[43] We are also adopting the changes to Exchange Act Rule 12h-3(b)(1) to conform the rule to the language of amended Exchange Act Section 15(d), and provide a clarifying note to Exchange Act Rule 12h-3(b)(1) as proposed. In addition to the changes to Exchange Act Rule 12h-3 that we proposed, we are adding a clarifying note to Exchange Act Rule 12h-6 directing foreign private issuers that

42 See letters from ASF and Barnard.

43 As adopted we are including a reference to Securities Act Rule 415(a)(1)(vii).

are ABS issuers to Exchange Act Rule 15d-22 for the requirements regarding suspension of reporting of ABS.

III. Paperwork Reduction Act

A. Background

Certain provisions of the disclosure rules and forms applicable to ABS issuers contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[44] The Commission published a notice requesting comment on the collection of information requirements in the Proposing Release for the amendments, and submitted these requirements to the Office of Management and Budget for review in accordance with the PRA.[45] 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 affected collections of information are:

(1) "Form 10-K" (OMB Control No. 3235-0063);

(2) "Form 10-D" (OMB Control No. 3235-0604);

(3) "Form 8-K" (OMB Control No. 3235-0288); and

(4) "Form 15" (OMB Control No. 3235-0167).

Compliance with the information collections is mandatory. Responses to the information collections are not kept confidential and there is no mandatory retention period for the collections of information.

Our PRA burden estimate for Form 10-K, Form 8-K and Form 15 is based on an average of the time and cost incurred by all types of public companies, not just ABS issuers,

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[44] 44 U.S.C. 3501 et seq.

[45] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

to prepare the collection of information. Form 10-D is a form that is only prepared and filed by ABS issuers. Form 10-D is filed within 15 days of each required distribution date on the ABS, as specified in the governing documents for such securities, containing periodic distribution and pool performance information.

Our PRA burden estimates for the collections of information are based on information that we receive on entities assigned to Standard Industrial Classification Code 6189, the code used by ABS issuers, as well as information from outside data sources.[46] In the Proposing Release, we based our estimates on an average of the data that we have available for years 2004 through 2009. In some cases, our estimates for the number of ABS issuers that file Form 10-D with the Commission are based on an average of the number of ABS offerings in 2006 through 2009.[47]

In the Proposing Release we requested comment on the PRA analysis. No commentators responded to our request for comment on the PRA analysis. Subsequent to the enactment of the Act, the number of Forms 10-K, 8-K and 10-D filed by ABS issuers is expected to increase each year by the number of ABS registered offerings and the number of Forms 15 filed by ABS issuers is expected to decrease by a similar number.

The amendments provide for ABS issuers to suspend their reporting obligation under certain circumstances. While we expect that some issuers will be able to suspend their reporting obligations in the future as a result of the rules we adopt today, for purposes of the PRA, we estimated that the proposal will not affect our PRA estimates over the next three

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

47 Form 10-D was not implemented until 2006. Before implementation of Form 10-D, ABS issuers often filed their distribution reports under cover of Form 8-K.

years.[48] We also estimated that the amendments to Exchange Act Rule 15d-22 relating to reporting and shelf registration and Exchange Act Rule 12h-3 to conform the rule to Exchange Act Section 15(d) will not affect our PRA estimates.

The amendments are generally consistent with our proposals, although the amendments do provide for semi-annual assessment, rather than an annual assessment, and provide for immediate suspension of reporting when there are no outstanding ABS. We do not believe that the changes from our proposal will affect our PRA estimates.

As indicated above, we do not estimate that the final rules will affect our PRA estimates over the next three years, however, as explained in further detail in the Proposing Release, the Act's amendment to Section 15(d) is expected to effect the number of periodic and current reports and Forms 15 filed by ABS issuers each year.

We are revising our estimates to reflect 2010 data regarding ABS filings. In the Proposing Release we based our estimates for the number of ABS issuers on an average of the data that we have available for years 2004 through 2009. The yearly average of ABS registered offerings with the Commission over the period from 2004 to 2009 was 958. The yearly average of ABS registered offerings with the Commission over the period from 2005 to 2010, a similar 6-year period, was 751.[49] As a result, for PRA purposes, we are updating

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48 Since historical data on the numbers of classes of ABS that reduce their non-affiliated holders to zero is not generally available, we are using statistics relating to average expected deal life to establish our PRA estimate. Statistics compiled from SDC Platinum suggest that the average expected deal life of a class of ABS is over 5 years.

49 We have chosen to continue using a six year average to estimate the number of ABS registered offerings despite the significant drop off in filings after 2007. As discussed in the Proposing Release, in order to estimate the number of Forms 10-K, Forms 10-D, Forms 8-K, and Forms 15 filed by ABS issuers for PRA purposes, we average the estimate of the number of those forms over three years. For the first year of our average, we are using an updated number of 751 as an estimate for the number of issuers we expect to file Forms 10-K, Forms 10-D and Forms 8-K. In the second year, we increase our estimate by 751 to a total of 1,502 and in the third year, the addition of another 751 brings the total to 2,253. The average number of issuers that we expect to file forms over three years would, therefore, be 1,502, however 751 of those issuers would have filed forms prior to the statutory change. We

our estimates of annual increases in Form 10-K filings to 751 filings,[50] in Form 10-D filings to 4,506 filings,[51] and in Form 8-K to 1,127 filings[52] and reducing the annual decrease in Form 15 filings to 751 filings.[53] In addition, consistent with our estimate in the Proposing Release that an average of six Form 10-D filings will be filed annually instead of ten Form 10-D filings, which forms the basis of the current PRA inventory for Form 10-D, we are reducing our current inventory of annual responses to Form 10-D to reflect the new annual estimate.

In summation, we estimate, for PRA purposes, increases of 90,120 total burden hours for Form 10-K (751 Forms 10-K times 120 burden hours per filing), 135,180 total burden hours for Form 10-D (4,506 Forms 10-D times 30 burden hours per filing), and 5,635 total burden hours for Form 8-K (1,127 Forms 8-K times 5 burden hours per filing), as well as a decrease of 1,127 total burden hours for Form 15 (751 Forms 15 times 1.5 burden hours per filing) as a result of the statutory changes to Exchange Act Section 15(d).[54] We allocate 75% of those hours (an increase of 67,590 hours for Form 10-K, 101,385 hours for Form 10-D, and 4,226 hours for Form 8-K) to internal burden and the remaining 25% to external costs

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reduce the estimated increase by 751 to account for those issuers. We are therefore increasing our estimate by 751 issuers to account for the increase in the number of issuers that will be required to file reports as a result of the statutory change. See the Proposing Release supra note 6 at note 30.

50 As discussed above, we estimate that an additional 751 issuers will be required to file reports as a result of the statutory change. We continue to estimate that each ABS issuer would have one annual Form 10-K filing.

51 We continue to estimate that each ABS issuer would have six annual Form 10-D filings resulting in 4,506 additional Form 10-D filings (751 ABS issuers x 6 filings) as a result of the statutory change.

52 We continue to estimate that each ABS issuer would have 1.5 annual Form 8-K filings resulting in 1,127 additional Form 8-K filings (751 ABS issuers x 1.5 filings) as a result of the statutory change.

53 As indicated in the Proposing Release, we assume that in any given year the issuers of all registered ABS issued in the prior year would have suspended reporting using Form 15. After the implementation of the Act, issuers are no longer able to automatically suspend reporting; therefore, Form 15 will no longer be used by these ABS issuers as it was in the past. As a result, for the purposes of PRA, we estimate a decrease in Form 15 filings of 751.

54 We allocate all of the burden for Form 15 filings to internal burden hours.

using a rate of $400 per hour (an increase of $9,012,000 for Form 10-K, $13,518,000 for Form 10-D and $563,500 for Form 8-K). In addition, we estimate, for PRA purposes, a decrease in total burden hours due to a change in agency estimate of the number of annual Form 10-D filings of 120,000 (4,000 Form 10-D filings times 30 burden hours per filing). We allocate 75% of those hours to internal burden (a decrease of 90,000) and the remaining 25% to external costs using a rate of $400 per hour (a decrease of $12,000,000).

The table below illustrates the changes in annual compliance burden in the collection of information in hours and costs for existing reports for ABS issuers as a result of the statutory changes mandated by the Act as well as the reduction in the estimated number of Form 10-D filings described above.

Form	Current Annual Responses	Proposed Annual Responses	Current Burden Hours	Decrease or Increase in Burden Hours	Proposed Burden Hours	Current Professional Costs	Decrease or Increase in Professional Costs	Proposed Professional Costs
10-K	13,545	14,296	21,363,548	67,590	21,431,138	2,848,473,000	9,012,000	2,857,485,000
10-D	10,000	10,506	225,000	11,385	236,385	30,000,000	1,518,000	31,518,000
8-K	115,795	116,922	493,436	4,226	497,662	54,212,000	563,500	54,775,500
15	3,000	2,249	4,500	(1,127)	3,373	0	0	0

IV. Benefit-Cost Analysis

Exchange Act Section 15(d) generally establishes an ongoing reporting obligation for issuers with a registration statement that has become effective pursuant to the Securities Act. Prior to enactment of the Act, Exchange Act Section 15(d) provided that for issuers without a class of securities registered under the Exchange Act the duty to file ongoing reports is automatically suspended as to any fiscal year, other than the fiscal year within which the registration statement for the securities became effective, if the securities of each class to which the registration statement relates are held of record by less than 300 persons. The Act amended Exchange Act Section 15(d) to eliminate the automatic suspension of the duty to file ongoing Exchange Act reports for ABS issuers and granted the Commission authority to issue rules providing for the suspension or termination of such duty. The Commission is exercising its authority under the Exchange Act, as amended by the Act, by amending Exchange Act Rules 12h-3, 12h-6 and 15d-22 to provide for the suspension of the duty to file for certain ABS issuers and reduce their compliance costs as discussed in this release.[55]

The Commission is sensitive to the benefits and costs imposed by the rules it is amending. The discussion below focuses on the benefits and costs of the decisions made by the Commission in the exercise of its new exemptive authority provided by the Act, rather than the costs and benefits of the Act itself.

A. Benefits

The amendments the Commission is adopting allow an issuer to suspend reporting under certain circumstances and update certain provisions relating to reporting obligations under a shelf registration statement. Providing for issuers to suspend reporting would provide the benefit of allowing those issuers that are now required by the Act to continue reporting to avoid the costs of preparing and filing annual and periodic reports with the Commission when only affiliates of the depositor hold any outstanding securities of the classes sold in registered transactions.

We believe that reporting of the ongoing performance of an ABS is useful to investors and the market by providing readily accessible information upon which investors may evaluate performance and make ongoing investment decisions. We also recognize, however, that there are circumstances where the costs do not justify the benefits of reporting

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55 The proposed amendments to Exchange Act Rules 12h-3, 12h-6 and 15d-22(a) and (c) do not substantively alter the current requirements and should help issuers comply with their obligations and avoid confusion.

to investors and the market. In adopting rules to provide for the suspension or termination of the duty to file for certain ABS issuers, we have sought to balance the value of the information to investors and the market with the burden on the issuers of preparing the reports. More specifically, we believe that when there are only affiliated holders of the ABS, those affiliates will generally be able to receive relevant information because of their relationship with the depositor. Therefore, we are adopting new Exchange Act Rule 15d-22(b) to provide for issuers to suspend their reporting obligation under Section 15(d), as to any semi-annual fiscal period, if, at the beginning of the semi-annual fiscal period, there are no longer ABS of the class that were sold in a registration statement held by non-affiliates of the depositor and a certification on Form 15 has been filed.

We originally proposed that ABS issuers assess annually whether non-affiliates hold the ABS sold in registered transactions. We recognize that there is a trade-off between allowing the assessment to take place too frequently or not frequently enough. If the assessment is conducted frequently, it might result in an ABS issuer changing its reporting status often with the effect of less continuity in its annual and other reports. Reporting gaps could be detrimental to investors' ability to evaluate ABS performance and make ongoing investment decisions. However, more frequent assessments will allow an ABS issuer to report less and cease reporting as soon as non-affiliates no longer hold its securities, thus reducing the issuer's reporting burden and associated costs. Less frequent assessment of whether only affiliates hold the registered ABS issued, might result in unnecessary continued reporting until the assessment is made, up to 12 months for an annual assessment. The new Exchange Act Rule 15d-22(b) allows for semi-annual assessment, which we believe appropriately balances these competing interests.

B. Costs

In revising Exchange Act Section 15(d), Congress exhibited an intent to increase the continued reporting by ABS issuers, but gave the Commission authority to place limitations on that reporting in the public interest. The Commission exercised this authority and is adopting amendments allowing ABS issuers to suspend their reporting obligation under certain limited conditions. Providing for the suspension of reporting limits the ability of market participants to access and review information for those ABS that suspend reporting. We believe that this cost is mitigated under these conditions, since affiliates will generally be able to receive relevant information because of their relationship with the depositor. Thus, only non-holders of a particular ABS are affected. Furthermore, the utility of the information to market participants is limited since ABS owned solely by affiliates generally have no public market.

We recognize that there are additional costs to assessing holders semi-annually and preparing ongoing disclosure for registered transactions relative to the costs of issuing in the private markets. An issuer's decision about whether to issue registered ABS may be affected by the threshold at which issuers may suspend their reporting obligations under Section 15(d). We solicited comments on whether an alternative suspension threshold might mitigate this effect or be more appropriate for other reasons. Although three commentators responded to our request with suggested alternatives, we are not adopting those alternatives, as discussed in Section II.A.3. above. No commentator provided us with data or analysis that would support an alternative threshold. Thus, we continue to believe that a threshold of zero non-affiliates is consistent with the Act and presents an appropriate balance between the value of the reported information to investors and the market, and the costs of preparing the reports.

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

Section 23(a) of the Exchange Act[56] requires the Commission, when making rules and regulations under the Exchange Act, to consider the impact a new rule would have on competition. Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act[57] requires the Commission, when engaging in rulemaking that requires it to consider whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. The discussion below focuses on the effects of the decisions made by the Commission in the exercise of its new exemptive authority provided by the Act, rather than the effects of the Act itself.

The Act amended Exchange Act Section 15(d) to eliminate the automatic suspension of the duty to file ongoing Exchange Act reports for ABS issuers and granted the Commission authority to issue rules providing for the suspension or termination of such duty. The Commission is exercising its authority under the Act by amending Exchange Act Rules 12h-3, 12h-6 and 15d-22 to provide for the suspension of the duty to file for certain ABS issuers and reduce their compliance costs as discussed in this release.

56 15 U.S.C. 78w(a).

57 15 U.S.C. 78c(f).

The amendments update the reporting requirements for takedowns from shelf registration in Exchange Act Rule 15d-22 and provide for the suspension of the duty to file for certain ABS issuers as discussed in this release. Providing for ABS issuers with only affiliated holders to suspend their duty to file decreases transparency regarding those issuers. The suspension of the duty to file reduces compliance costs for issuers, which could increase efficiency and facilitate capital formation.

An inability to suspend the duty to file may encourage some issuers to offer ABS privately or not to issue ABS at all, rather than registering those ABS and incurring the ongoing reporting costs. If issuers register fewer ABS, this would reduce liquidity, decrease transparency in the ABS market and decrease capital formation. The amendments provide for ABS issuers to suspend their duty to file when they have only affiliated investors remaining and provide issuers certainty regarding when they may suspend reporting, which may encourage some ABS issuers to register ABS and offer ABS in the public markets. These changes are intended to mitigate the aforementioned incentives to offer ABS privately or not to issue ABS at all.

The clarifications provided in Exchange Act Rule 15d-22, 12h-3, and 12h-6 may have a beneficial effect on the efficiency of managing ABS offerings, especially takedowns from ABS shelf registration, by providing issuers with a better understanding of their Exchange Act reporting obligations and facilitating compliance.

We do not believe the amendments will have an impact or burden on competition.

VI. Regulatory Flexibility Act Certification

Under Section 605(b) of the Regulatory Flexibility Act, we certified that, when adopted, the proposals would not have a significant economic impact on a substantial number of small entities. We included the certification in Part IX of the Proposing Release, but received no comment.

VII. Statutory Authority and Text of Rule and Form Amendments

We are adopting the amendments contained in this document under the authority set forth in Sections 3(b), 12, 13, 15, 23(a), and 36 of the Exchange Act.

List of Subjects

17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

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

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

1. The authority citation for part 240 continues to read as follows:

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

* * * * *

2. Amend § 240.12h-3 by:

a. In paragraph (b)(1) introductory text adding ", other than any class of asset-backed securities," in the first sentence after "Any class of securities"; and

b. Adding a Note to paragraph (b).

The addition to read as follows:

§ 240.12h-3 Suspension of duty to file reports under section 15(d).

* * * * *

(b) * * *

(2) * * *

NOTE TO PARAGRAPH (b): The suspension of classes of asset-backed securities is addressed in § 240.15d-22.

* * * * *

3. Amend § 240.12h-6 by adding a Note after paragraph (i) to read as follows:

§ 240.12h-6 Certification by a foreign private issuer regarding the termination of registration of a class of securities under section 12(g) or the duty to file reports under section 13(a) or section 15(d).

* * * * *

(i) * * *

NOTE TO § 240.12h-6: The suspension of classes of asset-backed securities is addressed in § 240.15d-22.

* * * * *

4. Revise § 240.15d-22 to read as follows:

§ 240.15d-22 Reporting regarding asset-backed securities under section 15(d) of the Act.

(a) With respect to an offering of asset-backed securities registered pursuant to §230.415(a)(1)(vii) or §230.415(a)(1)(x) of this chapter:

(1) Annual and other reports need not be filed pursuant to section 15(d) of the Act (15 U.S.C. 78o(d)) regarding any class of securities to which such registration statement

relates until the first bona fide sale in a takedown of securities under the registration statement; and

(2) The starting and suspension dates for any reporting obligation under section 15(d) of the Act (15 U.S.C. 78o(d)) with respect to a takedown of any class of asset-backed securities are determined separately for each takedown of securities under the registration statement.

(b) The duty to file annual and other reports pursuant to section 15(d) of the Act (15 U.S.C. 78o(d)) regarding any class of asset-backed securities is suspended:

(1) As to any semi-annual fiscal period, if, at the beginning of the semi-annual fiscal period, other than a period in the fiscal year within which the registration statement became effective, or, for offerings conducted pursuant to §230.415(a)(1)(vii) or §230.415(a)(1)(x), the takedown for the offering occurred, there are no asset-backed securities of such class that were sold in a registered transaction held by non-affiliates of the depositor and a certification on Form 15 (17 CFR 249.323) has been filed; or

(2) When there are no asset-backed securities of such class that were sold in a registered transaction still outstanding, immediately upon filing with the Commission a certification on Form 15 (17 CFR 249.323) if the issuer of such class has filed all reports required by Section 13(a), without regard to Rule 12b-25 (17 CFR 249.322), for the shorter of its most recent three fiscal years and the portion of the current year preceding the date of filing Form 15, or the period since the issuer became subject to such reporting obligation. If the certification on Form 15 is subsequently withdrawn or denied, the issuer shall, within 60 days, file with the Commission all reports which would have been required if such certification had not been filed.

NOTE 1 TO PARAGRAPH (b): Securities held of record by a broker, dealer, bank or nominee for any of them for the accounts of customers shall be considered as held by the separate accounts for which the securities are held.

NOTE 2 TO PARAGRAPH (b): An issuer may not suspend reporting if the issuer and its affiliates acquire and resell securities as part of a plan or scheme to evade the reporting obligations of Section 15(d).

(c) This section does not affect any other reporting obligation applicable with respect to any classes of securities from additional takedowns under the same or different registration statements or any reporting obligation that may be applicable pursuant to section 12 of the Act (15 U.S.C. 78l).

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

5. Amend Form 15 (referenced in § 249.323) by:

a. Adding a checkbox referring to "Rule 15d-22(b)" after the checkbox referring to "Rule 15d-6"; and

b. By revising the first sentence of the Instruction to read: "This form is required by Rules 12g-4, 12h-3, 15d-6 and 15d-22 of the General Rules and Regulations under the Securities Exchange Act of 1934."

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: August 17, 2011

Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65151 / August 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14069

In the Matter of

Timothy M. Gautney, Robert A. Bellia, Jr., and Erik S. Blum,

Respondents.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO ERIK S. BLUM

I.

On September 27, 2010, the Securities and Exchange Commission ("Commission") initiated proceedings pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Erik S. Blum ("Blum" 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 Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 as to Erik S. Blum, as set forth below.

III.

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

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

1. These proceedings arise out of an investigation into the churning activities of registered representatives ("RRs") affiliated with Aura Financial Services, Inc. ("Aura"). Aura was a Birmingham, Alabama-based corporation which was registered with the Commission as a broker-dealer from February 1997 until February 2010.

2. Erik S. Blum, 44, of Boca Raton, Florida, was registered with Aura from August 2006 until August 2009, and served as the manager of its Miami branch office, formerly located in West Palm Beach, Florida. He has worked in the securities business since 1987.

3. Between at least January 2008 and December 2008 in Aura's former Miami, Florida branch office, a former RR largely depleted the funds in two of his customers' accounts through improper churning.[2] Blum was responsible for supervising this RR.

4. Two metrics are commonly used to determine whether an account has been churned: the account's "annualized turnover ratio" and its "cost to equity ratio," which is also known as its "break even percentage." An annualized turnover ratio is the number of times per year a customer's securities are replaced by new securities. It is calculated by determining the aggregate amount of purchases in an account over a given period, calculating the ratio of those aggregate purchases to the account's average net equity during that period, and then annualizing that ratio. A turnover rate that exceeds six is presumptive of churning. A cost to equity ratio or break even analysis determines the rate of return that an account has to earn on an annual basis just to cover transaction costs, and thus "break even." Trading practices that require an account to earn returns in excess of 20% just to break even are indicative of possible churning.

5. The RR supervised by Blum churned the accounts of two Aura customers in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. These customers had annualized turnover rates, as reflected in quarterly reports sent to Blum, of 6 to 54 and cost to equity ratios of 14% to 54%.

6. These two customers opened and funded their accounts after being cold-called by, or otherwise introduced to, the RR. They had their accounts aggressively traded, though neither indicated to Aura an investment objective or risk tolerance supporting that trading. Neither customer had an understanding of the total transaction costs they were incurring by trading through Aura.

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2 Churning is the excessive buying and selling of securities in a customer's account by a broker, for the purpose of generating commissions and without regard to the customer's investment objectives or interest or with the intent to defraud. For churning to occur, the broker must exercise control over the investment decisions in the account, either through a formal written discretionary agreement or otherwise, such as through the customer routinely accepting the broker's recommendations without question.

7. Aura's Written Supervisory Procedures ("WSP"), dated 2007-2008, and in effect during the time of the churning by the RR, stated, among other things, that a turnover ratio greater than six:

> warrant[s] immediate attention and further review of a larger sample size, if applicable. The D[esignated] P[rincipal] should take immediate steps to determine that such trading activity is acceptable to the customer (acknowledgment by customer in writing may be sought), and conforms to the customer's objectives. Otherwise, steps may be taken to close the trading activity in the customer's accounts.

8. At least each quarter, Aura's Compliance Department provided Blum with excerpts of a report containing annualized turnover ratios, break even ratios, and other account metrics for the largest commission producing accounts from their branch. Aura's active account letter procedure, which was unwritten, required Blum to send such letters to all customers whose accounts had turnover ratios greater than six.

9. The active account letters, entitled "Intent to Maintain Active Account," did not explain why Aura was sending the letters to the customers and they were not sent along with cover letters. The body of the form letters did not identify the respective accounts as actively traded or that they had recently shown a certain number of trades or a certain amount of turnover, but stated that "certain clients may wish to engage in more frequent trading in their accounts." The letters included a general disclosure of the risks associated with "frequent" trading and numerous blanks for the customer to complete concerning numbers of trades over the past year, anticipated trades in the future year, investment objective, risk exposure, and other financial information. After the customer filled in the blanks, the firm's procedure contemplated that the customer would sign the letter and return it to the Aura branch where his account was located.

10. Blum failed reasonably to supervise the RR, from January 2008 through December 2008 while he was registered with Aura and subject to Blum's supervision in Aura's Miami, Florida branch office. The level of trading in the accounts churned by the RR was high enough to warrant increased review and customer contact. As reflected in the quarterly reports for 2008 sent to Blum, the RR's two victims had annualized turnover rates of 6 to 54 and cost to equity ratios of 14% to 54%.[3]

11. With each successive quarter of 2008, the RR's victims' turnover rates and cost to equity ratios increased in value. One of his victims appeared on the report sent to Blum in the first quarter with a turnover rate of 6 and a cost to equity ratio of 14%. In the second quarter, that victim's turnover rate increased to 33 and his cost to equity ratio increased to 23%. The RR's second churning victim appeared on the report with a turnover rate of 7 and a cost to equity ratio of 19%. In the third quarter, these victims appeared on the report with turnover rates of 41 and 9 and cost to equity ratios of 36% and 32%, respectively. By the fourth quarter, one victim had a

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3 Aura's WSPs provided, among other things, that an account with a turnover ratio greater than two and less than or equal to six "warrants further review."

turnover rate of 54 and cost to equity ratio of 54%. The turnover rate for the second victim was blank on this report although his cost to equity ratio was shown as 43%.

12. The high levels of trading were repeatedly brought to Blum's attention and Blum sent out active account letters after receiving the quarterly compliance reports indicating high levels of trading. During his investigative testimony, Blum conceded that sometimes the letters were signed and returned by the customers without the customers' having provided the information requested in the letters. In those cases, the RR would contact the customer and complete the form based on the information provided by the customer. The two customers whose accounts were churned told the staff that they did not fill out the information contained in the active account letters and one of these customers did not recall receiving the letter and questioned whether he actually signed the letter.

13. Blum treated the active account letter as a "negative response letter." In effect, Blum expected the letter to be returned if the customer had a problem with the account. If the letters were not returned or were missing information, his practice was not to contact customers himself. Instead, Blum left it to the RRs to follow-up with their customers. Blum failed to take any steps to modify his practice in the face of repeated red flags of excessive trading in the RRs customers' accounts.

14. The RR supervised by Blum was the subject of complaints that would have reinforced the need to contact customers, where unusual trading was apparent. The RR's history at the time the Commission filed its complaint showed two pending customer complaints: One complaint filed in June 2008 cited unauthorized trading. A second complaint filed in September 2008 alleged $150,000 in damages for not following customer instructions.

15. If Blum had reasonably followed-up on the red flags of high trading in the accounts of the RR, it is likely that he would have prevented or detected the RR's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

16. As a result of the conduct described above, Blum failed reasonably to supervise the RR within the meaning of Section 15(b)(4)(E) of the Exchange Act, as incorporated by reference in Section 15(b)(6) of the Exchange Act.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 15(b)(6) of the Exchange Act, Blum shall be, and hereby is barred from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent, with the right to reapply for association after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any application for permission to engage in a supervisory capacity by Blum 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 Blum, 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.

B. Blum shall pay disgorgement of $4,753, prejudgment interest of $355.47 and a civil penalty of $10,000 to the Commission. Payment shall be made in the following installments: $419.68 a month for 36 months. Payment is due on the 15th of each month. The first payment will be made within 21 days of the date of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement and prejudgment interest, plus any additional interest accrued pursuant to SEC Rule of Practice 600 and 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, Accounts Receivable, Securities and Exchange Commission, 100 F Street N.E., Mail Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Blum 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 Kristin B. Wilhelm, Division of Enforcement, Securities and Exchange Commission, 3475 Lenox Road N.E., Suite 500, Atlanta, Georgia 30326-1232.

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. 65154 / August 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14507

In the Matter of **Consolidated Energy, Inc., Diamond Home Services, Inc., Goran Capital Inc., Kingsley Coach, Inc. (The), Knockout Holdings, Inc., and Kuhlman Co., 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 Consolidated Energy, Inc., Diamond Home Services, Inc., Goran Capital Inc., Kingsley Coach, Inc. (The), Knockout Holdings, Inc., and Kuhlman Co., Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Consolidated Energy, Inc. ("CEIW") [1] (CIK No. 1061985) is a dissolved Wyoming corporation located in Betsy Layne, Kentucky with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CEIW 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 $12,060,135 for the prior nine months. On July 12, 2007, CEIW filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of

[1] The short form of each issuer's name is also its stock symbol.

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Kentucky, which was terminated on December 18, 2008. As of August 15, 2011, the common stock of CEIW was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Diamond Home Services, Inc. ("DHMS") (CIK No. 1012442) is a void Delaware corporation located in Lake Forest, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DHMS 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, 1999, which reported a net loss of $9,239,000 for the prior nine months. As of August 15, 2011, the common stock of DHMS was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Goran Capital Inc. ("GNCN") (CIK No. 925600) is an Ontario corporation located in Indianapolis, Indiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GNCN is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2003, which reported a net loss of $3,599,000 for the prior three months. As of August 15, 2011, the common stock of GNCN was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Kingsley Coach, Inc. (The) ("KNGS") (CIK No. 1026488) is a forfeited Delaware corporation located in Zimmerman, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). KNGS 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 $1,169,219 for the prior nine months. As of August 15, 2011, the common stock of KNGS was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Knockout Holdings, Inc. ("KNOH") (CIK No. 1128008) is a void Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). KNOH 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 $4,990,955 for the prior six months. As of August 15, 2011, the common stock of KNOH was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Kuhlman Co., Inc. ("KUHM") (CIK No. 1219641) is a permanently revoked Nevada corporation located in Minneapolis, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). KUHM 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 28, 2006, which reported a net loss of $11,980,922 for the prior thirty-nine weeks. As of August 15, 2011, the common stock of KUHM was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

7. 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.

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

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

August 18, 2011

In the Matter of **Consolidated Energy, Inc.,** **Diamond Home Services, Inc.,** **Goran Capital Inc.,** **Kingsley Coach, Inc. (The),** **Knockout Holdings, Inc., and** **Kuhlman Co., 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 Consolidated Energy, Inc. because it has not filed any periodic reports since the period ended September 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Diamond Home Services, Inc. because it has not filed any periodic reports since the period ended September 30, 1999.

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Kingsley Coach, Inc. (The) because it has not filed any periodic reports since the period ended March 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Knockout Holdings, 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 Kuhlman Co., Inc. because it has not filed any periodic reports since the period ended October 28, 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. EDT on August 18, 2011, through 11:59 p.m. EDT on August 31, 2011.

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. 65156 / August 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14508

In the Matter of **Colorado Wyoming Reserve Co.,** **Grant Life Sciences, Inc.,** **NOXSO Corp.,** **Omni Medical Holdings, Inc., and** **TSI, 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 Colorado Wyoming Reserve Co., Grant Life Sciences, Inc., NOXSO Corp., Omni Medical Holdings, Inc., and TSI, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Colorado Wyoming Reserve Company ("CWYR") [1] (CIK No. 318852) is dissolved Wyoming corporation located in Grand Junction, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CWYR 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 $554,349 for the prior nine months. As of August 15, 2011, the common stock of CWYR was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

[1] The short form of each issuer's name is also its stock symbol.

2. Grant Life Sciences, Inc. ("GLIF") (CIK No. 1210336) is a revoked Nevada corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GLIF is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2008, which reported a net loss of $5,132,638 for the prior three months. As of August 15, 2011, the common stock of GLIF 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. NOXSO Corp. ("NXSO") (CIK No. 314307) is a Virginia corporation located in Bountiful, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NXSO is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2004, which reported a net loss of $768,006 for the prior nine months. On February 6, 1997, NXSO was the subject of an involuntary Chapter 7 petition in the U.S. Bankruptcy Court for the Eastern District of Tennessee, which was converted to a Chapter 11 proceeding on June 9, 1997, and was terminated on January 15, 2003. As of August 15, 2011, the common stock of NXSO was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Omni Medical Holdings, Inc. ("OMHI") (CIK No. 1085402) is an expired Utah corporation located in Littleton, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OMHI 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 $1,752,431 for the prior nine months. As of August 15, 2011, the common stock of OMHI was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. TSI, Inc. ("TSIA") (CIK No. 99506) is a Montana corporation located in Great Falls, Montana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TSIA 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, 2004. As of August 15, 2011, the common stock of TSIA was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. 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.

7. 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

8. 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

August 18, 2011

In the Matter of **Colorado Wyoming Reserve Co.,** **Grant Life Sciences, Inc.,** **NOXSO Corp.,** **Omni Medical Holdings, Inc., and** **TSI, 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 Colorado Wyoming Reserve Company because it has not filed any periodic reports since the period ended March 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Grant Life Sciences, Inc. because it has not filed any periodic reports since the period ended March 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of NOXSO Corp. because it has not filed any periodic reports since the period ended December 31, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Omni Medical Holdings, 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 TSI, Inc. because it has not filed any periodic reports since the period ended September 30, 2004.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 18, 2011 through 11:59 p.m. EDT on August 31, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

Release No. 34-65153; File No. S7-32-11

Acceptance of Public Submissions Regarding the Study of Stable Value Contracts

AGENCIES: Commodity Futures Trading Commission; Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was enacted on July 21, 2010. Section 719(d) of the Dodd-Frank Act mandates that the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") jointly conduct a study to determine whether stable value contracts ("SVCs") fall within the definition of a swap. Section 719(d) of the Dodd-Frank Act also requires that the Commissions, in making that determination, jointly consult with the Department of Labor, the Department of the Treasury, and the State entities that regulate the issuers of SVCs. Further, Section 719(d) of the Dodd-Frank Act provides that if the Commissions determine that SVCs fall within the definition of a swap, they jointly shall determine if an exemption for SVCs from the definition of a swap is appropriate and in the public interest. In connection with this study, the Commissions' staffs seek responses of interested parties to the questions set forth below.

DATES: Please submit comments in writing on or before **[INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

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

CFTC:

- Agency website, via its Comments Online process:

http://comments.cftc.gov. Follow the instructions for submitting comments through the website.

- Mail: David A. Stawick, Secretary, Commodity Futures Trading

Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

- Hand Delivery/Courier: Same as mail above.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the

instructions for submitting comments.

Please submit your comments using only one method. "Stable Value Contract Study" must be in the subject field of responses submitted via e-mail, and clearly indicated on written submissions. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to www.cftc.gov. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in section 145.9 of the CFTC's regulations.[1]

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from www.cftc.gov that it may deem to be inappropriate for publication, including obscene language. All submissions that have been redacted or removed that contain comments on the merits of

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[1] 17 CFR 145.9.

the rulemaking will be retained in the public comment file and will be considered as required under applicable laws, and may be accessible under the Freedom of Information Act.

SEC:

Electronic comments:

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

Send an e-mail to rule-comments@sec.gov. Please include File Number S7-32-11 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 Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-32-11. 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 SEC will post all comments on the SEC's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the SEC's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the SEC does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: CFTC: Stephen A. Kane, Consultant, Office of the Chief Economist, (202) 418-5911, skane@cftc.gov; or David E. Aron, Counsel, Office of the General Counsel, (202) 418-6621, daron@cftc.gov, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581; SEC: Matthew A. Daigler, Senior Special Counsel, (202) 551-5500, Donna Chambers, Special Counsel, (202) 551-5500, or Leah Drennan, Attorney-Adviser, (202) 551-5500, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

On July 21, 2010, President Obama signed the Dodd-Frank Act into law.[2] Pursuant to section 719(d)(1)(A) of the Dodd-Frank Act, the Commissions jointly must conduct a study, not later than 15 months after the date of enactment of the Dodd-Frank Act, to determine whether SVCs fall within the definition of a swap.[3] Section

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[2] See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act is available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf.

[3] The term "swap" is defined in Commodity Exchange Act ("CEA") section 1a(47), 7 U.S.C. 1a(47). The term "security-based swap" is defined as an agreement, contract, or transaction that is a "swap" (without regard to the exclusion from that definition for security-based swaps) and that also has certain characteristics specified in the Dodd-Frank Act. See section 3(a)(68) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(68). Thus, a determination regarding whether SVCs fall within the definition of a swap also is relevant to a determination of whether SVCs fall within the definition of the term "security-based swap." These terms are the subject of further definition in joint proposed rulemaking by the Commissions. See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, File No. S7-16-11, 76 FR 29818 (May 23, 2011) ("Product Definitions Proposing Release"). Citations herein to provisions of the Commodity Exchange Act and the Securities Exchange Act of 1934 refer to the numbering of those provisions after the effective date of Title VII.

719(d)(1)(A) of the Dodd-Frank Act also requires the Commissions, in making such determination, jointly to consult with the Department of Labor, the Department of the Treasury, and the State entities that regulate the issuers of SVCs.

If the Commissions determine that SVCs fall within the definition of a swap, they jointly must determine if an exemption for SVCs from the definition of a swap is appropriate and in the public interest.[4] Until the effective date of any regulations enacted pursuant to Section 719(d) of the Dodd-Frank Act, and notwithstanding any other provision of Title VII of the Dodd-Frank Act, the Title VII requirements will not apply to SVCs.[5]

Section 719(d)(2) of the Dodd-Frank Act defines a "stable value contract" as:

> any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974, including plans described in section 3(32) of such Act) subject to participant direction, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) of such Code, an arrangement described in section

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4 See section 719(d)(1)(B) of the Dodd-Frank Act. Pursuant to section 719(d)(1)(B) of the Dodd-Frank Act, "The Commissions shall issue regulations implementing the determinations required under this paragraph."

5 See section 719(d)(1)(C) of the Dodd-Frank Act.

403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code).[6]

The Commissions' staffs understand that stable value funds ("SVFs") are a type of investment commonly offered through 401(k) and other defined contribution plans with the objective of providing preservation of principal, liquidity, and current income at levels that are typically higher than those provided by money market funds.[7] The Commissions' staffs further understand that SVCs are components of SVFs that SVF sponsors or managers purchase from SVC providers, including banks and insurers, that provide a guarantee, or "wrap," by the service provider to pay plan participants at "book value" should the market value of the SVF be worth less than the amount needed to pay that book value.[8] In furtherance of this SVC study, the Commissions' staffs seek responses to the any or all of the questions below. Commenters are encouraged to provide additional relevant information, including empirical evidence where appropriate and to the extent feasible, beyond that called for by these questions.

Swap Definitional and Exemptive Issues

1. Do SVCs possess characteristics that would cause them to fall within the definition of a swap? If so, please describe those characteristics.

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6 The Commissions understand that a bank, insurance company, or other state or federally regulated financial institution that offers an SVC is commonly referred to as an "SVC provider."

7 See, e.g., U.S. Government Accountability Office, 401(K) Plans: Certain Investment Options and Practices That May Restrict Withdrawals Not Widely Understood, at 10-11, GAO-11-234 (Washington, D.C.: Mar. 10, 2011); Proposed Exemptions From Certain Prohibited Transaction Restrictions, Department of Labor, 75 FR 61932, 61938 (Oct. 6, 2010).

8 See 401(K) Plans: Certain Investment Options and Practices That May Restrict Withdrawals Not Widely Understood, supra note 7, at 11. In the context of an SVC, the staffs understand, based on conversations with market participants, that the term "book value" means investment principal plus interest accrued using the crediting rate formula determined for the SVF and set forth in the SVC.

2. What characteristics, if any, distinguish SVCs from swaps?

3. Does the definition of the term "stable value contract" in Section 719(d)(2) of the Dodd-Frank Act encompass all of the products commonly known as SVCs?

4. Are the proposed rules and the interpretive guidance set forth in the Product Definitions Proposing Release[9] useful, appropriate, and sufficient for persons to consider when evaluating whether SVCs fall within the definition of a swap? If not, why not? Would SVCs satisfy the test for insurance provided in the Product Definitions Proposing Release? Why or why not? Is additional guidance necessary with regard to SVCs in this context? If so, what further guidance would be appropriate? Please explain.

5. If the Commissions were to determine that SVCs fall within the definition of a swap, what would be their underlying reference asset?

6. If the Commissions were to determine that SVCs fall within the definition of a swap, what facts and considerations, policy and otherwise, would support exempting SVCs from the definition of a swap? What facts and considerations, policy and otherwise, would not support exempting SVCs from the definition of a swap?

7. If the Commissions were to (a) determine that SVCs fall within the definition of a swap but provide an exemption from the definition of a swap, (b) determine that SVCs fall within the definition of a swap and not provide an exemption from such definition, or (c) determine that such contracts are not swaps, what beneficial or adverse regulatory or legal consequences, if any, could result? For example, could any

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9 See supra note 3. The Commissions note that any comment submitted in response to this question will be taken into consideration by the Commissions as they consider any final action on the Product Definitions Proposing Release.

of such determinations lead to beneficial or adverse treatment under the Employee Retirement Income Security Act ("ERISA"), bankruptcy law, tax law, or accounting standards, as compared to the regulatory regimes applicable to SVCs, in the event that the Commissions were to determine that SVCs are not swaps or grant an exemption from the definition of a swap?

Market and Product Structure Issues

8. What are the different types of SVCs, how are they structured, and what are their uses? Please describe in detail.

9. Please describe the operation of SVCs and SVFs generally in terms of contract structure, common contract features, investments, market structure, SVC providers, regulatory oversight, investor protection, benefits and drawbacks, risks inherent in SVCs, and any other information that commenters believe the Commissions should be aware of in connection with the SVC study.

10. What provisions of SVCs, if any, allow SVC providers to terminate SVCs that prevent benefit plan investors from transacting at book value? What are the trade-offs, including the costs and benefits of such provisions? Please describe in detail.

11. Describe the benefits and risks of SVCs for SVC providers. How do SVC providers mitigate those risks? Please provide detailed descriptions. How effective are any such measures?

12. Describe the benefits and risks of SVCs for investors in SVFs. Please provide detailed descriptions.

13. The Commissions' staffs understand that SVC providers sometimes negotiate so-called "immunization" provisions with SVF managers and that such

provisions typically allow SVC providers (or SVF managers) to terminate the SVCs based upon negotiated triggers, which can include underperformance of the portfolio against a benchmark. The Commissions' staffs also understand that, once immunization provisions have been triggered and are in effect, the SVF must be managed according to the immunization guidelines, which typically require the liquidation of all securities rated below AAA and in certain cases may require the portfolio to be invested 100% in Treasury securities. What risks, if any, do "immunization" provisions in SVCs pose to investors in SVFs? If immunization provisions in SVCs pose risks to investors in SVFs, are these risks clearly disclosed to investors? Are these risks required to be disclosed to investors? What are the sources of such requirements? How do SVF managers or SVC providers address the risk that immunization will be exercised? How effective are any such measures?

14. The Commissions' staffs understand that some SVCs grant SVC providers the right to limit coverage of employer-driven events or employee benefit plan changes. Such events or changes could cause a decrease in a SVF's value and result in large scale investor withdrawals or redemptions (sometimes called a "run on the fund"). How do SVC providers and SVF managers manage this risk, if at all? How effective are any such measures?

15. The Commissions' staffs understand that SVF managers infuse capital into their funds in certain instances. Please describe the circumstances under which an SVF fund manager would provide such capital support for its fund.

16. The Commissions' staffs understand that "pull to par" provisions of SVCs provide that SVCs will not terminate (absent the application of another contract

termination provision) until the gap between the market value of the wrapped assets and the SVC book value is closed, however long that takes. The Commissions' staffs also understand that pull to par provisions are standard for SVCs. Are these understandings correct? Please describe pull to par provisions and how prevalent such provisions are in SVCs.

17. How have SVFs and SVCs been affected by the recent financial crisis? How many SVC providers are in the market today? Is the number of SVC providers higher or lower than prior to the financial crisis that began in 2008? Are fees now higher or lower than prior to the financial crisis?

18. Do investors have incentives to make a run on a SVF when its market-to-book ratio is substantially below one? What protections, if any, do SVCs provide to protect fund investors who do not redeem their fund shares amid a run on the fund? How effective are any such protections?

19. How do market risk measures assess the risk of a run on a SVF? To the extent that SVC providers use value-at-risk ("VaR") models, do such VaR models adequately assess the risk of loss resulting from such events or other possible but extremely unlikely events? Do other loss models more adequately assess the risk of loss, such as the expected value of a loss or the expected value given a loss, which employs the entire loss probability distribution without excluding events in the extreme tail of the loss distribution?

20. Are certain SVC providers more likely, as a result of credit cyclicality, to become financially distressed? If so, is such financial distress likely to occur

concurrently with financial distress of SVFs? If so, can the risk of such concurrent financial distress be mitigated? How effective are any such measures?

21. Do SVC providers pose systemic risk concerns? Are there concerns with entities that may be systemically important institutions providing SVCs? What are the consequences for SVFs, employee benefit/retirement plans, and the financial system should an SVC provider fail?

22. Are there issues specific to financial institutions providing SVCs, including institutions that are systemically significant, that the Commissions should consider in connection with the SVC study? If so, please describe.

Regulatory Issues

23. What disclosures to benefit plan investors in SVFs currently are required, and what are the sources of such requirements? What additional disclosure typically is provided, either voluntarily or on request? What additional disclosure, if any, would be warranted and why would it be warranted? Please explain in detail.

24. What financial and regulatory protections currently exist that are designed to ensure that SVC providers can meet their obligations to investors, and what are the sources of such protections? Does the level of protection vary depending on the SVC provider? How effective are any such measures?

25. Currently, do entities other than state-regulated insurance companies and federally- or state-regulated banks provide SVCs? If so, what kinds of entities do so and how are they regulated? If not, are there any barriers to the provision of SVCs by entities other than state-regulated insurance companies and federally- or state-regulated banks?

26. What role do SVF managers play in protecting the interests of plan participants with respect to SVFs? How effective are any such measures?

Compliance Issues if the Commissions Were to Determine SVCs Were Swaps

27. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, should the regulatory regime for SVCs be limited or tailored in any way? If so, how? Please explain in detail. Should any of the requirements for capital and margin for SVCs differ from those for swaps that are not SVCs? Why or why not? If the requirements for capital and margin should differ, please explain in detail what those differences should be.

28. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would the requirements of any regulatory regime for swaps impact fee structures or fees charged by SVC providers? Please describe (quantitatively, if possible) the relationship of any new federal regulation under the Dodd-Frank Act to possible changes in fee structures or fees, to the extent feasible, and state any assumptions used in quantifying such relationship.

29. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would this decision influence the availability of SVFs to investors? Would this designation affect existing SVFs and the ability of SVFs to purchase SVCs? If so, how and why?

By the Commodity Futures Trading Commission.

David A. Stawick
Secretary

Date: August 18, 2011

By the Securities and Exchange Commission.

EMM

Elizabeth M. Murphy
Secretary

Date: August 18, 2011

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65173 / August 19, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14297

In the Matter of

MATTHEW J. RYAN,

Respondent.

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

I.

On March 15, 2011, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Matthew J. Ryan ("Ryan" or "Respondent").

II.

In response to 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, 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 Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

Respondent

1. Ryan is the owner and sole managing member of Prime Rate and Return LLC ("Prime Rate") a limited liability company incorporated in Delaware in April 2001 with its principal place of business in Troy, New York. Prime Rate sometimes does business as, among other names, American Integrity Financial Company ("American Integrity"), through which it offered fixed-rate investment products to investors. Neither Prime Rate nor American Integrity is registered in any capacity with the Commission. From June 1997 through July 2003 and from January 2004 through December 2009, Ryan was a registered representative associated with broker-dealers registered with the Commission. Ryan, 46 years old, is a resident of Troy, New York.

Other Relevant Entity

2. **Prime Rate d/b/a American Integrity** is a limited liability company incorporated in Delaware in April 2001 with its principal place of business in Troy, New York. Prime Rate sometimes did business as American Integrity. Neither Prime Rate nor American Integrity is registered in any capacity with the Commission. Neither Prime Rate nor American Integrity has offered securities pursuant to an offering registered with the Commission.

Ryan's Criminal Conviction

3. On February 22, 2011, Ryan pleaded guilty to one count of securities fraud in violation of Sections 10(b) and 32 of the Exchange Act, Rule 10b-5 thereunder, and Title 18 of the United States Code, Section 2, before the United States District Court for the Northern District of New York, in United States v. Matthew John Ryan, Crim. Indictment No. 1:10-cr-00319-NAM. The count of the criminal indictment to which Ryan pleaded guilty alleged, among other things, that:

a. At all times relevant to the Indictment, Ryan was the founder, owner, and sole managing member of Prime Rate doing business as American Integrity. For most of the relevant period, Ryan was a registered representative of a registered broker-dealer and operated out of a branch office of the broker-dealer located in Troy, New York.

b. From in or about February 2002, Ryan has been soliciting and receiving money from investors as a purported representative of American Integrity. Ryan offered and sold investors purported contracts with American Integrity pursuant to which American Integrity promised to pay a "guaranteed" fixed rate of interest on the initial investment.

c. Ryan periodically sent to each investor a Statement of Account Values ("account statement"). Each account statement reflected the investor's purported account number, interest rate, and account value, and the amount of interest claimed to have been credited to the account.

d. To give the appearance of legitimacy to American Integrity, Ryan falsely represented to investors that American Integrity was a substantial Manhattan-based financial services firm with numerous employees and for which he was merely a representative. Ryan created fictitious American Integrity employees and used their names in correspondence with investors. Ryan's communications with investors and prospective investors gave the firm's address as 208 East 51st Street in midtown Manhattan. Ryan knew that this address was simply a mail drop to create the false impression that American Integrity had an office in Manhattan. Likewise, the toll-free number that Ryan established was merely an answering service that relayed messages to him, and American Integrity had no "representative" other than Ryan.

e. Ryan made false representations to investors that their investments were safe, by representing that they were insured up to specific dollar amounts. Ryan also made false representations to investors that American Integrity was qualified to serve as a custodian of individual retirement accounts and other tax-deferred investments and to receive roll-overs from such tax-deferred investments and preserve their tax-deferred status.

f. Since at least 2004, Ryan used funds that investors invested in American Integrity for multiple purposes he concealed from investors, including (i) to repay loans for the purchase or refinancing of real estate held in Prime Rate's name; (ii) to pay other investors' returns; and (iii) to pay his own personal expenses, including payments on his loans for luxury cars.

g. Since in or about October 2004, Ryan has deposited American Integrity investor funds in a bank account in the name of "Prime Rate & Return Dba American Integrity" (the "American Integrity Account"). Ryan is and has been the only signatory for this account. As of March 31, 2010, Ryan had deposited approximately $5.8 million into the American Integrity Account. Of that amount, more than $4.8 million were investor funds.

h. As of March 31, 2010, Ryan had withdrawn or transferred from the American Integrity Account (i) $1.9 million to pay American Integrity investors purported interest and principal; (ii) $845,000 to pay Prime Rate; (iii) $265,000 to pay loans on real estate owned by Ryan and/or Prime Rate; and (iv) $125,000 to pay expenses related to his luxury vehicles.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Ryan 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, or 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.

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 Walter, Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65171 / August 19, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14510

In the Matter of JACOB SPINNER, 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 Jacob Spinner ("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 August 2000 through October 2002, Respondent was a registered representative associated with Refco Securities L.L.C. ("Refco"), a former broker dealer that first registered with the Commission in 1981. From September 2000 through June 2002,

Respondent was also a registered representative associated with Pond Securities d/b/a Pond Equities ("Pond"), a former broker dealer that first registered with the Commission in 1992. Respondent was also associated with Pond from October 2002 through January 2004 and from July 2004 through December 2006. Respondent is 40 years old and is a resident of Cedarhurst, New York.

2. On April 4, 2006, the Commission filed a Complaint against Respondent in Securities and Exchange Commission v. Andreas Badian et al., Civil Action Number 06-cv-02621, in United States District Court for the Southern District of New York. On August 8, 2011, a judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §77q(a)], Section 10(b) [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5] and from aiding and abetting violations of Exchange Act § 17(a) [15 U.S.C. § 78q(a)] and Rule 17a-3 thereunder [17 C.F.R. § 240.17a-3(a)].

3. The Commission's Complaint alleged that while he was a registered representative at Refco and Pond in 2001, Respondent violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by participating in a scheme to defraud by manipulating the price of the common stock of Sedona Corporation at the direction of Andreas Badian. The Complaint also alleged that Respondent aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by knowingly and substantially assisting in Refco's creation of materially inaccurate trade tickets.

IV.

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

Accordingly, it is hereby ORDERED:

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Walter
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65172 / August 19, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14511

In the Matter of MOTTES DRILLMAN, 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 Mottes Drillman ("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 July 2000 through July 2002, Respondent was a registered representative associated with Refco Securities L.L.C. ("Refco"), a former broker dealer that first registered with the Commission in 1981. From July 2000 through July 2002,

Respondent was also a registered representative associated with Pond Securities d/b/a Pond Equities ("Pond"), a former broker dealer that first registered with the Commission in 1992. Respondent was also associated with Pond from October 2002 through December 2006. Respondent is 41 years old and is a resident of Lawrence, New York.

2. On April 4, 2006, the Commission filed a Complaint against Respondent in Securities and Exchange Commission v. Andreas Badian et al., Civil Action Number 06-cv-02621, in United States District Court for the Southern District of New York. On August 8, 2011, a judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §77q(a)], Section 10(b) [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5] and from aiding and abetting violations of Exchange Act § 17(a) [15 U.S.C. § 78q(a)] and Rule 17a-3 thereunder [17 C.F.R. § 240.17a-3(a)].

3. The Commission's Complaint alleged that while he was a registered representative at Refco and Pond in 2001, Respondent violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by participating in a scheme to defraud by manipulating the price of the common stock of Sedona Corporation at the direction of Andreas Badian. The Complaint also alleged that Respondent aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by knowingly and substantially assisting in Refco's creation of materially inaccurate trade tickets.

IV.

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

Accordingly, it is hereby ORDERED:

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

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. 65179 / August 22, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13507

In the Matter of EVERGREEN INVESTMENT MANAGEMENT COMPANY, LLC and EVERGREEN INVESTMENT SERVICES, INC., Respondents.	ORDER APPROVING FINAL ACCOUNTING, DIRECTING PAYMENT OF REMAINDER OF FAIR FUND TO UNITED STATES TREASURY, AND TERMINATING THE FAIR FUND

On June 8, 2009, Evergreen Investment Management Company, LLC and Evergreen Investment Services, Inc. (collectively, "Respondents") consented to the entry of an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934, Sections 203(e) 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"), that directed, among other things, that the Respondents pay a total of $7,125,001 in disgorgement, prejudgment interest and civil penalties and that established a Fair Fund to provide for the distribution of these monies and the $33 million that the Respondents undertook to pay to the Fair Fund to the investors who were harmed as a result of the conduct described in the Order. The Order required the Respondents to be responsible for self administering the distribution of the $40,125,001 in the Fair Fund to those shareholders of the Evergreen Ultra Short Opportunities Fund ("Ultra Fund") who were harmed as a result of the mispricing of the Ultra Fund's net asset value from February 2007 through June 18, 2008, utilizing a methodology that had been reviewed and approved by the Commission staff. The Order further required the Respondents to distribute any money remaining in the Fair Fund following the distribution described above to those Ultra Fund shareholders who redeemed their shares on June 18, 2008 and, if funds permitted, to those Ultra Fund shareholders who redeemed their shares prior to that date according to a methodology set forth therein. The Order further provided that any money

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remaining in the Fair Fund following the distributions referred to above would be sent to the U.S. Treasury.

The Respondents ultimately distributed approximately $39.7 million of the Fair Fund to about 8,000 investors. Due to factors beyond the Respondents' control (*e.g.*, uncashed checks and checks that were returned as undeliverable), $429,533.71 remained in the Fair Fund after the distribution was complete. Pursuant to the terms of the Order, the Respondents have transferred this sum to the Commission.

The Respondents, through the Fund Administrator they retained, have submitted for approval by the Commission a Final Accounting pursuant to the terms of the Order.

Accordingly, IT IS ORDERED that the Final Accounting submitted by the Respondents is approved.

IT IS FURTHER ORDERED that the $429,533.71 remaining in the Fair Fund shall be transferred to the United States Treasury.

IT IS FURTHER ORDERED that the Fair Fund be terminated.

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. 65187 / August 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14512

In the Matter of **Magic Lantern Group, Inc.,** **Map VII Acquisition, Inc.,** **Memotec Communications, Inc.,** **Millstream II Acquisition Corp.,** **Modena 3, Inc., and** **North American Energy of Delaware, Inc.** **(n/k/a Ora Electronics, 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 Magic Lantern Group, Inc., Map VII Acquisition, Inc., Memotec Communications, Inc., Millstream II Acquisition Corp., Modena 3, Inc., and North American Energy of Delaware, Inc. (n/k/a Ora Electronics, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Magic Lantern Group, Inc. (CIK No. 811933) is an inactive New York corporation located in Oakville, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Magic Lantern 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, 2004, which

reported a net loss of over $15.8 million for the prior twelve months. As of August 22, 2011, the company's stock (symbol "GMLI") was traded on the over-the-counter markets.

2. Map VII Acquisition, Inc. (CIK No. 1393933) is a void Delaware corporation located in Melville, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Map VII Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of over $11,000 for the prior nine months.

3. Memotec Communications, Inc. (CIK No. 1022046) is a Quebec corporation located in Montreal, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Memotec Communications, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A registration statement on August 7, 1997, which reported a net loss of over $12 million (Canadian) for the fiscal year ended December 31, 1996.

4. Millstream II Acquisition Corp. (CIK No. 1304562) is a dissolved Delaware corporation located in Wayne, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Millstream II is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended September 30, 2006.

5. Modena 3, Inc. (CIK No. 1271076) is a void Delaware corporation located in Manchester, Connecticut with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Modena 3 is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 2006, which reported a net loss of $1,050 for the prior nine months.

6. North American Energy of Delaware, Inc. (n/k/a Ora Electronics, Inc.) (CIK No. 225854) is a forfeited Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). North American Energy of Delaware 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, 1996, which reported a net loss of over $27,000 for the prior six months. On April 16, 2002, Ora Electronics filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, and the case was terminated on January 17, 2003. As of August 22, 2011, the company's stock (symbol "ORAE") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, 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 file 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

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. 65190 / August 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14513

In the Matter of Shepaug Corp., Simone Group, Inc., Skynet Holdings, Inc., Skyview Development Corp., SMC Ventures, Inc. (f/k/a Gensci Regeneration Sciences, Inc.), Sonora Diamond Corp., and Sonus Communication Holdings, 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 Shepaug Corp., Simone Group, Inc., Skynet Holdings, Inc., Skyview Development Corp., SMC Ventures, Inc. (f/k/a Gensci Regeneration Sciences, Inc.), Sonora Diamond Corp., and Sonus Communication Holdings, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Shepaug Corp. (CIK No. 206018) is a merged out Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Shepaug is delinquent in its

periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1993.

2. Simone Group, Inc. (CIK No. 813424) is a forfeited Delaware corporation located in Long Island City, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Simone Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended October 31, 1994.

3. Skynet Holdings, Inc. (CIK No. 1051066) is a Delaware corporation located in Bala Cynwyd, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Skynet is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 1999, which reported a net loss of $6.16 million for the prior three months. On January 19, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Georgia, and the case was terminated on August 20, 2003.

4. Skyview Development Corp. (CIK No. 1390016) is a Delaware corporation located in Clifton, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Skyview 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 $1,520 for the prior nine months.

5. SMC Ventures, Inc. (f/k/a Gensci Regeneration Sciences, Inc.) (CIK No. 934801) 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). SMC 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, 2002, which reported a net deficit of $105 million (Canadian) for the prior twelve months. As of August 22, 2011, the company's stock (symbol "SMCVF") was traded on the over-the-counter markets.

6. Sonora Diamond Corp. (CIK No. 790307) 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). Sonora Diamond 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 $1.2 million (Canadian) for the prior twelve months.

7. Sonus Communication Holdings, Inc. (CIK No. 791219) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sonus is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of over $1.4 million for the prior nine months. On March 26, 2002, the company filed a Chapter 11

petition in the U.S. Bankruptcy Court for the Southern District of New York, and the case was terminated on August 22, 2005.

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 domestic issuers to file quarterly reports. Rule 13a-16 requires foreign private issuers to file 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.

10. 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 Casey
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9252 / August 25, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3261 / August 25, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14514

In the Matter of **GSCP (NJ), L.P.** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND 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 8A of the Securities Act of 1933 ("Securities Act") and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against GSCP (N.J.), L.P. ("GSC" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and 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[1] that:

Summary

1. These proceedings arise out of the structuring and marketing of the Squared CDO 2007-1 ("Squared") collateralized debt obligation ("CDO"), which was offered to investors in early 2007. J.P. Morgan Securities LLC (f/k/a J.P. Morgan Securities Inc.) ("J.P. Morgan Securities") structured and marketed Squared, a largely synthetic CDO whose assets consisted primarily of Credit Default Swaps ("CDSs") whose reference securities were other CDOs. GSC served as collateral manager in connection with the selection of assets for and managing of the Squared portfolio. Synthetic CDO squareds were designed to, and did, result in leveraged exposure to the housing market and therefore magnified losses when the United States housing market experienced a downturn.

2. GSC failed to ensure that investors were adequately informed that the hedge fund Magnetar Capital LLC ("Magnetar"), with economic interests adverse to investors in Squared, played a significant role in the portfolio selection process. While participating in the selection of CDO securities for the investment portfolio, Magnetar (who also invested $8.9 million in the subordinated notes, or equity) took the short position for CDO securities with a notional value of approximately $600 million, representing approximately half of Squared's investment portfolio. The marketing materials for Squared, including the term sheet, pitch book and offering circular, all represented that the investment portfolio of CDO securities was selected by GSC, without disclosing the role played by Magnetar, a fact known by GSC.

3. J.P. Morgan Securities sold approximately $150 million of the so-called "mezzanine" tranches of Squared's liabilities ("Notes") to a group of approximately 15 domestic and foreign institutional investors ("Mezzanine Investors"). All of the 10 Mezzanine Investors interviewed by the Commission staff indicated that they would have considered it important to their investment decision to have known that the equity investor in Squared took the short position for approximately half of the investment portfolio and played a significant role in the collateral selection process.

4. Squared, which priced on April 19, 2007 and closed on May 11, 2007, declared an event of default on January 18, 2008. By January 29, 2008, 50% of the CDO securities in the investment portfolio had been downgraded and 34% of the portfolio was on negative downgrade watch. As a result, the Mezzanine Investors lost most, if not all, of their principal. While J.P. Morgan Securities and its affiliates sustained losses of approximately $880 million in connection with the entire super senior tranche, it also avoided potentially substantial losses when it closed the deal and removed the warehouse financing exposure from its books.

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

Respondent

5. GSC, a registered investment adviser to various funds, was headquartered in Florham Park, New Jersey. GSC served as collateral manager for a number of CDOs, including Squared. As of December 31, 2006, GSC had closed nine structured finance CDO transactions, had more than $12.9 billion in structured finance assets under management and over $22 billion in total assets under management. GSC filed for Chapter 11 bankruptcy protection on August 31, 2010.

Other Relevant Person and Entity

6. Edward Steffelin ("Steffelin"), age 41, was a Managing Director at GSC's offices in New York City and an associated person of GSC during the relevant period. Steffelin was in charge of the GSC team responsible for Squared. He obtained his Series 7 and 63 licenses in March 2010 and is currently a registered representative with a broker-dealer based in Scottsdale, Arizona.

7. J.P. Morgan Securities is the principal U.S. broker-dealer of J.P. Morgan Chase & Co., a global investment banking, securities and investment management firm headquartered in New York City. J.P. Morgan Securities structured and marketed Squared.

Facts

CDOs and CDO Squared Transactions Generally

8. CDOs are complex, structured investment vehicles generally backed by residential mortgage backed securities, commercial mortgage backed securities, or other types of asset-backed fixed income securities which are packaged and held by a special purpose vehicle ("SPV") that issues notes entitling the holders to payment derived from the performance of the securities. A CDO portfolio may contain cash assets, such as the fixed income securities described above, and synthetic assets, such as CDSs[2] that reference the performance of fixed income securities. A "CDO squared" is a CDO whose portfolio contains securities issued by other CDOs or references the performance of securities issued by other CDOs.

9. The underwriter and structurer of a CDO squared typically provides a warehouse facility, pursuant to which it acquires and holds the assets selected by the collateral manager prior to the closing of the deal. The process of selecting portfolio assets colloquially is known as "ramping", and the individual CDO securities or bonds are colloquaially known as "names." At closing, the SPV typically acquires the collateral on the terms negotiated by the underwriter and structurer, and pays the underwriter and structurer through the proceeds of the sale of notes to investors.

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2 CDSs are a type of bilateral contract in which a seller of protection agrees to pay a buyer of protection a specified amount of money if the issuer of the referenced bond defaults on its obligations. The counterparty CDS buyer, in return for that protection, periodically pays a specified fee, or spread, to the seller during the term of the CDS contract.

10. A CDO squared issues notes whose payments are made in waterfall fashion, with priority of payment determined by the risk profile of the investment tranche. Investors in the super senior, AAA tranche receive first priority of payment. The lower "mezzanine" tranches are junior in priority and, therefore, carry greater risk and lower payment priority than the super senior tranche. The unrated equity tranche carries the greatest risk, as it is the first to experience losses.

Squared CDO

11. Squared was a $1.1 billion, largely synthetic CDO Squared. As such, its collateral portfolio consisted primarily of CDS assets that referenced the securities issued by other CDOs.

12. GSC and J.P. Morgan Securities executed the engagement letter for Squared on or about January 11, 2007. The engagement letter provided that J.P. Morgan would serve as arranger and placement agent, and would provide warehouse financing pursuant to a separate written agreement, and GSC would serve as portfolio manager. Steffelin signed the engagement letter on behalf of GSC.

Squared Collateral Selection Process: Phase One

13. The collateral selection and warehousing process for Squared began on or about January 12, 2007. Between January 12 and February 7, 2007, GSC selected for the warehouse 27 names with a notional value of $436.4 million. During this phase, GSC selected this collateral and placed it in the J.P. Morgan Securities warehouse with little or no input from Magnetar.

14. Magnetar bought the CDS protection, or took the short position, on three of the selected CDO securities with a notional value of $60 million. The short counterparties on the remaining 24 CDO securities were identified using a "bid wanted in competition" or "BWIC" process, in which a list of bonds is submitted to various brokers to solicit bids for protection on those bonds.

Squared Collateral Selection Process: Phase Two

15. On or about January 29, 2007, J.P. Morgan Securities executed a letter agreement with Magnetar obligating Magnetar to purchase the equity of Squared.

16. Shortly after executing the equity purchase agreement, Magnetar began to play a significant role in the process of selecting the remaining collateral for Squared. Between February 8 and 23, 2007, Magnetar took the short position on 18 of the 19 synthetic names that were selected for the Squared portfolio. Names for which Magnetar was not interested in taking the short position were neither included in the portfolio nor bid out to the market (using the customary BWIC process) to find other potential buyers of protection.

17. From early January through late February 2007, Steffelin engaged in a series of discussions with the Magnetar employee primarily responsible for the firm's participation in the Squared transaction about possibly setting up a collateral manager for Magnetar.

18. Steffelin and Magnetar ultimately did not reach an agreement. However, such discussions with Magnetar at the same time he was ramping the portfolio for Squared posed a potential conflict of interest for Steffelin, who was permitting Magnetar to participate in the collateral selection process despite its having economic interests adverse to Squared's other investors.

19. Steffelin did not disclose this potential conflict of interest to J.P. Morgan Securities, the SPVs that issued the notes, or any of the Mezzanine Investors.

Squared Collateral Selection Process: Phase Three

20. On or about February 24, 2007, J.P. Morgan Securities closed the warehouse for Squared, meaning it stopped acquiring collateral for the portfolio. Between this time period and the deal closing, GSC, J.P. Morgan, and Magnetar discussed securities that might ultimately be included in the portfolio. On or about April 18, 2007, an agreement was reached among GSC, J.P. Morgan and Magnetar on the vast majority of the remaining names to be included in the Squared portfolio. The deal priced on April 19, 2007. None of the CDS names were bid out to the market, as Magnetar was pre-identified as the buyer.

21. The following chart summarizes the three phases of the warehousing and portfolio selection for Squared:

Phase	Total Notional Value ($)	Total Number of Names	Magnetar Short Position ($)	Number of Magnetar Names
I	436.4M	27	60M	3
II	365M	19	360M	18
III	293.9M	19	183.9M	12
Total	1.1B	65	603.9M	33

22. By the time Squared closed, Magnetar's $8.9 million "long" position from purchasing the equity was dwarfed by its $600 million "short" position as the purchaser of CDS protection.

23. Statistical analyses conducted in connection with the Commission staff's investigation indicate that Magnetar's involvement in the collateral selection process contributed, beginning in early 2008, to the negative performance of Squared's investment portfolio.

Disclosures Regarding the Role of GSC

24. During March and April 2007, J.P. Morgan Securities marketed the mezzanine tranches of Squared to potential investors. GSC participated in these efforts by meeting with potential investors and talking to them over the phone.

25. J.P. Morgan Securities' sales and marketing employees emphasized to investors the advantages of having GSC select and manage the portfolio. GSC was aware of this marketing emphasis.

26. Unbeknownst to the Mezzanine Investors, Phases II and III of the collateral selection process involved significant input from Magnetar, which engaged in back-and-forth negotiations with GSC and J.P. Morgan Securities, pursuant to which an agreement was reached on the portfolio.

27. The written marketing materials for Squared, including the pitch book, term sheet and offering circular, represented that GSC selected the investment portfolio. For example, J.P. Morgan Securities' April 2007 term sheet for the Squared CDO described GSC as the "Portfolio Selector."

28. Similarly, the J.P. Morgan Securities March 2007 pitch book for Squared, which provided an overview of GSC's senior management team, business strategy, expertise and credit selection process, represented that the portfolio would be selected and managed by GSC. GSC supplied this information for the pitch book, and reviewed and edited the document before it was provided to investors.

29. The May 2007 offering circular for Squared represented that the investment portfolio was selected by GSC in accordance with its "research, credit analysis and judgment."

30. GSC reviewed and edited the offering circular before it was provided to investors.

31. Although the offering circular disclosed that a noteholder may hold a short position with respect to the CDO securities or buy credit protection with respect to the CDO securities, and that a noteholder may act with respect to those positions "without regard to whether any such action might have an adverse effect on the Issuer, the Noteholders, related Reference Entity or any Reference Obligation," this disclosure did not indicate that a noteholder like Magnetar was involved in the portfolio selection process.

32. GSC also failed to disclose Magnetar's involvement in the collateral selection process to either of the SPVs that issued the Notes. Domestic and offshore SPVs were formed to issue the Notes in Squared. GSC entered into a Collateral Management Agreement with the offshore SPV, pursuant to which GSC was appointed as its investment adviser and agreed to select and manage the collateral. (As the Delaware SPV did not purchase any collateral, it was not a party to this agreement.) The SPVs were clients of GSC.

33. During the course of the Commission staff's investigation, the Chairman of the board of the offshore SPV and the sole director of the domestic SPV indicated that, had they been informed that: 1) a third party with economic interests adverse to that of the investors had played a significant role in the collateral selection process; or 2) the employee at the collateral manager principally responsible for the Squared transaction was talking about going into business with a third party that he was allowing to participate in the collateral selection process, they would have informed their respective legal counsel and asked them to determine whether these facts needed to be disclosed in the offering documents.

Squared's Mezzanine Investors

34. J.P. Morgan Securities sold Notes with a par value of $150 million to the Mezzanine Investors, a group of approximately fifteen (15) institutional investors including seven located in the United States and eight located overseas (the Mezzanine Investors actually paid $145.8 million due to modest pricing discounts). The seven domestic Mezzanine Investors in Squared were: Thrivent Financial for Lutherans, a Minneapolis, Minn.-based not-for-profit life insurance organization ($10 million notional); General Motors Asset Management, a New York City-based asset manager for General Motors' pension plans ($10 million notional); Security Benefit Corporation, a Topeka, Kansas-based provider of insurance and retirement products ($12 million notional); Moneygram International, Inc., a Minneapolis, Minn-based provider of global money transfer and bill payment services ($15 million notional); Fifth Third Asset Management Inc., a Cincinnati, Ohio-based investment adviser and mutual fund company ($4 million notional); Morgan Asset Management Inc., the Birmingham, Alabama-based asset management unit of broker-dealer Morgan & Keegan Co. ($6 million notional); and Dillon Read Finance L.P., a New York City-based affiliate of a hedge fund unit within a major investment and commercial bank ($20 million notional).

35. The eight foreign Mezzanine Investors were: two Taiwanese life insurance companies, Far Glory Life Insurance Company Ltd. ($5 million notional) and Taiwan Life Insurance Company Ltd. ($3 million notional); three banks, Paris-based Caisse D'Epargne ($20 million notional), Tokyo-based Tokyo Star Bank ($8 million notional) and Singapore-based United Overseas Bank ($13 million notional); two asset managers, Hong Kong-based East Asia Asset Management Ltd. ($1 million notional) and Tel Aviv-based Leader Capital Markets Ltd. ($2 million notional); and a Sydney-based hedge fund, Basis Pac-Rim Opportunity Fund ($10 million notional). The Mezzanine Investors lost most, if not all, of their principal when their Notes became nearly worthless less than one year after closing.

36. All of the ten Mezzanine Investors interviewed by the Commission's staff indicated that they would have considered it important to their investment decision to have known that the equity investor in Squared had taken the short position for approximately half of the investment portfolio and played a significant role in the collateral selection process.

GSC's Failure to Retain Adequate Books and Records

37. GSC failed to retain books and records regarding the process by which it purported to select the investment portfolio for Squared. Specifically, GSC did not retain the vast majority of email communications between GSC, J.P. Morgan Securities and/or Magnetar concerning the collateral selection process for Squared. Emails documenting internal GSC discussions of potential bonds for Squared also were not preserved in GSC's books and records.

38. GSC failed to maintain these email records in contravention of its email retention policy set forth in its "Policy and Procedures" manual. That policy states, in part, that the firm is required to retain written communications "related to any recommendation made or proposed to be made and any advice given or proposed to be given."

Violations

39. Section 206(2) of the Advisers Act prohibits investment advisers from "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Section 206(2) of the Advisers Act imposes a fiduciary duty on investment advisers obligating them to disclose all material information, including conflicts of interest, to their clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-97 (1963). Proof of scienter is not required to establish a violation of Section 206(2), but rather may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *Capital Gains*, 375 U.S. at 194-95.); *see also SEC v. Wash. Inv. Network*, 475 F.2d 392, 396 (D.C. Cir. 2007).

40. Sections 17(a)(2) and (3) of the Securities Act prohibit fraud in the offer or sale of any security or securities-based swap agreement. Scienter is not required to prove violations of Sections 17(a)(2) or (3). *Aaron v. SEC*, 446 U.S. 680, 697 (1980). Instead, violations of these sections may be established by showing negligent conduct. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997).

41. Rule 204-2(a)(7) promulgated under Section 204 of the Advisers Act requires SEC-registered investment advisers to retain all written communications related to any recommendation made or proposed to be made and any advice given or proposed to be given.

42. As a result of the negligent conduct described above, GSC violated Section 206(2) of the Advisers Act, Sections 17(a)(2) and (3) of the Securities Act, Section 204 of the Advisers Act and Rule 204-2(a)(7) thereunder.

Remedial Efforts

In determining to accept the offer, the Commission considered cooperation afforded the Commission staff by GSC.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent GSC cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and (3) of the Securities Act and Sections 204 and 206(2) of the Advisers Act and Rule 204-2 promulgated thereunder.

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. 65205 / August 26, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3263 / August 26, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14515

In the Matter of **Renee Marie Brown,** **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 Renee Marie Brown ("Brown" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") that 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.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. Brown, age 47, is a resident of Golden Valley, Minnesota. In October 2001, she founded Wildwood Wealth Management, LLC (Wildwood), a Minneapolis, Minnesota-based investment adviser that was registered with the Commission. Brown holds several securities licenses, including series 7, 24, 63, and 66 licenses. From February 22, 2010 until March 8, 2010, Brown was associated with Sawtooth Asset Management, Inc. ("Sawtooth"), an investment adviser registered with the Commission. On March 8, 2010, Brown terminated her association with Sawtooth. From June 6, 2005 until March 11, 2010, Brown was a registered representative with CapitalQuest Securities, Inc. ("CapitalQuest"), a broker-dealer registered with the Commission. On March 11, 2010, CapitalQuest terminated Brown. Brown started Aaria Capital, Inc. ("Aaria"), her own business.

2. On August 17, 2011, a final judgment was entered by consent against Brown, permanently enjoining her from future violations of Sections 17(a)(1), (2) and (3) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77q(a)(1), (2) and (3)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5], and Sections 206(1), 206(2) and 206(4) of the Advisers Act [15 U.S.C. §§ 80b-6(1), 80b-6(2) and 80b-6(4)] and Rule 206(4)-8 thereunder [17 C.F.R. 275.206(4)-8], in the civil action entitled Securities and Exchange Commission v. Renee Marie Brown, et al., Civil Action Number 10-cv-1207, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleges that, Brown, a Minnesota-based investment adviser, defrauded clients into transferring their money to Investors Income Fund X, LLC ("the Fund") and falsely represented that the Fund was a "bond fund" with fixed annual returns of 8% or 9%. The Commission further alleges that she distributed bogus "returns" to investors in order to further the fiction that the Fund was a legitimate and successful investment opportunity. From July 2009 through March 2010, clients invested more than $1.1 million with the Fund. The Commission alleges that Brown used most of that money to, among other things, purchase a condominium and build-out office space for her new business.

IV.

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

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.

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. 65218 / August 29, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14521

In the Matter of **Matthews Studio Equipment Group,** **Meridian Point Realty Trust 83,** **More Cash for Life (Worldwide) Ltd.,** **New York Networks, Inc. (f/k/a Caliper Acquisition Corporation),** **Nomatterware, Inc.,** **Normark Ventures Corp., and** **Novaheadinc,** **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 Matthews Studio Equipment Group, Meridian Point Realty Trust 83, More Cash for Life (Worldwide) Ltd., New York Networks, Inc. (f/k/a Caliper Acquisition Corporation), Nomatterware, Inc., Normark Ventures Corp., and Novaheadinc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Matthews Studio Equipment Group (CIK No. 855575) is a suspended California corporation located in Burbank, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Matthews Studio Equipment Group is delinquent in its periodic filings with the Commission, having not

filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2000, which reported a net loss of over $26,000 for the prior nine months. On April 6, 2000, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, and the case was dismissed on January 31, 2006.

2. Meridian Point Realty Trust 83 (CIK No. 703702) is a California trust located in Mentor, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Meridian Point Realty is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1999, which reported a net loss of over $143,000 for the prior nine months.

3. More Cash for Life (Worldwide) Ltd. (CIK No. 1399692) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). More Cash for Life is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on May 17, 2007, which reported a net loss of over $9,000 between its inception date on May 11, 2007 and May 15, 2007.

4. New York Networks, Inc. (f/k/a Caliper Acquisition Corporation) (CIK No. 1107572) is a void Delaware corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). New York Networks 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 $780 for the prior nine months. New York Networks filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Western District of New York on April 11, 2008, and the case was terminated on November 2, 2009.

5. Nomatterware, Inc. (CIK No. 1120023) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Nomatterware is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of over $1.6 million for the prior nine months. As of August 26, 2011, the company's stock (symbol "NOMW") was traded on the over-the-counter markets.

6. Normark Ventures Corp. (CIK No. 1126380) is a defaulted Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Normark Ventures 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 April 30, 2006, which reported a net loss of over $56,000 for the prior twelve months.

7. Novaheadinc (CIK No. 1177673) is a delinquent Colorado corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Novaheadinc is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the

period ended September 30, 2002, which reported a net loss of over $265,000 for the prior nine months.

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 domestic 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

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. 65216 / August 29, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14519

In the Matter of JAY L. LEBOUEF, 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 Jay L. LeBoeuf ("LeBoeuf") ("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.B.2 and III.B.4 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. LeBoeuf was previously associated with a registered broker-dealer and held Series 22 and 63 licenses from 1987 to 2005 and a series 39 license from 1998 to 2005 at which time he let all of his licenses lapse. LeBoeuf, 50 years old, is a resident of Parker, Colorado.

2. On June 9th, 2011, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Jay L. LeBoeuf, et. al., Civil Action Number 11-CV-187 J, in the United States District Court for the District of Wyoming.

3. The Commission's complaint alleged that, in connection with six oil and gas related offerings, LeBoeuf misused and misappropriated investor funds, falsely stated to investors the amount of their funds to be invested, mislead investors as to the returns they would receive, mislead investors regarding a permanent injunction obtained against him by the State of Colorado barring him from selling securities, mislead investors regarding a judgment entered against him in a bankruptcy proceeding where the court found LeBoeuf took advantage of an unsophisticated elderly investor and awarded the investor's estate $3 million, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint also alleged that LeBoeuf acted as an unregistered broker-dealer when he actively solicited investors and raised over $500,000 from nine investors in eight different states after his licenses had lapsed.

4. On February 28th, 2011, LeBoeuf pled guilty to one count of mail fraud in violation of Title 18 United States Code, Sections 1341 and 1342 before the United States District Court for the of Wyoming, in United States v. Jay L. LeBoeuf, et. al., Crim. Information No. 11-CR-00037. On May 27th 2011, a judgment in the criminal case was entered against LeBoeuf. He was sentenced to a prison term of 30 months followed by 3 years of supervised release and ordered to make restitution in the amount of $492,365.41.

5. The counts of the criminal information to which LeBoeuf pled guilty alleged, inter alia, that LeBoeuf defrauded investors and obtained money and property by means of materially false and misleading statements, that he used the United States mails to send offering materials with false and misleading statements, and that he caused commercial interstate carriers to deliver investors' checks to him.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL 111-203, July 21, 2010, 124 Stat. 1376, Respondent 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.

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.

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. 9254 / August 30, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65223 / August 30, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3268 / August 30, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29775 / August 30, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-11818

In the Matter of

Banc of America Capital Management, LLC, BACAP Distributors, LLC, and Banc of America Securities, LLC,

Respondents.

ORDER MODIFYING ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940

I.

On February 9, 2005, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the

Investment Company Act of 1940 ("Investment Company Act") (the "2005 Order"),[1] against Banc of America Capital Management, LLC ("BACAP"), BACAP Distributors, LLC, and Banc of America Securities, LLC ("BAS") (collectively "Respondents").

II.

In anticipation of the proceedings, Respondents consented to the entry of the 2005 Order. Among other things, the 2005 Order required Respondents to cease and desist from further violations of the federal securities laws, directed Respondents to pay disgorgement and civil money penalties, and directed Respondents to comply with certain undertakings.

III.

By and through their respective successors, Respondents have submitted an Amended Offer of Settlement (the "Offer") proposing to relieve Respondents of their continuing obligation to conduct third-party periodic reviews in accordance with paragraphs 141 and 145 of the 2005 Order and to order that Merrill Lynch, Pierce, Fenner & Smith Incorporated, as acquirer of BAS, will maintain a compliance and ethics oversight infrastructure that provides equivalent protections to the infrastructure that BAS was required to maintain pursuant to paragraph 138 of the 2005 Order. Solely for the purposes 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 Modifying Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b)and Section 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

IV.

The Commission deems it appropriate and in the public interest to amend the 2005 Order as agreed to in the Respondents' Offer.

Accordingly, IT IS HEREBY ORDERED that:

A. Paragraph 138 of the 2005 Order is amended as follows to order:

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), as the acquirer of Bank of America Investment Services, Inc. ("BAI"), the successor to the retail sales of mutual funds business of BAS, will maintain a compliance and ethics oversight infrastructure that provides equivalent protections to the compliance and ethics oversight

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[1] See Securities Act Rel. No.8538, February 9, 2005, Admin. Proc. File No. 3-11818.

infrastructure that BAS was required to maintain under Paragraph 138 of the original 2005 Order. By October 2011, Merrill Lynch shall retain a third-party, who is not an interested person, as defined in the Investment Company Act, to conduct a review of the compliance and ethics oversight infrastructure applicable to Merrill Lynch to determine if the infrastructure provides equivalent protections to the compliance and ethics oversight infrastructure required under Paragraph 138 of the original 2005 Order. Merrill Lynch shall promptly deliver the third party's report, along with any recommendations, to Merrill Lynch's Compliance and Risk Operating Committees, the Merrill Lynch Board of Directors, and the Commission staff.

B. Paragraph 141 of the 2005 Order is amended as follows to order:

In the event that BACAP or BACAP Distributors or their successors (the "BACM Entities") seek to advise, sponsor or distribute mutual funds, other than money-market funds ("Long-Term Funds"), the BACM Entities shall retain a third-party, who is not an interested person, as defined in the Investment Company Act, to conduct a compliance review of the BACM Entities. At the conclusion of the review, the BACM Entities shall require the third-party to issue a report of its findings and recommendations concerning the BACM Entities' supervisory, compliance, and other policies and procedures reasonably designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by the BACM Entities and their employees in connection with their duties and activities on behalf of and related to the Long-Term Funds. The BACM Entities shall promptly deliver the report, along with any recommendations, to BACM Entities' Internal Compliance Controls Committee, the Audit Committee of the board of each Long-Term Fund, and the Commission staff.

C. Paragraph 145 of the 2005 Order is amended as follows to order:

By October 2011, Merrill Lynch, as the acquirer of BAI, shall undergo a compliance review by a third-party who is not an interested person, as defined in the Investment Company Act, of Merrill Lynch. At the conclusion of the review, Merrill Lynch shall require the third party to issue a report of its findings and recommendations concerning Merrill Lynch's supervisory, compliance, and other policies and procedures reasonably designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by Merrill Lynch and its employees in connection with the retail sales of mutual funds. Merrill Lynch shall promptly deliver such report, along with any recommendations, to Merrill Lynch's Compliance and Risk Operating Committees, the Merrill Lynch Board of Directors, and the Commission staff.

D. All other provisions of the 2005 Order remain in effect.

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. 65221 / August 30, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14522

In the Matter of **Somerset International 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 Somerset International Group, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Somerset International Group, Inc. (CIK No. 350524) is a void Delaware corporation located in Bedminster, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Somerset is delinquent in its periodic filings with the Commission because the company's Forms 10-K filed for the periods ended December 31, 2009 and December 31, 2010 were materially deficient because they did not include audited financial statements as required by Regulation S-X. As of August 26, 2011, the company's stock (symbol "SOSI") was quoted on OTC Link (previously, "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).

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 and compliant 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 domestic issuers to file quarterly reports.

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

III.

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

A. Whether the allegations contained in Section II 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
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 30, 2011

In the Matter of **Somerset International 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 Somerset International Group, Inc.

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. EDT on August 30, 2011, through 11:59 p.m. EDT on September 13, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **August 2011**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

MARY L. SCHAPIRO, CHAIRMAN

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(12 DOCUMENTS)

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65132)

August 15, 2011

Order Temporarily Exempting the Floor Broker Operations of Broker-Dealers with Market Access That Handle Orders on a Manual Basis from the Automated Controls Requirement of Rule 15c3-5(c)(1)(ii) and Rule 15c3-5(c)(2) under the Securities Exchange Act of 1934

I. Introduction

Pursuant to Rule 15c3-5(f) under the Securities Exchange Act of 1934 ("Exchange Act"),[1] the Securities and Exchange Commission ("Commission"), by order, may exempt from the provisions of Rule 15c3-5 ("Rule"), either unconditionally or on specified terms and conditions, any broker or dealer, if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[2] As discussed below, the Commission temporarily is exempting the floor broker operations of broker-dealers with market access that handle orders on a manual basis ("Floor Brokers") from the automated controls requirement of Rules 15c3-5(c)(1)(ii)[3]and (c)(2)[4] until November 30, 2011.[5]

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1 See 17 CFR 240.15c3–5(f).

2 See also Exchange Act Section 36(a)(1), 15 U.S.C. 78mm(a)(1) (providing general authority for Commission to grant exemptions from provisions of Exchange Act and rules thereunder, provided the Commission makes certain required findings).

3 See 17 CFR 240.15c3–5(c)(1)(ii).

4 See 17 CFR 240.15c3–5(c)(2).

5 On June 27, 2011, the Commission extended the compliance date, until November 30, 2011, for all of the requirements of Rule 15c3-5 for fixed income securities, and the requirements of Rule 15c3-5(c)(1)(i) for all securities. See Securities Exchange Act Release No. 64748 (June 27, 2011), 76 FR 38293 (June 30, 2011).

II. Background

On November 3, 2010, the Commission adopted Rule 15c3-5 under the Exchange Act.[6] Among other things, Rule 15c3-5 requires each broker-dealer with access to trading securities[7] directly on an exchange or ATS, including a broker-dealer providing sponsored or direct market access to customers or other persons, and each broker-dealer operator of an ATS that provides access to trading securities directly on its ATS to a person other than a broker-dealer, to establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, is reasonably designed to (1) systematically limit the financial exposure of the broker-dealer that could arise as a result of market access,[8] and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access.[9] The required financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds,[10] or that appear to be erroneous.[11] The regulatory risk management controls and supervisory procedures must also be reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis,[12] prevent the entry of orders that the broker-dealers or customer is restricted

6 See Exchange Act Release No. 63241 (Nov. 3, 2010), 75 FR 69792 (Nov. 15, 2010) ("Rule 15c3-5 Adopting Release").

7 Rule 15c3-5 applies to trading in all securities on an exchange or ATS. Id. at 69765.

8 See 17 CFR 240.15c3–5(c)(1).

9 See 17 CFR 240.15c3–5(c)(2).

10 See 17 CFR 240.15c3–5(c)(1)(i).

11 See 17 CFR 240.15c3–5(c)(1)(ii).

12 See 17 CFR 240.15c3–5(c)(2)(i).

from trading,[13] restrict market access technology and systems to authorized persons,[14] and assure appropriate surveillance personnel receive immediate post-trade execution reports.[15]

The Commission has received a request from NYSE Amex LLC ("NYSE Amex"), NYSE Arca, Inc. ("NYSE Arca"), and New York Stock Exchange LLC ("NYSE")(collectively, "NYSE Euronext") to extend the compliance date for the automated controls requirement pursuant to Rules 15c3-5(c)(1)(ii) and (c)(2) for Floor Brokers until November 30, 2011.[16] Specifically, NYSE Euronext indicated that more time is needed to complete the implementation of the automated controls required pursuant to Rules 15c3-5(c)(1)(ii) and (c)(2) for orders handled on a manual basis because the floor broker operations of broker-dealers with market access historically have used manual systematic controls for their risk management and regulatory purposes with respect to manual orders, and they will need additional time to complete the development and implementation of automated controls for such manual orders.[17] NYSE Euronext explained that certain Floor Brokers initially believed that their existing combination of automated and manual controls would be sufficient for compliance with Rule 15c3-5,[18] and only recently became aware that the required pre-trade controls under the Rule must be systemic and automated for compliance purposes.[19] NYSE Euronext also explained that

13 See 17 CFR 240.15c3–5(c)(2)(ii).

14 See 17 CFR 240.15c3–5(c)(2)(iii).

15 See 17 CFR 240.15c3–5(c)(2)(iv).

16 See letter from Janet McGinness, Senior Vice President – Legal and Corporate Secretary, NYSE Euronext, on behalf of NYSE Amex, NYSE Arca, and NYSE, to Elizabeth Murphy, Secretary, Commission, dated June 29, 2011 ("NYSE Euronext Letter").

17 Id.

18 Id. at 2.

19 See Rule 15c3-5 Adopting Release.

additional time would provide the NYSE Euronext with an opportunity to update Floor Broker-related systems and thereby facilitate compliance with the Rule by Floor Brokers.[20]

III. Discussion

The Commission is temporarily exempting Floor Brokers from the automated controls requirement of Rules 15c3-5(c)(1)(ii)[21] and (c)(2)[22] until November 30, 2011. The Commission believes that providing additional time for such Floor Brokers to complete the development and implementation of automated controls pursuant to Rules 15c3-5(c)(1)(ii) and (c)(2) for orders handled on a manual basis, where manual systematic controls historically were used for risk management and regulatory purposes, is reasonable. In addition, the Commission believes that temporarily exempting Floor Brokers from the automated controls requirement of Rules 15c3-5(c)(1)(ii) and (c)(2) until November 30, 2011, should facilitate the orderly and meaningful implementation of the required automated risk management controls for those Floor Brokers that need more time to be in compliance with the Rule.

For the foregoing reasons, the Commission finds that granting the foregoing temporary exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

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20 NYSE Euronext Letter at 2.

21 See 17 CFR 240.15c3–5(c)(1)(ii).

22 See 17 CFR 240.15c3–5(c)(2).

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Rule 15c3-5(f),[23] that the floor broker operations of broker-dealers with market access that handle orders on a manual basis are temporarily exempted from the automated controls requirement of Rules 15c3-5(c)(1)(ii)[24] and (c)(2)[25] until November 30, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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23 See 17 CFR 240.15c3–5(f).

24 See 17 CFR 240.15c3–5(c)(1)(ii).

25 See 17 CFR 240.15c3–5(c)(2).

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65152 / August 17, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-12737

In the Matter of

FOLGER NOLAN FLEMING DOUGLAS CAPITAL MANAGEMENT, INC., NEIL C. FOLGER and DAVID M. BROWN,

Respondents.

ORDER DIRECTING DISBURSEMENT OF DISTRIBUTION FUND

On March 1, 2011, the United States Securities and Exchange Commission ("Commission") issued a Notice of Proposed Plan of Distribution and Opportunity for Comment ("Plan") proposed by the Division of Enforcement in connection with this proceeding (Exchange Act Rel. No. 63994). The Commission received no comments and on April 13, 2011, the Commission approved the Plan pursuant to delegated authority (Exchange Act Rel. No. 64295).

The Plan provides for the distribution of the Distribution Fund consisting of $246,472.45 in disgorgement and prejudgment interest, plus additional accumulated interest, by the U.S. Department of the Treasury's Financial Management Service ("FMS"), with the assistance of the Fund Administrator, to eligible investors according to the methodology set forth in the Plan. The Plan provides that the Fund Administrator will compile an electronic file listing the payees and amounts with the identification information required to make the distribution. The validated electronic payment file has been received and accepted by the staff.

Accordingly, it is ORDERED that the Commission staff shall disburse the Distribution Fund in the amount stated in the validated electronic payment file of $246,472.45, as provided for in the Distribution Plan.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65204 / August 26, 2011

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3262 / August 26, 2011

Admin. Proc. File No. 3-13986

In the Matter of

ERIC S. BUTLER
c/o Paul T. Weinstein, Esq.
Emmet, Marvin & Martin, LLP
120 Broadway, 32nd Floor
New York, NY 10271

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

INVESTMENT ADVISER PROCEEDING

Grounds for Remedial Action

Criminal Convictions

Former associated person of registered broker-dealer and investment adviser was criminally convicted for participating in a conspiracy to commit securities fraud and conspiracy to commit wire fraud. *Held,* it is in the public interest to bar Respondent from association with any broker, dealer, or investment adviser.

APPEARANCES:

Paul T. Weinstein, of Emmet, Marvin & Martin, LLP, for Eric S. Butler.

David S. Stoelting and *Eric M. Schmidt,* for the Division of Enforcement.

Appeal filed: February 9, 2011
Last brief received: June 27, 2011

I.

Eric S. Butler appeals from the decision of an administrative law judge barring him from association with any broker, dealer, or investment adviser based on his criminal convictions for securities fraud, for participating in a conspiracy to commit securities fraud, and for participating in a conspiracy to commit wire fraud.[1] We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.[2]

II.

A. Criminal Convictions

During the period at issue, Butler was associated with Credit Suisse Securities (USA) LLC ("Credit Suisse" or the "Firm"), a broker-dealer and investment adviser registered with the Commission. On April 14, 2009, Butler and his partner at Credit Suisse, Julian Tzolov, were indicted in the United States District Court for the Eastern District of New York for participating in a conspiracy to commit securities fraud and to commit wire fraud, and for committing securities fraud.[3] The indictment charged that Butler and Tzolov made unauthorized purchases of securities for the accounts of their customers, and fraudulently concealed the nature of these purchases. This case focuses on auction rate securities ("ARSs"), defined in the indictment as "debt instruments with long-term maturities for which the interest rates were set at auctions held at regular intervals."[4] The indictment described how Butler and Tzolov "contacted . . .

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1 *Eric S. Butler*, Initial Decision Rel. No. 413 (Jan. 19, 2011), 100 SEC Docket 37127.

2 As indicated, we have conducted an independent review of the record in this case after giving the parties the opportunity to fully brief their positions. We note, however, that Commission Rule of Practice 411(e) authorizes "summary affirmance" of an initial decision where "no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument." Although we generally have limited application of this rule in conducting our reviews, we may apply it in the future where, as here, the relevant facts are undisputed and the initial decision does not embody an important question of law or policy warranting further review by the Commission. *See* 17 C.F.R. § 201.411(e).

3 The indictment charged one count of conspiracy to commit securities fraud, in violation of 18 U.S.C. § 371; one count of conspiracy to commit wire fraud, in violation of 18 U.S.C. § 1349; and one count of securities fraud in violation of 15 U.S.C. §§ 78j(b), 78ff.

4 *See also* Current Accounting and Disclosure Issues in the Division of Corporation Finance (March 4, 2005), *available at* http://www.sec.gov/divisions/corpfin/acctdis030405.htm#P514_81909 ("Auction rate securities are long-term variable rate bonds tied to short-term

(continued...)

companies to discuss the benefits of investing in" a particular type of asset-backed ARSs "secured by student loans" that were "guaranteed by the U.S. Department of Education" and for which "the risk of default . . . was low" (the "SL-ARSs"). The indictment charged that Butler and Tzolov described the SL-ARSs to the customers as "low-risk products . . . guaranteed by the U.S. government" that "could be easily sold and converted into cash," and that customers agreed to such investments "intend[ing] to use SL-ARSs as a mechanism to manage their monthly short-term cash assets." Rather than purchasing solely SL-ARSs, however, Butler and Tzolov used some of the customers' funds "to purchase other [non-SL-ARS] types of ARSs," including mortgaged backed CDO-ARSs. The indictment described a fraudulent scheme by Tzolov and Butler to "conceal[] the true nature of" these purchases from their customers, including by "falsif[ying] the names of the products [in emails to the customers] to make it appear that those products were SL-ARSs when they were, in fact, other types of ARSs."

Tzolov pleaded guilty to securities fraud and conspiracy to commit securities fraud, and testified at Butler's trial.[5] Tzolov testified that Butler and Tzolov invested funds of customers who authorized purchases of SL-ARSs in non-SL-ARS without authorization to do so; made these unauthorized purchases in order to earn higher commissions than were available for SL-ARS; and misled customers by falsely telling them that these securities were SL-ARSs. Butler's trial also included testimony from representatives of Butler and Tzolov's customers.[6] Consistent with Tzolov's testimony, the customer representatives testified that Butler and Tzolov had not been authorized to purchase non-SL-ARSs, and misled them regarding these purchases.[7]

On August 17, 2009, after a sixteen-day jury trial in the Eastern District of New York, the jury found Butler guilty on all counts of the indictment. Before rendering its verdict, the jury was instructed that conspiracy convictions required findings that Butler acted "voluntarily," "deliberately" and "purposefully," i.e., that he "intentionally join[ed] the conspiracy with the

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4 (...continued)
interest rates that are reset through a "dutch auction" process which occurs every 7 - 35 days. The holder can participate in the auction and liquidate the auction rate securities to prospective buyers through their broker/dealer.").

5 On July 22, 2009, Tzolov pleaded guilty to the conspiracy to commit securities fraud and the securities fraud charges in the indictment, and also consented to the entry of a Commission order barring him from association with any broker, dealer, or investment adviser. *Julian T. Tzolov*, Securities Exchange Act Rel. No. 62351 (June 22, 2010), 98 SEC Docket 29406.

6 Their customers included Randgold Resources Ltd., Potash Corporation, Copa Airlines, Roche International Ltd., and GlaxoSmithKline Holdings (Americas) Inc.

7 Evidence at the trial also included customer account records; promotional materials; and e-mails among Butler, Tzolov, and the customers.

purpose of helping to achieve an unlawful object."[8] Based on the convictions, Butler was sentenced to five years imprisonment and a $5 million fine.[9] Butler appealed the criminal case to the United States Court of Appeals for the Second Circuit.

B. Institution of Administrative Proceedings and Initial Decision

We issued an order instituting these administrative proceedings against Butler on July 30, 2010 pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940.[10] On January 19, 2011, a law judge issued an initial decision by summary disposition,[11] finding that the jury verdict established the statutory basis for sanctions and that Butler was estopped from collaterally attacking his convictions. Concluding that the conduct underlying Butler's convictions was egregious, recurrent, and involved a high degree of scienter, and that there were no extraordinary mitigating circumstances in this case, the

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8 On September 29, 2009, finding that the "jury could have found the evidence overwhelming as to guilt," the district court denied Butler's motion for a post-verdict judgment of acquittal or for a new trial.

9 Butler was fined $500,000 for each of the conspiracy to commit securities fraud and the conspiracy to commit wire fraud counts, and $5,000,000 for the securities fraud count. The fines were imposed concurrently for a total of $5,000,000. The five-year prison terms for each conviction were also imposed concurrently. Butler was also sentenced to three years of supervised release for each count to run concurrently, and ordered to forfeit $250,000, the estimated gain from his misconduct. The judgment and sentence were entered by the district court on February 9, 2010. On June 25, 2010, the district court ordered continuation of Butler's bail pending resolution of the appeal finding, among other things, that "the appeal is not for the purpose of delay and raises a substantial question of law or fact likely to result in (i) reversal, (ii) an order for a new trial, (iii) a sentence that does not include a term of imprisonment, or (iv) a reduced sentence to a term of imprisonment less than the total of the time already served plus the expected duration of the appeal process" (citing 18 U.S.C. § 3143(b)(1)).

10 15 U.S.C. §§ 78*o*(b), 80b-3(f).

11 A hearing officer "may grant . . . summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law." Rule of Practice 250(b), 17 C.F.R. § 201.250(b).

law judge barred him from associating with any broker, dealer, or investment adviser.[12] This appeal followed.

C. Appellate Decision in the Second Circuit

On June 15, 2011, while this appeal of the administrative law judge's decision was pending, the Second Circuit affirmed Butler's convictions for conspiracies to commit securities fraud and wire fraud, but reversed his securities fraud conviction on venue grounds and remanded the conspiracy counts of the indictment for resentencing.[13] Despite the reversal of the securities fraud conviction, however, the Second Circuit did not credit Butler's claims that "none of the government's evidence proved materiality or intent beyond a reasonable doubt," or that the trial court's evidentiary rulings denied him "a fair chance to refute the government's case." Instead, it held that, "[a]t trial, the government proved that Butler and Tzolov made false statements to the investors about the types of securities purchased on their behalf," "falsified the names of the securities [in email confirmations] to make it appear as though they were student-loan-backed ARS," and "falsely stated that he was investing in student-loan-backed ARS." As a result of this conduct, the court found, "many clients were saddled with hundreds of millions of dollars in ARS that were not backed by student loans."[14]

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[12] On January 26, 2011, a district court in the Southern District of New York enjoined Butler from committing future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, based on the verdict in the criminal case. In doing so, the court in the civil proceeding rejected Butler's claim that the criminal trial "deprived him of a full and fair opportunity to litigate" and held that the "presence of appellate issues . . . will not defeat the application of collateral estoppel." *SEC v. Tzolov*, 2011 U.S. Dist. LEXIS 8562, at *14 & 15 (S.D.N.Y. Jan. 26, 2011).

[13] On June 23, 2011, the Division of Enforcement transmitted to us the Second Circuit June 15, 2011 opinion and summary order addressing Butler's arguments on appeal (together, the "Second Circuit Decision"). In its transmittal letter, the Division argued that the Second Circuit Decision further supports the decision to bar Butler. Butler did not respond to the Division's letter or otherwise address the Second Circuit Decision in subsequent pleadings. We take official notice of the Second Circuit Decision pursuant to Rule of Practice 323, 17 C.F.R. § 201.323.

[14] After considering Butler's objections to evidentiary rulings by the district court, the Second Circuit Decision "recognized . . . serious concerns over the propriety of . . . allowing" certain disputed evidence, but deemed any error harmless because the "remaining evidence was more than sufficient to convict [Butler]."

III.

A. Exchange Act Section 15(b) and Advisers Act Section 203(f) authorize administrative proceedings based on convictions for certain enumerated offenses, including any felony or misdemeanor "aris[ing] out of the conduct of the business of a broker [or] dealer" or that "involves the purchase or sale of any security."[15] Upon such a conviction, the Exchange Act and the Advisers Act authorize discipline if such person was associated with a broker-dealer or an investment adviser, in each case, "at the time of the alleged misconduct."[16]

We find that these statutory requirements have been satisfied. Butler does not dispute that his convictions for conspiracy to commit securities fraud and conspiracy to commit wire fraud satisfy the requisite statutory benchmarks for discipline.[17] Moreover, he was associated with a firm that was both a broker-dealer and an investment adviser when he engaged in the

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[15] 15 U.S.C. § 78*o*(b)(4)(B) and (6)(A); 15 U.S.C. § 80b-3(e)(2)(B) and (f); *see also Kornman v. SEC*, 592 F.3d 173, 184 (D.C. Cir. 2010) ("Congress has authorized the Commission to discipline persons who have been convicted of crimes that suggest a lack of fitness to remain in the securities industry.").

[16] 15 U.S.C. § 78*o*(6)(A); 15 U.S.C. § 80b-3(f).

[17] Given the recent reversal of the securities fraud conviction, this opinion is based solely on the conspiracy convictions. However, the securities fraud jury verdict was a proper basis for both the order instituting proceedings and the initial decision when issued despite the then-pending appeal. Each verdict was a conviction under the relevant statutory provisions. *See* Investment Advisers Act § 202(a)(6) (defining "convicted" to "include[] a verdict, judgment, or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea, or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed"); *Alexander Smith*, 22 S.E.C. 13, 20-21 (1946) (stating that "when there has been a verdict . . . there is a 'conviction' contemplated by Section 15(b) of the Exchange Act"). *See also Elliott v. SEC*, 36 F.3d 86, 87 (11th Cir. 1994) (per curiam) ("Nothing in the statute's language prevents a bar [from being] entered if a criminal conviction is on appeal."); *Hunt v. Liberty Lobby, Inc.*, 707 F.2d 1493, 1497 (D.C. Cir. 1983) ("Under well-settled federal law, the pendency of an appeal does not diminish the res judicata effect of a judgment rendered by a federal court."); Restatement (Second) of Judgments § 13, cmt. g (1982) ("[A] judgment otherwise final [for purposes of res judicata] remains so despite the taking of an appeal unless what is called an appeal actually consists of a trial de novo.").

misconduct giving rise to these convictions.[18] Accordingly, the Exchange Act Section 15(b) and Advisers Act Section 203(f) requirements have been met.[19]

B. The Exchange Act and the Advisers Act authorize us to censure, place limitations on, suspend, or bar an associated person based on these findings if we find that such sanction is in the public interest.[20] In analyzing the public interest we consider, among other things: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations.[21] Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."[22] Based on these factors, we conclude that the bars are amply warranted.[23]

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[18] In his answer to the order instituting proceedings, Butler denied that he was a registered representative of Credit Suisse and denied Credit Suisse's registration as an investment adviser and broker-dealer. In finding that Butler met the statutory requirements for discipline, the law judge cited FINRA records of his employment history attached to the Division's motion for summary disposition and took official notice of Credit Suisse's Form ADV and Form BD filed with the Commission as proof of its relevant registrations. Butler does not dispute these findings in the present appeal.

[19] *See* 15 U.S.C. § 80b-2(a)(17) (defining "person associated with an investment adviser"); 15 U.S.C. § 78c(a)(18) (defining "person associated with a broker or dealer"); *Kornman*, 592 F.3d at 183 (citing "Congress['s] . . . original intent that misconduct during a past association . . . subjects a person to administrative proceedings and sanctions under the Exchange and Advisers Acts").

[20] 15 U.S.C. §§ 78*o*(b)(6)(A), 80b-3(f).

[21] *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

[22] *David Henry Disraeli*, Exchange Act Rel. No. 57027 (Dec. 21, 2007), 92 SEC Docket 852, 875, *petition denied*, 33 F. App'x 334 (D.C. Cir. 2008) (per curiam).

[23] The indictment and jury instructions, together with the Second Circuit Decision, establish the factual framework for our analysis of the convictions. *See United States v. Fabric Garment Co.*, 366 F.2d 530, 534 (2d Cir. 1966) ("[A] prior criminal conviction will work an estoppel in favor of the Government in a subsequent civil proceeding with respect to questions distinctly put in issue and directly determined in the criminal prosecution . . . . In the case of a criminal conviction based on a jury verdict of guilty, issues which were essential to the verdict must be regarded as having been determined by the judgment." (internal punctuation omitted)

(continued...)

Butler's criminal convictions were based on conduct reflecting "an egregious abuse of the trust placed in him as a securities professional."[24] Butler's conduct was not a brief, isolated incident; he was convicted for conspiring to commit securities fraud and wire fraud over an extended period. The evidence at the trial indicated that the conspiracy continued for years, involved multiple customers, and had serious implications for such customers, whom Butler denied complete and accurate information regarding the securities in their accounts. Butler's criminal conduct left customers "saddled with hundreds of millions of dollars" of fraudulently purchased securities, purchases for which Butler had received substantial commissions.

Butler claims that he had "no scienter to defraud or harm any investor." Consistent with his challenges to the criminal convictions, he also downplays his conduct as sales of "a very high quality product viewed universally as safe" to "sophisticated investors," and, in so doing, attempts to shift responsibility to the investors. These assertions belie the jury findings that he acted "knowingly and willfully," i.e., "with knowledge of, and the intent to further," securities fraud and wire fraud. Irrespective of the purported safety of the non-SL-ARSs held in the customer accounts, as the Second Circuit Decision concluded, "the government proved that Butler and Tzolov made false statements to the investors about the types of securities purchased on [the investors'] behalf," both by "falsifying the names" of securities in order to mislead the investors and by mischaracterizing the securities when "investors called Butler to ask questions concerning their investments." This pattern of dishonesty and willingness to abuse his customers' trust reflects either a fundamental misunderstanding of, or an insufficient regard for, his responsibilities toward his customers, and is highly relevant to determining his "fit[ness] to work in an industry where honesty and rectitude concerning financial matters is critical."[25] Moreover, Butler's unwillingness to acknowledge the wrongfulness of the actions he took to mislead his customers raises serious concerns about the likelihood that he will engage in similar misconduct if presented with the opportunity.[26]

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[23] (...continued)
(citing *Emich Motors Corp. v. General Motors Corp.*, 340 U.S. 558, 569 (1951))); *see also Alexander V. Stein*, 52 S.E.C. 296, 301 & n.19 (1995); *William F. Lincoln*, 53 S.E.C. 452, 453 & n.3 (1998); *Robert Berkson*, 47 S.E.C. 280, 281-82 & n.6 (1980).

[24] *John S. Brownson*, 55 S.E.C. 1021, 1029 (2002), *petition denied*, 66 F. App'x 687 (9th Cir. 2003) (unpublished).

[25] *Don Warner Reinhard*, Exchange Act Rel No. 63720 (Jan. 14, 2011), 100 SEC Docket 36940, 36948.

[26] Like the law judge, we treat a refusal to concede wrongdoing as an aggravating factor. *See Seghers v. SEC*, 548 F.3d 129, 137 (D.C. Cir. 2008) (finding that this analysis does not constitute an "unconstitutional[] burden" or "deny [respondent] due process").

As we have long held, "[a]bsent extraordinary mitigating circumstances," a person convicted of conspiracy to commit securities fraud "cannot be permitted to remain in the securities industry."[27] Butler offers no evidence of such extraordinary circumstances and, therefore, under all of the circumstances, we believe the bars are amply warranted.[28]

IV.

Butler challenges the law judge's determination to issue the initial decision based on the Division's motion for summary disposition. He claims that the law judge "erred by failing to find that questions of fact existed in the record, rendering summary disposition inappropriate," arguing that he was entitled to a hearing to evaluate the credibility of the witnesses and to weigh other evidence from the criminal trial.[29] Although Butler acknowledges precedent permitting us "to bar relitigation of the fact of a criminal conviction in an administrative proceeding," he argues that collateral estoppel should not be applied in this case because the district court denied him a "full and fair opportunity" to contest the criminal charges. He urges us to evaluate his evidentiary and procedural challenges to his conviction, credit his claim that "fundamental erroneous rulings . . . render[ed] the [criminal] proceeding unfair," and find that the convictions accordingly constitute an inappropriate basis for collateral estoppel.

As the Supreme Court has explained, collateral estoppel "protects . . . from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions."[30] Accordingly, we have

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27 *Brownson*, 55 S.E.C. at 1027.

28 Although the conspiracy convictions fully justify the bars imposed here, the Southern District of New York district court's decision to impose civil anti-fraud injunctions based on Butler's convictions further demonstrates the public interest in administrative bars. *See supra* note 12; *Reinhard*, 100 SEC Docket at 36946-47 (considering a subsequent criminal conviction as part of the public interest analysis in proceedings originally instituted in connection with a civil injunction); *Robert Bruce Lohmann*, 56 S.E.C. 573, 583 n. 20 (2003) (finding that matters "not charged in the OIP" may nevertheless be considered in assessing sanctions in the public interest).

29 For instance, he argues that the securities he purchased were "substantially identical" to SL-ARS, that we should reject the credibility of trial witnesses, and that the investors were not actually misled as to the nature of purchases in their accounts.

30 *Montana v. United States*, 440 U.S. 147, 153-54 (1979). "[A]ffording [litigants] a second opportunity in which to litigate" by introducing evidence that is "historical in nature" and "is not the result of a different factual situation or changed circumstances" "would contravene the very principles upon which collateral estoppel is based and should not be allowed." *Yamaha*

(continued...)

long held that follow-on proceedings based on a criminal conviction are not an appropriate forum to "revisit the factual basis for," or legal defenses to, the conviction.[31] Because these proceedings do not relitigate factual assertions "that cannot be reconciled with the convictions," Butler's claims regarding the propriety of the conduct giving rise to his criminal convictions do not constitute genuine issues of material fact in these follow-on proceedings.[32]

We are not persuaded by Butler's claim that his procedural challenges to the criminal trial require us to undertake a separate "assessment of the underlying facts" independent of the factual, evidentiary, and credibility determinations made during his trial. Butler's challenges to the fairness of his criminal trial "are appropriately reserved for the federal courts,"[33] and he has been

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[30] (...continued)
Corp. of Am. v. United States, 961 F.2d 245, 257 (D.C. Cir. 1992); *see also* Restatement (Second) of Judgments § 27(c) ("[I]f the party against whom preclusion is sought did in fact litigate an issue of ultimate fact and suffered an adverse determination, new evidentiary facts may not be brought forward to obtain a different determination of that ultimate fact. . . . [S]imilarly if the issue was one of law, new arguments may not be presented to obtain a different determination of that issue.").

[31] *Jose P. Zollino*, Exchange Act Rel. No. 55107 (Jan. 16, 2007), 89 SEC Docket 2598, 2605; *see also Elliott*, 36 F.3d at 87; *Sherwin Brown,* Investment Advisers Act Rel. No 3217 (June 17, 2011), __ SEC Docket __, __ (rejecting "attempts to relitigate the District Court's findings" in injunctive proceedings); *Joseph P. Galluzzi*, 55 S.E.C. 1110, 1116 nn.20-22 (2002) (collecting cases); *John Edelman*, 52 S.E.C. 789, 790 (1996) (noting that the "public interest demands prompt enforcement" through follow-on proceedings while any appeals of the underlying proceedings "are underway").

[32] *David G. Ghysels*, Exchange Act Rel. No. 62937 (Sept. 20, 2010), 99 SEC Docket 32610, 32616-17, *consolidated with criminal appeal* 09-5349-cr(L) (2d Cir. May 4, 2011); *see also Kornman*, 592 F.3d at 183 ("Because the Commission proceedings against Kornman were based on the record in his criminal case that disposed of the central issue regarding the nature of his 'alleged misconduct' for administrative enforcement purposes, a summary proceeding was appropriate under Commission precedent."); *Schield Mgmt. Co.*, 58 S.E.C. 1197, 1213 (2006) (declining to consider assertions "in conflict with the allegations" in the injunctive complaint).

[33] *Ghysels*, 99 SEC Docket at 32620. Butler argued that the then-pending appeal should preclude collateral estoppel, particularly emphasizing the district court's finding, in connection with the decision to continue bail pending resolution of the appeal, that the appeal raised "a substantial question of law or fact." These claims were rendered moot by the Second Circuit Decision. *See supra* notes 13 & 14 and accompanying text.

(continued...)

afforded opportunities to contest the criminal charges fully and vigorously.[34] The jury trial lasted several weeks and involved testimony and cross-examination of his former Credit Suisse partner and customers. Moreover, Butler was afforded an opportunity to pursue his procedural and other objections to his convictions on appeal, and the Second Circuit rejected his claim that the district court's evidentiary rulings denied him a fair trial, concluding that the evidence presented at the trial "was more than sufficient to convict" Butler.[35] Because Butler is precluded from challenging the underlying convictions in these proceedings and does not offer evidence of extraordinary circumstances mitigating the seriousness of his conduct, we find no error in the law judge's decision to bar Butler by summary disposition.

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33 (...continued)

In any case, we previously rejected these arguments for delay. Order Denying Stay or Postponement of Administrative Proceedings, Admin. Proc. File. No. 3-13986 (Mar. 30, 2011), __ SEC Docket __; *see also* Restatement (Second) of Judgments § 13, cmt. g & reporter's note to cmt. f (noting that, for res judicata purposes, "finality is not affected by . . . a stay [in the first proceedings] . . . pending appeal" and the "best general solution" to the possibility of a successful appeal is to "hold[] that a judgment is final despite pendency of an appeal and is thus available as res judicata in a second action, while recognizing that the court in the second action has discretion in proper circumstances to suspend proceedings").

34 *See Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 333 (1979) (finding collateral estoppel appropriate when the defendant "had every incentive to litigate [the earlier proceeding] fully and vigorously"). The "full and fair adjudication" requirement focuses on whether the party had "an adequate *opportunity or incentive* to obtain a full and fair adjudication in the first proceedings." Restatement (Second) of Judgments § 28(j) (emphasis added). It does not require a reevaluation of the fairness of the outcome or of the kind of procedural trial decisions that are the focus of Butler's claims; in any case, Butler been afforded an opportunity to pursue these claims in his criminal appeal. *See id.* (stating that "a refusal to give the first judgment preclusive effect should not . . . be based simply on a conclusion that the first determination was patently erroneous"); Am. Jur § 574 ("The relevant inquiry is not whether the party adequately defended or prosecuted the prior action, but whether he or she had a full and fair opportunity to do so."); *see also SEC v. Tzolov*, 2011 U.S. Dist. LEXIS, at *15 (finding that Butler had a full and fair opportunity to litigate based on the "jury trial from July 22, 2009 through August 17, 2009, where Butler was represented by a team of capable attorneys").

35 *See supra* note 14.

* * * *

Securities industry bars in this case reflect the importance of "deterrence, both specific and general, as a component in analyzing the remedial efficacy of sanctions"[36] and serve as a "legitimate prophylactic remedy consistent with [our] statutory obligations"[37] to "protect[] investors and the integrity of the markets by preventing those convicted of crimes from acting in the capacity of a securities professional."[38] With respect to specific deterrence, Butler's participation in a criminal conspiracy that fraudulently "saddled [investors] with hundreds of millions of dollars" in securities demonstrated the public interest in preventing Butler's future participation in the "securities industry[, which] presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence."[39] The bars also serves the public's interest in general deterrence by discouraging other securities

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36 *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005); *see also Schield Mgmt. Co.*, 58 S.E.C. at 1217-18 & n.46 (citing cases).

37 *Kornman*, 592 F.3d at 189.

38 *Lincoln*, 53 S.E.C. at 461 n.31 (citing cases noting remedial purpose of bars by FDIC, FDA, CFTC, and HUD); *see also SEC v. Palmisano*, 135 F.3d 860, 866 (2d Cir. 1998) (finding that "deterrence of securities fraud serves other important nonpunitive goals, such as encouraging investor confidence, increasing the efficiency of financial markets, and promoting the stability of the securities industry"); *LaCrosse v. CFTC*, 137 F.3d 925, 932 (7th Cir. 1998) (finding that a CFTC trading ban was "intended to ensure market integrity and enhance public confidence").

39 *Seghers*, 91 SEC Docket at 2304; *see also Elliott*, 50 S.E.C. at 1276 (noting the "many opportunities for abuse and overreaching" in the securities industry).

professionals from misleading, or disregarding their responsibilities toward, their customers and clients.

Accordingly, we hold that it is in the public interest to bar Butler from association with any broker, dealer, or investment adviser. An appropriate order will issue.[40]

By the Commission (Chairman SCHAPIRO and Commissioners WALTER, AGUILAR, and PAREDES).

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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[40] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65204 / August 26, 2011

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3262 / August 26, 2011

Admin. Proc. File No. 3-13986

In the Matter of

ERIC S. BUTLER

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Eric S. Butler be barred from association with any broker, dealer, or investment adviser.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9253 / August 26, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65208 / August 26, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3265 / August 26, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29771 / August 26, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14516

In the Matter of

DAVID G. BROUWER,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY 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"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against David G. Brouwer ("Respondent" or "Brouwer").

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 Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) 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 Respondent's Offer, the Commission finds[1] that:

Summary

Respondent made material misrepresentations about and failed to disclose certain material risks associated with equity-linked notes that he recommended as investments to certain customers in 2007 and 2008 while Respondent was a registered representative associated with broker-dealer and investment adviser Great American Advisors, Inc. ("Great American"). Additionally, Respondent's recommendation of equity-linked notes to at least two of his customers was unsuitable based on their investment objectives, stated risk tolerance, and other factors.

Respondent

1. **Brouwer** was a registered representative with Great American from May 2002 until September 2009, when he was permitted to resign. Brouwer holds Series 7 and 63 licenses. Respondent, 58 years old, is a resident of Homestead, Florida.

Other Relevant Entity

2. **Great American** is registered with the Commission as a broker-dealer and investment adviser. Great American is incorporated in Ohio, with its principal place of business in

[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.

Cincinnati, Ohio. On July 12, 2010, Great American ceased its retail brokerage business. It continues to operate as a broker-dealer and investment adviser to service its other businesses.

Background

3. Great American hired Brouwer in 2002 to work as a registered representative at its Homestead, Florida branch office. The branch was located at a local bank branch. The bank referred numerous customers to Brouwer.

4. A portion of Brouwer's customers, including some of the bank referred customers, sought a higher yielding alternative to the relatively low yields offered at the time through bank products.

5. During 2007 and 2008, Brouwer recommended equity-linked notes to many of his customers. The equity-linked notes Brouwer recommended are known as structured notes in which there is a derivatives exposure to the holder of the note due to the reverse convertible nature of the terms of the note. The equity-linked notes offered investors high yields, monthly income, and short-term maturities (often less than one year). The security either matured at par, in which case the investor recouped his principal investment in a cash payment and periodic interest payments, or did not mature at par, in which case the investor received shares of the underlying security valued at the lower price -- less than the investment principal. Whether the security matured at par was dependent on a predetermined price floor for the underlying equity. If the trading price of the underlying shares falls below that predetermined price floor, the investor will receive shares in the referenced company rather than a cash payment.

6. Brouwer recommended equity-linked notes that presented a risk of loss of principal. If the security ultimately did not mature at par, and was therefore redeemed for stock, an investor could lose some or all of his principal. Brouwer told customers that the equity-linked notes were safe when in fact they were not and failed to disclose certain of the investment's material risks. Brouwer failed to adequately disclose that there was a possibility that the equity-linked notes would convert into the underlying securities at a value less than the invested principal.

7. Brouwer's recommendations of equity-linked notes were unsuitable for at least two customers, based on their stated risk tolerance, investment objectives and other factors. Those customers stated their risk tolerance as "low," and listed "income" as their investment objective on their new account forms.

Violations

8. As a result of the conduct described above, Brouwer willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

IV.

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

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

A. Respondent Brouwer cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Brouwer be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization, and prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affliated person of such investment adviser, depositor, or principal underwriter.

C. 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.

D. 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.

E. Respondent shall, within ten (10) days of the entry of this Order, pay disgorgement of $33,000 and prejudgment interest of $6,137.25 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $33,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies David G. Brouwer 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 Glenn S. Gordon, Associate Director, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Ave., Suite 1800, Miami, FL 33131.

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. 65215 / August 29, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3266 / August 29, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14518

In the Matter of

SHAWN A. ICELY,

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 Shawn A. Icely ("Icely" 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. From February 2007 until December 2009, Icely was a registered representative in the Sarasota branch office of American Portfolios Financial Services, Inc. During the same period, Icely was also associated with American Portfolios Advisors, Inc. as a registered investment adviser. After leaving American Portfolios, Icely was employed at Cambridge Investment Research, Inc., where he was terminated in March 2010 for failing to disclose outside businesses. Icely, 34, is a resident of Sarasota, Florida.

2. On June 20, 2011, a final judgment was entered by consent against Icely, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Shawn A. Icely, Civil Action Number 8:10-cv-2363-T17-AEP, in the United States District Court for the Middle District of Florida.

3. The Commission's complaint alleges that from no later than November 2008 through December 2009, Icely engaged in a scheme to defraud at least eleven American Portfolios customers by selling their securities and taking approximately $625,000 from their customer accounts. Icely diverted the funds to bank accounts in the name of his company, Icely, Inc. In most instances, Icely facilitated the transfer of customer funds with wire request or IRA distribution forms that were forged, and that falsely stated the funds would be transferred to a bank account in the customer's name. To conceal his fraud, Icely told customers he transferred their money to bank accounts in their name or that he transferred their money to new accounts he opened for them at another broker-dealer. In at least two instances, Icely provided customers with fake account statements. Icely proceeded to use his customers' funds to pay both his company and personal expenses.

IV.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65217 / August 29, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3267 / August 29, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29772 / August 29, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14520

In the Matter of **MATTHEW CRISP,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS 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**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), 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 ("IC Act") against Matthew Crisp.

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>SUMMARY</u>

1. In this matter, Matthew Crisp ("Respondent" or "Crisp") exploited undisclosed conflicts of interest for his personal gain. While working as a partner and fiduciary of Adams Street Partners, LLC ("Adams Street"), a registered investment adviser to multiple private equity funds, Crisp and a friend secretly formed a private investment vehicle called AV Partners LP. Crisp then usurped from Adams Street's funds, for AV Partners, a

lucrative investment opportunity in a private company. Crisp concealed the misappropriation with misrepresentations and omissions regarding at least four material facts: (1) that Crisp redirected the investment opportunity from Adams Street's funds to AV Partners; (2) Crisp's involvement with AV Partners, and the resulting conflicts of interest; (3) that Crisp was motivated by personal profits and conflicting loyalties, not a purported prior commitment, when steering the investment opportunity to AV Partners; and (4) that Crisp's conduct violated provisions of Adams Street's Integrity Policy and the limited partnership agreements for Adams Street's funds.

2. Crisp further enriched himself with a personal payment of $150,000 during a later buyout of the same private company. That money should have gone to Adams Street to reduce the fees due from its private equity funds. Crisp's deceit also secured for AV Partners a second investment opportunity in another private company in which Adams Street's funds invested. Further, Crisp attempted to arrange a second payout to AV Partners from that same company. Although later forced to repay the money, Crisp initially profited by over $2 million from this conduct, at the expense of Adams Streets and its private equity funds.

B. RESPONDENT

3. Crisp, age 40, resides in Burlingame, California. He was a partner in Adams Street from June 2006 until his termination in March 2008. Crisp earned both a B.S. and a M.S. from the University of Virginia.

C. OTHER RELEVANT ENTITIES

4. Adams Street is a Delaware limited liability company headquartered in Chicago, Illinois. Adams Street has been registered with the Commission as an investment adviser since November 2000. Adams Street is the Management Company for, and Managing Member of the General Partner of, multiple private equity funds primarily for institutional investors, including Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. Among others things, Adams Street's funds make direct investments in private companies that are seeking venture capital, growth equity, or additional liquidity.

5. AV Partners LP ("AV Partners") is an unregistered investment club established orally by Crisp and a friend, Joseph Wolf, to make investments together. It was never formally constituted as a limited partnership (or other type of entity).

D. CRISP EXPLOITED UNDISCLOSED CONFLICTS OF INTEREST FOR HIS PERSONAL GAIN

Adams Street Hired Crisp

6. In June 2006, Adams Street hired Crisp as a partner assigned to its direct investment group. Crisp located technology and growth equity companies for Adams

Street's private equity funds to invest in, he advised in which opportunities Adams Street's funds should invest, he executed on and managed the investment transactions on behalf of Adams Street and its funds, and he monitored the companies after the initial investments. As an investment adviser, and as an associated person to a registered investment adviser, Crisp owed fiduciary duties to Adams Street's funds.

Crisp and Wolf Secretly Formed AV Partners

7. Towards the end of 2006, Crisp and Wolf discussed forming AV Partners. They orally established the entity as an informal investment club to make investments together. In February and March 2007, they circulated draft partnership agreements, which they do not appear to have executed. The initials "A" and "V" are the first letters of the first names of Wolf's daughter and Crisp's son, respectively.

8. Wolf provided the initial funds for AV Partners's investments. Crisp provided access to and analysis of potential deals. Both decided what investments to make. After Wolf was repaid his initial investment money, Crisp and Wolf shared profits evenly. Crisp and Wolf shared losses evenly. Crisp therefore had a direct interest in AV Partners's investments.

9. Crisp's fiduciary duties and Adams Street's policies required him to disclose to Adams Street personal investments and any conflicts of interest, including Crisp's involvement with AV Partners. Adams Street's policies required both annual and quarterly disclosure forms, which Crisp completed. Crisp, however, consistently concealed from Adams Street and its employees his interest in, and involvement with, AV Partners. Crisp knew that his deceit in turn led Adams Street not to disclose AV Partners to Adams Street's private equity funds, and thus to the funds' investors.

10. Crisp failed to make the required disclosures to Adams Street and its funds, despite knowing that Wolf had disclosed AV Partners to the compliance department of his employer, a registered investment adviser to a registered investment company. On or around May 7, 2007, Wolf asked Crisp to send Wolf a copy of a private placement memorandum so that Wolf could provide it to his own compliance department.

11. Moreover, as detailed below, on at least three occasions in two separate transactions, Crisp lied about his involvement with AV Partners.

Crisp Usurped a Lucrative Investment Opportunity from Adams Street's Funds for AV Partners with Material Misrepresentations and Omissions

12. In 2006 and 2007, Crisp worked on an Adams Street investment in the VIP Tour Company, which operated a secondary market ticket brokerage business called TicketsNow (the "TicketsNow transaction"). Adams Street typically assigned a lead sponsor, who was primarily responsible for the deal, and a co-sponsor, who provided support, to each potential transaction. In the TicketsNow transaction, Crisp served as lead sponsor. Another Adams Street partner served as co-sponsor.

13. As lead sponsor on the TicketsNow transaction, Crisp met with Adams Street's Direct Investment Team to discuss the transaction, co-authored (with the deal co-sponsor) a memorandum recommending the investment to Adams Street's Investment Committee, and took the lead on otherwise communicating with Adams Street personnel about the transaction. The memorandum to the Investment Committee that Crisp co-authored advised about the company and the market sector, and recommended that Adams Street's funds invest in TicketsNow. The Investment Committee decided, as the Management Company and Managing Member of the General Partner, to invest Adams Street's funds' money in the TicketsNow transaction.

14. To win the opportunity to invest in TicketsNow, in 2006 Adams Street committed to invest a total of $15 million from its private equity funds. This total commitment exceeded Adams Street's typical investment amount for its funds. As a result, in or around December 2006, Adams Street's partners decided to syndicate to (or, share with) other investors a portion of the $15 million total commitment. Around this time, Crisp and the transaction co-sponsor agreed that Adams Street should syndicate up to $1.5 million of the commitment to TicketsNow. Adams Street's other partners approved this amount. As lead sponsor, Crisp led efforts to locate syndicate investors for the TicketsNow transaction.

15. The TicketsNow transaction closed in two tranches. The first tranche closed on or around January 19, 2007. Investors in the first tranche received promissory notes convertible to Series A Preferred Stock of TicketsNow. Three of Adams Street's funds – Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. – invested a total of $9 million at that time. Adams Street did not syndicate any part of the first tranche. The second tranche closed on or around June 15, 2007. Investors in the second tranche received Series A Preferred Stock of TicketsNow.

16. Around the time of the closing of the first tranche, Crisp and Wolf discussed AV Partners investing in TicketsNow. On or around January 17, 2007, Crisp sent TicketsNow's investment summary to Wolf. On or around January 18, Crisp wrote in an email to a TicketsNow employee that AV Partners "will likely be in for $500,000 to $1 million" in the TicketsNow transaction.

17. By May 2007, however, Crisp had increased AV Partners's investment in the TicketsNow transaction by $500,000. On or around May 4, 2007, Crisp and Wolf decided that AV Partners would invest $1.5 million in the TicketsNow transaction – not the $500,000 to $1 million that Crisp previously represented. On or around May 14, Crisp sent an email to attorneys negotiating the documents for the second closing stating that Adams Street "syndicated $2M of our $6M remaining investment in TicketsNow." (In addition to AV Partner's $1.5 million, Adams Street syndicated $500,000 to Croft & Bender, an entity familiar to Adams Street and suggested by the TicketsNow transaction co-sponsor.)

18. Crisp's May 16 email instructed that his increased syndication to AV Partners reduced *pro rata* the amounts invested in the TicketsNow transaction by Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. As a

result, Crisp's syndication to AV Partners harmed Adams Street's funds. Adams Street never authorized or instructed Crisp to syndicate more than $1.5 million in the TicketsNow transaction. Crisp lacked the authority to single-handedly change the agreed-upon syndication amount.

19. Crisp concealed his misappropriation of the investment opportunity in TicketsNow's securities, for AV Partners from Adams Street's funds, with intentional and reckless misrepresentations and omissions regarding at least four material facts:

a. First, Crisp concealed from Adams Street that he redirected the $500,000 opportunity from Adams Street's funds to AV Partners until two days before the closing of the second tranche. Then, Crisp lied about taking the opportunity for AV Partners. On June 13, 2007, Crisp sent the Adams Street deal co-sponsor documents indicating that Crisp syndicated a total of $2 million – not the previously-discussed and agreed upon $1.5 million – in the transaction. When asked about the discrepancy in the syndication amount by the co-sponsor, Crisp falsely replied that the co-sponsor was thinking of a different transaction. Crisp never revealed that he adjusted the syndication amount and that he and Wolf alone decided how much AV Partners would invest in the TicketsNow transaction.

b. Second, Crisp misrepresented to and concealed from Adams Street and TicketsNow Crisp's involvement with AV Partners, and the resulting conflicts of interest. On or around May 16, 2007, a TicketsNow employee asked Crisp "[w]ho are AV Partners?" Crisp falsely stated that "AV Partners is the investment vehicle of a friend." Adams Street's transaction co-sponsor also asked Crisp multiple times about AV Partners. Each time, Crisp falsely responded that AV Partners was Wolf's personal investment vehicle. Crisp described Wolf as a wealthy individual who set up his own investment vehicle to invest in venture backed companies. Crisp said that he was friendly with Wolf and that they had previously invested together. Moreover, as stated, Crisp failed to disclose AV Partners to Adams Street in the firm's required annual and quarterly disclosures.

c. Third, Crisp misrepresented to and concealed from Adams Street and TicketsNow that Crisp was motivated by personal profits and conflicting loyalties, not a purported prior commitment, when steering the investment opportunity to AV Partners. On or around May 16, 2007, a TicketsNow employee emailed that he was "surprised" by the increased allocation to AV Partners, and asked Crisp "[w]as this discussed before?" Crisp falsely responded that he "syndicated to both groups [AV Partners and Croft & Bender] right after we did the first close" in January 2007, "Im [*sic*] just honoring my word here." Likewise, in his June 13, 2007 email, Crisp falsely stated that he had committed AV Partners's investment amount "6 months ago right after the first close" and that "[n]ow that things are looking peachy, I wish I hadn't syndicated anything." Crisp thus falsely indicated that he had syndicated to AV Partners solely to satisfy a prior obligation, and that he was powerless to change it. In truth, on or around May 4, 2007, Crisp and Wolf decided that AV Partners would invest $1.5 million in TicketsNow, noting its "value." Also, in fact, Crisp was not honoring a prior commitment – Crisp personally profited more from AV Partners's investment than if Adams Street had invested in TicketsNow.

d. Fourth, on or around May 9, 2007, Crisp falsely represented and warranted to Adams Street that he was in compliance with Adams Street's Integrity Policy. Among other things, the Integrity Policy provided that employees, such as Crisp, obtain Adams Street's prior approval before investing in portfolio companies, such as TicketsNow. Crisp also hid that his conduct violated, and thus rendered false, similar provisions of Adams Street's limited partnership agreements for its funds – including for Adams Street V, L.P., Adams Street 2006 Direct Fund, L.P., and Adams Street 2007 Direct Fund, L.P – as well as other documents. Crisp was aware of these requirements, having sought approval in September 2006 for an unrelated transaction. And in another potential Adams Street transaction, Crisp recused himself from Adams Street's dealings with a company owned by his brother, and in which Crisp had an interest, because of the potential conflict of interest. Yet Crisp never sought or obtained prior approval for AV Partners's investment in TicketsNow.

20. Crisp's conduct also substantially assisted Adams Street's violations with respect to its funds.

21. In February 2008, another ticket broker company purchased TicketsNow by paying a specified amount of cash for each outstanding share of TicketsNow stock. TicketsNow's shareholders – including AV Partners and Adams Street's private equity funds – received almost four times their initial investment amount. AV Partners received approximately $5,749,808. This translated to a profit of $4,249,808 after Wolf was repaid his initial investment capital. Crisp personally received $2,124,904 – half of AV Partners's profits. The additional $500,000 investment that Crisp usurped from Adams Street for AV Partners resulted in profits (after Wolf was repaid his initial investment) of approximately $1,416,603, of which Crisp received $708,301.

Crisp Further Enriched Himself in the TicketsNow Buyout

22. At the time of the TicketsNow buyout in February 2008, Crisp served on the TicketsNow board of directors as Adams Street's representative. He acted as the firm's primary point of contact with TicketsNow.

23. On or about February 29, 2008, Crisp received a $150,000 "transaction bonus" from the TicketsNow closing money. TicketsNow's other outside directors did not receive similar payments. Indeed, when he learned that certain officers of TicketsNow were to receive bonuses, Crisp demanded that he too be paid a bonus for his contribution to the company. Crisp initially asked for a larger payment, but was negotiated down to $150,000.

The payment reduced the amount that the company's shareholders – including Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. – received from the buyout proceeds.

24. Crisp did not tell Adams Street or its funds that he requested, negotiated, and received this money. Crisp acted as Adams Street's primary point of contact throughout the buyout and handled virtually all communications with Adams Street's attorneys for the buyout. He instructed TicketsNow personnel to wire the money to his personal bank account – the same account in which Adams Street deposited Crisp's salary. After receiving the money, Crisp took no apparent steps to pay it to Adams Street before he was terminated on or about March 20, 2008.

25. Crisp knew, but ignored, that Adams Street's policies prohibit employees, like Crisp, from receiving personal payments in connection with Adams Street's transactions. And Crisp knew, but ignored, that the limited partnership agreements for Adams Street's funds promise that compensation paid to Adams Street partners, like Crisp, from a portfolio company "shall be remitted to the Management Company [Adams Street] and shall reduce the Management Fee" paid by the funds. Crisp's conduct rendered these representations to Adams Street's funds and investors false. Crisp's decision to ignore these provisions and to keep the money further demonstrates his fraudulent intent and substantial assistance of Adams Street's violations.

Crisp's Deceit Secured a Second Investment Opportunity for AV Partners, and Crisp Tried to Arrange a Second Payout to AV Partners

26. Between March and May 2007 – while Crisp was also syndicating the second tranche of the TicketsNow transaction – Adams Street committed certain of its private equity funds to invest $14 million in a travel company named Sherman's Travel. Adams Street anticipated syndicating $1 million of the committed amount. Crisp again served as lead sponsor for this transaction and the same Adams Street partner as in the TicketsNow transaction served as co-sponsor.

27. As lead sponsor on the Sherman's Travel transaction, Crisp met with Adams Street's Direct Investment Team to discuss the transaction, co-authored (with the deal co-sponsor) a memorandum recommending the investment to Adams Street's Investment Committee, and took the lead on otherwise communicating with Adams Street personnel about the transaction. The memorandum to the Investment Committee that Crisp co-authored advised about the company and the market sector, and recommended that Adams Street's funds invest in Sherman's Travel. The Investment Committee decided, as the Management Company and Managing Member of the General Partner, to invest Adams Street's funds' money in the Sherman's Travel transaction.

28. Crisp again syndicated the stock investment opportunity – this time, all $1 million – to AV Partners. AV Partners continues to own its shares of Sherman's Travel. In their May 4, 2007 email exchange, Crisp and Wolf initially discussed investing $1.5 million in Sherman's Travel, which would have exceeded Adams Street's $1 million syndication

amount for that deal. Instead, Crisp and Wolf invested the extra $500,000 in TicketsNow, which ultimately proved to be the more lucrative opportunity.

29. Crisp again lied about his involvement with AV Partners in connection with the Sherman's Travel transaction. On May 4, 2007, a Sherman's Travel employee asked Crisp by email about AV Partners. Crisp falsely replied that AV Partners was Wolf's "'personal' investment vehicle, named after the first names of his kids."

30. In December 2007 and January 2008, a Sherman's Travel representative and Crisp exchanged ideas about raising additional capital for the company. Crisp proposed a payout to AV Partners while negotiating possible changes to Adams Street's funds' investment. Ultimately, the discussions did not culminate in a transaction.

Adams Street Terminated Crisp and Crisp Admitted his Wrongdoing

31. After discovering Crisp's misconduct and conducting an internal investigation, Adams Street terminated Crisp on or about March 20, 2008. Adams Street also self-reported the matter to the staff of the Commission. In or around May 2008, Crisp paid $2,274,903.86 to Adams Street, which equaled Crisp's half of AV Partners's payout from the TicketsNow transaction, plus his $150,000 merger compensation from the same deal. Crisp, through AV Partners, still holds the interest in Sherman's Travel. Crisp's repayment did not include $708,302 of AV Partners's profits (after Wolf was repaid his initial investment) from Crisp's increased syndication to it in the TicketsNow transaction.

32. During a phone call with one of Adams Street's partners after Crisp's termination in March 2008, Crisp admitted that his conduct was "clearly against Adams Street's policy, so I [Crisp] didn't tell you [the Adams Street partner]" about the conduct.

33. In or around January 2009, Crisp told an Adams Street partner in a telephone conversation that Crisp sought to raise investor money to start his own investment fund.

34. Crisp's actions described above made use of the mails and other means and instrumentalities of interstate commerce.

E. VIOLATIONS

35. As a result of the conduct described above, Crisp willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits fraudulent conduct by advisers to "pooled investment vehicles" with respect to investors or prospective investors in those pools.

36. In the alternative, as a result of the conduct described above, Crisp willfully aided and abetted and caused Adams Street's violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits fraudulent conduct by advisers to

"pooled investment vehicles" with respect to investors or prospective investors in those pools.

37. As a result of the conduct described above, Crisp 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.

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 Respondent pursuant to Section 203(f) of the Advisers Act including, but not limited to, a bar, disgorgement and prejudgment interest, and a civil penalty pursuant to Section 203(i) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the IC Act including, but not limited to, a bar, disgorgement and prejudgment interest, and a civil penalty pursuant to Section 9(d) of the IC Act; and

E. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3269 / August 31, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14523

In the Matter of **Sean Mansfield,** **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 Sean Mansfield ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Mansfield was a partner with Financial Counselors, LLC, an investment adviser registered with the Commonwealth of Massachusetts. He served as the chief investment officer and chief compliance officer for Financial Counselors. Mansfield, 38 years old, is a resident of West Springfield, Massachusetts. From September 1999 through July 2002, Mansfield was a registered representative associated with broker-dealers registered with the Commission.

2. On March 29, 2011, Mansfield pled guilty in the United States District Court for the District of Massachusetts to an Information charging him with 17 counts of wire fraud in violation of Title 18 United States Code Section 1343, two counts of embezzlement from a pension fund in violation of Title 18 United States Code Section 664, and four counts of money laundering in violation of Title 18 United States Code Section 1957(a), in the criminal action entitled United States v. Sean Mansfield, Criminal Action No. 11-30009-MAP, in the United States District Court for the District of Massachusetts.

3. The Information alleged that, among other things, Mansfield devised a scheme to defraud clients of Financial Counselors and other investment advisory clients. It further alleged that Mansfield obtained more than $3 million from such clients by: (1) transferring, without authorization, the client funds to third parties in the expectation that those third parties would reward him personally; (2) by transferring, without authorization, the client funds directly to him for his own personal benefit; and (3) by inducing clients to transfer money into a purported investment fund controlled by him and by taking that money for his own purposes.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Mansfield 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.

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
Rel. No. 65235 / August 31, 2011

Admin. Proc. File No. 3-13932

In the Matter of the Application of RICHARD G. CODY c/o Stephen Z. Frank, Esq. P.O. Box 129 North Conway, NH 03860 For Review of Disciplinary Action Taken by FINRA	ORDER DENYING MOTION FOR RECONSIDERATION

I.

On May 27, 2011, we issued an opinion (the "Opinion") sustaining the findings of violations and sanctions imposed by FINRA on Richard G. Cody, formerly a registered representative associated with Leerink Swann & Co. The Opinion found that Cody recommended unsuitable trading in customer accounts, sent misleading account summaries and information to customers, and failed to timely disclose two customer settlement agreements. The Opinion sustained FINRA's sanctions, which suspended Cody from associating with any FINRA member firm for one year, fined him $27,500, and assessed costs.

On June 20, 2011, Cody filed a motion seeking reconsideration. Cody's request for reconsideration focuses on the Opinion's findings that he violated NASD Rule 2310 which requires that, in recommending the purchase, sale, or exchange of any security to a customer, a member must have reasonable grounds for believing that the recommendation is suitable for that customer based on the facts, if any, disclosed by the customer as to his other securities holdings and the customer's financial situation and needs. The Opinion held that Cody violated Rule 2310 by: (i) recommending that his customers invest in securities issued by a Credit Suisse First Boston Mortgage Securities Corp. IndyMac Manufactured Housing Passthru (the "Credit Suisse Securities") without conducting a reasonable investigation of the Credit Suisse Securities; (ii) recommending purchases of three non-investment grade securities to a customer who "was retired, needed to preserve principle, requested low-risk investments, and needed immediate income to cover living expenses"; and (iii) recommending an excessive level of trading in customer accounts in which the customers had not expressed interest in short-term or speculative trading.

II.

We review Cody's request for reconsideration under Rule of Practice 470.[1] Under that rule, a motion for reconsideration "shall briefly and specifically state the matters of record alleged to have been erroneously decided, the grounds relied upon, and the relief sought."[2] Reconsideration is an extraordinary remedy[3] designed "to correct manifest errors of law or fact, or to permit the presentation of newly discovered evidence."[4] Under Rule 470, we do not grant reconsideration to consider arguments previously addressed or authority previously available,[5] and will only consider additional evidence if "the movant could not have known about or

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[1] 17 C.F.R. § 201.470.

[2] *Id.* Cody's filings in support of his motion for reconsideration fail to meet the deadline and length requirements set forth in our Rules of Practice. A motion for reconsideration of a Commission opinion shall "be filed within 10 days after service of the order," and such motion, together with any accompanying brief and pleadings incorporated by reference, may not exceed 7,000 words. 17 C.F.R. §§ 201.470(b), 154(c). Cody filed three separate motions requesting an extension of the deadline to June 30, 2011. Although the Commission extended the deadline to June 20, 2011, Cody's requests for further extension were denied under our "policy of strongly disfavoring" extension requests. *See* 17 C.F.R. § 201.161(b)(1). Cody filed a motion for reconsideration on June 20, 2011. He also filed a separate "Memorandum of Issues for Reconsideration" on July 1, 2011. We construe this July 1, 2001 filing as a brief in support of his motion, and have considered the arguments therein, even though the submission was untimely and violated the length limitations described above.

[3] *See Bowman Trans., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 294-95 (1974) (stating that "there is sound basis for adhering to [the Court's] practice of declining to require reopening of the record, except in the most extraordinary circumstances"); *see also* Rules of Practice, Securities Exchange Act Rel. No. 35833 (June. 23, 1995), 60 Fed. Reg. 32,738, 32,780 ("A motion for reconsideration is intended to be an exceptional remedy.").

[4] *Perpetual Sec., Inc.*, Exchange Act Rel. No. 56962 (Dec. 13, 2007), 92 SEC Docket 472, 473; *see also Laminaire Corp.*, Exchange Act Rel. No. 56789 (Nov. 15, 2007), 91 SEC Docket 3221, 3223.

[5] *Manuel P. Asensio*, Exchange Act Rel. No. 62645 (Aug. 4, 2010), 99 SEC Docket 30990, 30991 (citing *KPMG Peat Marwick LLP*, Order Denying Request for Reconsideration, 55 S.E.C. 1, 3 n.7 (2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002)); *see also Fundamental Portfolio Advisors, Inc.*, Order Denying Motion for Reconsideration, Exchange Act Rel. No. 51725 (May 23, 2005), 85 SEC Docket 1754, 1756 n.5.

adduced [such evidence] before entry" of the Opinion.[6] In addition, we look to "settled principles of federal court practice establish[ing] that a party may not seek rehearing of an appellate decision in order to advance an argument that it could have made previously but elected not to . . . or to 'shift position and present an issue which was previously conceded.'"[7]

Cody's claims do not meet the rigorous standards for reconsideration. The Opinion found, based on a *de novo* review of the record, that the preponderance of the evidence established the suitability violations and supported the sanctions. Although Cody disputes the Opinion's factual findings and FINRA's credibility determinations, he does not demonstrate manifest error in those findings. He also disputes the Opinion's analysis of the FINRA rule, but does not establish any manifest error of law. Instead, Cody's request for reconsideration repeats and reformulates arguments that were rejected in the Opinion, reasserts previously abandoned arguments, and inappropriately cites previously available authority or evidence to make or supplement new arguments.

For instance, in seeking reconsideration of the Opinion's conclusion that he lacked a reasonable basis for recommending the Credit Suisse Securities, Cody claims that the Opinion "did not apply the information that Cody knew." He does not, however, point to any record evidence demonstrating error in the Opinion's conclusion that he failed to "understand the risks and rewards inherent in [his own] recommendation." Cody now suggests that the credit rating alone established a reasonable basis for his recommendation because "Financial Regulators and market participants rely on credit ratings." In support of this argument, he also cites general ratings agency statements. However, Cody offers these claims for the first time in seeking reconsideration, and offers no explanation for his failure to make these arguments or to provide support for them in his original briefs to us.[8]

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6 *Perpetual Sec.*, 92 SEC Docket at 473 (quoting *Feeley & Willcox Asset Mgmt. Corp.*, 56 S.E.C. 1264, 1269 n.18 (2003)).

7 *KPMG*, 55 S.E.C. at 3 n.7 (2001) (internal citations omitted).

8 As we have held, reconsideration is properly denied when respondents cite arguments and authority in a motion for reconsideration that could have been, but were not, developed in the original appeal briefs. *See supra* note 7; *Laurie Jones Canady*, 54 S.E.C. 255 (1999) (denying motion for reconsideration citing an argument that was not addressed by respondent in briefs submitted to the Commission as part of the original appeal), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000); *Rockies Fund, Inc.*, Exchange Act Rel. No. 56344 (Aug. 31, 2007), 91 SEC Docket 1418, 1424 n.21 ("[H]aving failed to cite this authority at an earlier time, respondents may not rely on it" in a motion for reconsideration); *see also KPMG*, 289 F.3d at 120 (stating that "[a]n argument cannot be merely hinted at to be raised; it must be 'pressed' to be preserved"); 17 C.F.R. § 201.450(b) (requiring briefs to succinctly state "each [claimed] exception to the findings or conclusions being reviewed").

(continued...)

Moreover, as the Opinion stated, Cody previously conceded before FINRA that "in the end suitability is his responsibility." The Opinion also concluded that, as a securities professional, Cody "had an independent obligation to ensure that he understood" the securities before recommending them to his customers. We see no basis for altering this conclusion.

Cody also seeks reconsideration of the Opinion's conclusion that his recommendation of bonds that had been rated speculative and highly speculative were unsuitable for a customer who "was retired, needed to preserve principle, requested low-risk investments, and needed immediate income for monthly withdrawals to cover living expenses." Cody now argues that his recommendations were appropriate because "he was very familiar" with the issuers of the securities. FINRA previously rejected his claim that securities issued by "household name" issuers were necessarily suitable for this particular customer in light of "the risk that [the customer] was able and willing to take." Cody did not address FINRA's analysis of his "household name" defense in his briefs to the Commission, and his motion offers no basis for reconsidering that determination.[9]

In seeking reconsideration of the excessive trading findings, Cody offers various explanations for the frequent trading reflected in the record. However, the FINRA Hearing Panel questioned Cody about this level of trading, and found his testimony "evasive and inconsistent on several topics" and that "the explanations he offered for his actions were unconvincing." It specifically observed that, "when questioned about his trading by the Panel, Cody offered generalizations to the effect that he was trading to grow the value of the accounts and increase their yields, but was unable to offer any specific colorable explanation of how his trades were designed to achieve those goals." As the Opinion noted, "[t]he credibility determination of an initial fact finder is entitled to considerable weight and deference" and the Opinion did not find substantial evidence for overcoming FINRA's credibility determinations. Having failed to offer credible explanations for his trading, Cody's attempts to reformulate previously rejected

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[8](...continued)

We deny reconsideration under such circumstances to encourage parties to file briefs that fully support their arguments and address opposing arguments in the first instance, and thereby ensure that our opinion is based on fully developed arguments by the parties. *See Canady*, 54 S.E.C. at 257 ("Underlying this position is the concern that, otherwise, the opposing party would not have the opportunity to establish relevant facts that might affect the applicability of" a defense asserted for the first time in a motion for reconsideration); 17 C.F.R. § 201.470(b) (stating that opposing parties are not permitted to file responses to motions for reconsideration "unless requested by the Commission").

[9] *See KPMG Peat Marwick*, 55 S.E.C. at 3 n.7 (finding respondent was "foreclosed from resurrecting an argument as part of a motion for reconsideration" when the respondent "made and lost" the argument before an administrative law judge and then "abandoned [the argument] on review" in its Commission appeal). The Opinion also addressed and rejected Cody's claim that the customer's withdrawals justified the risks posed by these recommendations.

explanations or to offer new post hoc rationalizations at this late stage are not an appropriate basis for reconsideration.

Cody also urges reconsideration of his trading activity, arguing that the excessive trading analysis should have taken into account different customer accounts or a different time frame. However, Cody does not challenge the Opinion's findings that, for both accounts and periods at issue, Cody controlled the relevant trading and the customers were not interested in short-term trading or speculation. Moreover, the Opinion previously rejected his claims that the excessive trading analysis focused on "an inappropriately abbreviated timeframe" and that "his trading levels in [the] accounts were appropriate as part of a 'family plan.'"

The Opinion also addressed the various procedural challenges Cody raises in his request for reconsideration, including his objections to FINRA's investigation and the FINRA complaint, and his claims that he was inappropriately denied the opportunity to introduce expert testimony and other documentary evidence. He does not offer reason to revisit the Opinion's conclusions.

Nor does Cody establish a basis to reconsider remand of the proceeding. Cody claims that the Opinion "acknowledged [that] the underlying data could have been faulty" and "acknowledged the need for additional documentation." However, he does not address the Commission's analysis finding that he failed to "establish[] that any of the additional documentary evidence that he sought would have aided in his defense," that the Commission "is not bound to admit or consider expert testimony," and that "Cody has not substantiated a need for expert testimony." Cody has not demonstrated error in these findings,[10] and remanding under these circumstances would undermine both the fairness and the efficiency of these proceedings and improperly circumvent the finality of our review of the disciplinary process.[11] We do not find reconsideration merited.

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[10] Cody indicates that he delayed presenting or describing additional, unspecified, exonerating evidence because he "believed it would be inappropriate to provide such new information [in the appeal] . . . which was a reason for Cody's request to remand." However, under Rule 450(b), in a disciplinary proceeding reviewed by the Commission, a party disputing "the admission or exclusion of evidence" is required to set forth "the substance of the evidence admitted or excluded . . . in the brief, in an appendix thereto, or by citation to the record." 17 C.F.R. § 200.450(b).

[11] *See Feeley & Willcox*, 56 S.E.C. at 1270 (declining reconsideration to adduce or incorporate new evidence that was available before the Commission's opinion issued, finding that "there are fairness as well as efficiency concerns that would be implicated were we to accept the material at this point"); *Rockies Fund, Inc.*, 91 SEC Docket at 1420 (finding that a motion for reconsideration that was "based on a reworking of arguments and facts previously considered and rejected by the Commission and the Court of Appeals" was "an inappropriate attempt to avoid the finality of the Commission's administrative process.").

Therefore, IT IS ORDERED that the motion for reconsideration filed by Richard G. Cody be, and it hereby is, denied.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-9255; 34-65231 / August 31, 2011]

Order Making Fiscal Year 2012 Annual Adjustments to Registration Fee Rates

I. Background

The Commission collects fees under various provisions of the securities laws. Section 6(b) of the Securities Act of 1933 ("Securities Act") requires the Commission to collect fees from issuers on the registration of securities.[1] Section 13(e) of the Securities Exchange Act of 1934 ("Exchange Act") requires the Commission to collect fees on specified repurchases of securities.[2] Section 14(g) of the Exchange Act requires the Commission to collect fees on proxy solicitations and statements in corporate control transactions.[3]

The Investor and Capital Markets Fee Relief Act of 2002 ("Fee Relief Act")[4] has required the Commission to make annual adjustments to the fee rates applicable under these sections for each of the fiscal years 2003 through 2011 in an attempt to generate collections equal to yearly targets specified in the statute.[5] Under the Fee Relief Act, each year's fee rate has been announced on the preceding April 30, and has taken effect five days after the date of enactment of the Commission's regular appropriation.

1 15 U.S.C. 77f(b).

2 15 U.S.C. 78m(e).

3 15 U.S.C. 78n(g).

4 Pub. L. No. 107-123, 115 Stat. 2390 (2002).

5 *See* 15 U.S.C. §§ 77f(b)(5), 77f(b)(6), 78m(e)(5), 78m(e)(6), 78n(g)(5), and 78n(g)(6).

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") changes many of the provisions related to these fees. The Dodd-Frank Act created new annual collection targets for FY 2012 and thereafter. It also changed the date by which the Commission must announce a new fiscal year's fee rate (August 31) and the date on which the new rate takes effect (October 1).

II. Fiscal Year 2012 Annual Adjustment to the Fee Rate

Section 6(b)(2) of the Securities Act, as amended by the Dodd-Frank Act, requires the Commission to make an annual adjustment to the fee rate applicable under Section 6(b).[6] The annual adjustment to the fee rate under Section 6(b) of the Securities Act also sets the annual adjustment to the fee rates under Sections 13(e) and 14(g) of the Exchange Act.[7]

Section 6(b)(2) sets forth the method for determining the annual adjustment to the fee rate under Section 6(b) for fiscal year 2012. Specifically, the Commission must adjust the fee rate under Section 6(b) to a "rate that, when applied to the baseline estimate of the aggregate maximum offering prices for [fiscal year 2012], is reasonably likely to produce aggregate fee collections under [Section 6(b)] that are equal to the target fee collection amount for [fiscal year 2012]." That is, the adjusted rate is determined by dividing the "target fee collection amount" for fiscal year 2012 by the "baseline estimate of the aggregate maximum offering prices" for fiscal year 2012.

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6 The annual adjustments are designed to adjust the fee rate in a given fiscal year so that, when applied to the aggregate maximum offering price at which securities are proposed to be offered for the fiscal year, it is reasonably likely to produce total fee collections under Section 6(b) equal to the "target fee collection amount" specified in Section 6(b)(6)(A) for that fiscal year.

7 *See* Sections 13(e)(6) and 14(g)(6) of the Exchange Act. On October 1, 2011, Sections 13(e)(4) and 14(g)(6) of the Exchange Act, as amended by the Dodd-Frank Act, will require an annual adjustment to the fee rates under Sections 13(e) and 14(g) of the Exchange Act to the same level as the new the fee rate under Section 6(b) of the Securities Act.

Section 6(b)(6)(A) specifies that the "target fee collection amount" for fiscal year 2012 is $425,000,000. Section 6(b)(6)(B) defines the "baseline estimate of the aggregate maximum offering price" for fiscal year 2012 as "the baseline estimate of the aggregate maximum offering price at which securities are proposed to be offered pursuant to registration statements filed with the Commission during [fiscal year 2012] as determined by the Commission, after consultation with the Congressional Budget Office and the Office of Management and Budget . . . ."

To make the baseline estimate of the aggregate maximum offering price for fiscal year 2012, the Commission used a methodology similar to that developed in consultation with the Congressional Budget Office ("CBO") and Office of Management and Budget ("OMB") to project the aggregate offering price for purposes of the fiscal year 2012 annual adjustment.[8] Using this methodology, the Commission determines the "baseline estimate of the aggregate maximum offering price" for fiscal year 2012 to be $3,708,294,634,490.[9] Based on this estimate, the Commission calculates the fee rate for fiscal 2012 to be $114.60 per million. This adjusted fee rate applies to Section 6(b) of the Securities Act, as well as to Sections 13(e) and 14(g) of the Exchange Act.

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8 For the fiscal year 2011 estimate, the Commission used a ten-year series of monthly observations ending in March 2010. For fiscal year 2012, the Commission used a ten-year series ending in July 2011.

9 Appendix A explains how we determined the "baseline estimate of the aggregate maximum offering price" for fiscal year 2012 using our methodology, and then shows the purely arithmetical process of calculating the fiscal year 2012 annual adjustment based on that estimate. The appendix includes the data used by the Commission in making its "baseline estimate of the aggregate maximum offering price" for fiscal year 2012.

III. Effective Dates of the Annual Adjustments

The fiscal year 2012 annual adjustments to the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act will be effective on October 1, 2011, under the changes made by the Dodd-Frank Act.[10]

IV. Conclusion

Accordingly, pursuant to Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act,[11]

IT IS HEREBY ORDERED that the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act shall be $114.60 per million effective on October 1, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

10 On October 1, 2011, Section 6(b)(4) of the Securities Act and Sections 13(e)(6) and 14(g)(6) of the Exchange Act, as amended by the Dodd-Frank Act, will require the fiscal year 2012 annual adjustments to the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act to be effective on October 1, 2011.

11 15 U.S.C. 77f(b), 78m(e), and 78n(g).

APPENDIX A

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress has, among other things, established a target amount of monies to be collected from fees charged to issuers based on the value of their registrations. This appendix provides the formula for determining such fees, which the Commission adjusts annually. Congress has mandated that the Commission determine these fees based on the "aggregate maximum offering prices," which measures the aggregate dollar amount of securities registered with the Commission over the course of the year. In order to maximize the likelihood that the amount of monies targeted by Congress will be collected, the fee rate must be set to reflect projected aggregate maximum offering prices. As a percentage, the fee rate equals the ratio of the target amounts of monies to the projected aggregate maximum offering prices.

For 2012, the Commission has estimated the aggregate maximum offering prices by projecting forward the trend established in the previous decade. More specifically, an ARIMA model was used to forecast the value of the aggregate maximum offering prices for months subsequent to July 2011, the last month for which the Commission has data on the aggregate maximum offering prices.

The following sections describe this process in detail.

A. Baseline estimate of the aggregate maximum offering prices for fiscal year 2012.

First, calculate the aggregate maximum offering prices (AMOP) for each month in the sample (July 2001 - July 2011). Next, calculate the percentage change in the AMOP from month to month.

Model the monthly percentage change in AMOP as a first order moving average process. The moving average approach allows one to model the effect that an exceptionally high (or low) observation of AMOP tends to be followed by a more "typical" value of AMOP.

Use the estimated moving average model to forecast the monthly percent change in AMOP. These percent changes can then be applied to obtain forecasts of the total dollar value of registrations. The following is a more formal (mathematical) description of the procedure:

1. Begin with the monthly data for AMOP. The sample spans ten years, from July 2001 to July 2011.

2. Divide each month's AMOP (column C) by the number of trading days in that month (column B) to obtain the average daily AMOP (AAMOP, column D).

3. For each month t, the natural logarithm of AAMOP is reported in column E.

4. Calculate the change in log(AAMOP) from the previous month as $\Delta_t = \log(AAMOP_t) - \log(AAMOP_{t-1})$. This approximates the percentage change.

5. Estimate the first order moving average model $\Delta_t = \alpha + \beta e_{t-1} + e_t$, where e_t denotes the forecast error for month t. The forecast error is simply the difference between the one-month ahead forecast and the actual realization of Δ_t. The forecast error is expressed as $e_t = \Delta_t - \alpha - \beta e_{t-1}$. The model can be estimated using standard commercially available software. Using least squares, the estimated parameter values are α=0.0005219 and β=–0.87539.

6. For the month of August 2011 forecast $\Delta_{t=8/11} = \alpha + \beta e_{t=8/11}$. For all subsequent months, forecast $\Delta_t = \alpha$.

7. Calculate forecasts of log(AAMOP). For example, the forecast of log(AAMOP) for October 2011 is given by $FLAAMOP_{t=10/11} = \log(AAMOP_{t=7/11}) + \Delta_{t=8/11} + \Delta_{t=9/11} + \Delta_{t=10/11}$.

8. Under the assumption that e_t is normally distributed, the n-step ahead forecast of AAMOP is given by $\exp(FLAAMOP_t + \sigma_n^2/2)$, where σ_n denotes the standard error of the n-step ahead forecast.

9. For October 2011, this gives a forecast AAMOP of $14.6 Billion (Column I), and a forecast AMOP of $307.6 Billion (Column J).

10. Iterate this process through September 2012 to obtain a baseline estimate of the aggregate maximum offering prices for fiscal year 2012 of $3,708,294,634,490.

B. Using the forecasts from A to calculate the new fee rate.

1. Using the data from Table A, estimate the aggregate maximum offering prices between 10/1/11 and 9/30/12 to be $3,708,294,634,490.

2. The rate necessary to collect the target $425,000,000 in fee revenues set by Congress is then calculated as: $425,000,000 ÷ $3,708,294,634,490= 0.000114608.

3. Round the result to the seventh decimal point, yielding a rate of 0.0001146 (or $114.60 per million).

Table A. Estimation of baseline of aggregate maximum offering prices .

Fee rate calculation.

a. Baseline estimate of the aggregate maximum offering prices, 10/1/11 to 9/30/12 ($Millions)	3,708,295
b. Implied fee rate ($425 Million / a)	$114.60

Data

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Maximum Offering Prices, in $Millions	(D) Average Daily Aggregate Max. Offering Prices (AAMOP) in $Millions	(E) log(AAMOP)	(F) Change in AAMOP	(G) Forecast log(AAMOP)	(H) Standard Error	(I) Forecast AAMOP, in $Millions	(J) Forecast Aggregate Maximum Offering Prices, in $Millions
Jul-01	21	264,590	12,600	23.257					
Aug-01	23	245,591	10,678	23.091	-0.165				
Sep-01	15	178,524	11,902	23.200	0.108				
Oct-01	23	260,719	11,336	23.151	-0.049				
Nov-01	21	286,199	13,629	23.335	0.184				
Dec-01	20	395,230	19,762	23.707	0.372				
Jan-02	21	401,290	19,109	23.673	-0.034				
Feb-02	19	476,837	25,097	23.946	0.273				
Mar-02	20	380,160	19,008	23.668	-0.278				
Apr-02	22	282,947	12,861	23.277	-0.391				
May-02	22	215,645	9,802	23.006	-0.272				
Jun-02	20	277,757	13,888	23.354	0.348				
Jul-02	22	208,638	9,484	22.973	-0.381				
Aug-02	22	265,750	12,080	23.215	0.242				
Sep-02	20	109,565	5,478	22.424	-0.791				
Oct-02	23	179,374	7,799	22.777	0.353				
Nov-02	20	243,590	12,179	23.223	0.446				
Dec-02	21	212,838	10,135	23.039	-0.184				
Jan-03	21	201,839	9,611	22.986	-0.053				
Feb-03	19	144,642	7,613	22.753	-0.233				
Mar-03	21	444,331	21,159	23.775	1.022				
Apr-03	21	142,373	6,780	22.637	-1.138				
May-03	21	328,792	15,657	23.474	0.837				
Jun-03	21	281,580	13,409	23.319	-0.155				
Jul-03	22	304,383	13,836	23.351	0.031				
Aug-03	21	328,351	15,636	23.473	0.122				
Sep-03	21	459,563	21,884	23.809	0.336				

Oct-03	23	285,039	12,393	23.240	-0.569				
Nov-03	19	257,779	13,567	23.331	0.091				
Dec-03	22	244,998	11,136	23.133	-0.197				
Jan-04	20	369,784	18,489	23.640	0.507				
Feb-04	19	221,517	11,659	23.179	-0.461				
Mar-04	23	448,543	19,502	23.694	0.514				
Apr-04	21	260,029	12,382	23.240	-0.454				
May-04	20	227,239	11,362	23.154	-0.086				
Jun-04	21	370,668	17,651	23.594	0.441				
Jul-04	21	305,519	14,549	23.401	-0.193				
Aug-04	22	179,688	8,168	22.823	-0.577				
Sep-04	21	357,007	17,000	23.556	0.733				
Oct-04	21	254,489	12,119	23.218	-0.338				
Nov-04	21	363,406	17,305	23.574	0.356				
Dec-04	22	570,918	25,951	23.979	0.405				
Jan-05	20	375,484	18,774	23.656	-0.324				
Feb-05	19	338,922	17,838	23.605	-0.051				
Mar-05	22	590,862	26,857	24.014	0.409				
Apr-05	21	282,018	13,429	23.321	-0.693				
May-05	21	323,652	15,412	23.458	0.138				
Jun-05	22	517,022	23,501	23.880	0.422				
Jul-05	20	457,487	22,874	23.853	-0.027				
Aug-05	23	605,534	26,328	23.994	0.141				
Sep-05	21	312,281	14,871	23.423	-0.571				
Oct-05	21	258,956	12,331	23.235	-0.187				
Nov-05	21	192,736	9,178	22.940	-0.295				
Dec-05	21	308,134	14,673	23.409	0.469				
Jan-06	20	526,550	26,328	23.994	0.585				
Feb-06	19	301,446	15,866	23.487	-0.506				
Mar-06	23	1,211,344	52,667	24.687	1.200				
Apr-06	19	407,345	21,439	23.788	-0.899				
May-06	22	260,121	11,824	23.193	-0.595				
Jun-06	22	375,296	17,059	23.560	0.367				
Jul-06	20	232,654	11,633	23.177	-0.383				

Aug-06	23	310,050	13,480	23.325	0.147				
Sep-06	20	236,782	11,839	23.195	-0.130				
Oct-06	22	213,342	9,697	22.995	-0.200				
Nov-06	21	292,456	13,926	23.357	0.362				
Dec-06	20	349,512	17,476	23.584	0.227				
Jan-07	20	372,740	18,637	23.648	0.064				
Feb-07	19	278,753	14,671	23.409	-0.239				
Mar-07	22	862,786	39,218	24.392	0.983				
Apr-07	20	562,103	28,105	24.059	-0.333				
May-07	22	470,843	21,402	23.787	-0.272				
Jun-07	21	586,822	27,944	24.053	0.267				
Jul-07	21	326,612	15,553	23.468	-0.586				
Aug-07	23	369,172	16,051	23.499	0.032				
Sep-07	19	241,059	12,687	23.264	-0.235				
Oct-07	23	239,652	10,420	23.067	-0.197				
Nov-07	21	458,654	21,841	23.807	0.740				
Dec-07	20	410,200	20,510	23.744	-0.063				
Jan-08	21	354,433	16,878	23.549	-0.195				
Feb-08	20	263,410	13,171	23.301	-0.248				
Mar-08	20	596,923	29,846	24.119	0.818				
Apr-08	22	292,534	13,297	23.311	-0.809				
May-08	21	456,077	21,718	23.801	0.491				
Jun-08	21	461,087	21,957	23.812	0.011				
Jul-08	22	232,896	10,586	23.083	-0.730				
Aug-08	21	395,440	18,830	23.659	0.576				
Sep-08	21	177,636	8,459	22.858	-0.800				
Oct-08	23	360,494	15,674	23.475	0.617				
Nov-08	19	288,911	15,206	23.445	-0.030				
Dec-08	22	319,584	14,527	23.399	-0.046				
Jan-09	20	375,065	18,753	23.655	0.255				
Feb-09	19	249,666	13,140	23.299	-0.356				
Mar-09	22	739,931	33,633	24.239	0.940				
Apr-09	21	235,914	11,234	23.142	-1.097				
May-09	20	329,522	16,476	23.525	0.383				

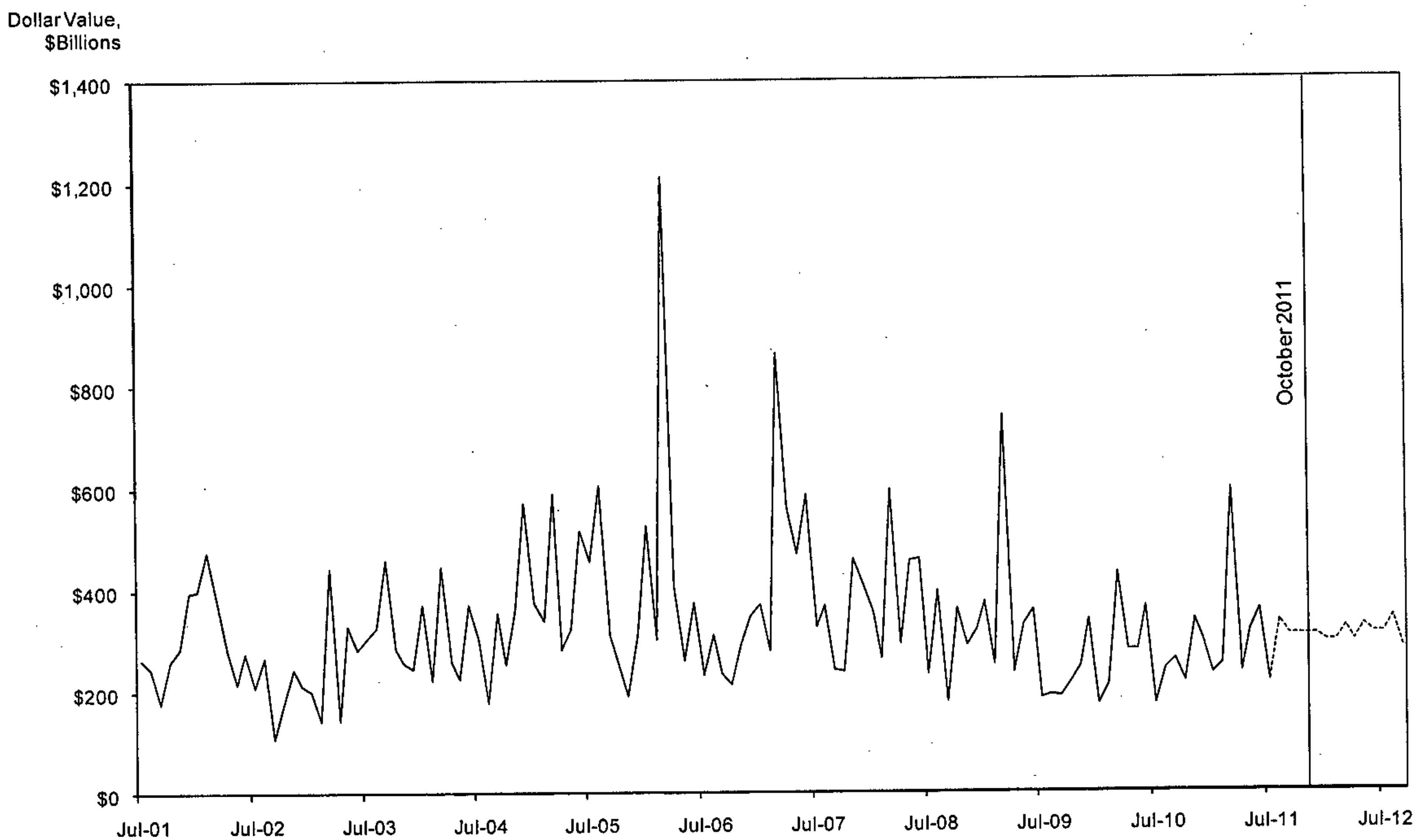
Jun-09	22	357,524	16,251	23.511	-0.014				
Jul-09	22	185,187	8,418	22.854	-0.658				
Aug-09	21	192,726	9,177	22.940	0.086				
Sep-09	21	189,224	9,011	22.922	-0.018				
Oct-09	22	215,720	9,805	23.006	0.085				
Nov-09	20	248,353	12,418	23.242	0.236				
Dec-09	22	340,464	15,476	23.463	0.220				
Jan-10	19	173,235	9,118	22.933	-0.529				
Feb-10	19	209,963	11,051	23.126	0.192				
Mar-10	23	432,934	18,823	23.658	0.533				
Apr-10	21	280,188	13,342	23.314	-0.344				
May-10	20	278,611	13,931	23.357	0.043				
Jun-10	22	364,251	16,557	23.530	0.173				
Jul-10	21	171,191	8,152	22.822	-0.709				
Aug-10	22	240,793	10,945	23.116	0.295				
Sep-10	21	260,783	12,418	23.242	0.126				
Oct-10	21	214,988	10,238	23.049	-0.193				
Nov-10	21	340,112	16,196	23.508	0.459				
Dec-10	22	297,992	13,545	23.329	-0.179				
Jan-11	20	233,668	11,683	23.181	-0.148				
Feb-11	19	252,785	13,304	23.311	0.130				
Mar-11	23	595,198	25,878	23.977	0.665				
Apr-11	20	236,355	11,818	23.193	-0.784				
May-11	21	319,053	15,193	23.444	0.251				
Jun-11	22	359,727	16,351	23.518	0.073				
Jul-11	20	215,391	10,770	23.100	-0.418				
Aug-11	23					23.338	0.364	14,603	335,859
Sep-11	21					23.339	0.367	14,625	307,130
Oct-11	21					23.339	0.370	14,648	307,608
Nov-11	21					23.340	0.373	14,671	308,086
Dec-11	21					23.340	0.376	14,694	308,565
Jan-12	20					23.341	0.378	14,716	294,328
Feb-12	20					23.341	0.381	14,739	294,785
Mar-12	22					23.342	0.384	14,762	324,768

Apr-12	20					23.342	0.386	14,785	295,702
May-12	22					23.343	0.389	14,808	325,778
Jun-12	21					23.343	0.392	14,831	311,453
Jul-12	21					23.344	0.394	14,854	311,938
Aug-12	23					23.344	0.397	14,877	342,177
Sep-12	19					23.345	0.400	14,900	283,107

Figure A

Aggregate Maximum Offering Prices Subject to Securities Act Section 6(b)

(Dashed Line Indicates Forecast Values)



SECURITIES AND EXCHANGE COMMISSION

Release No. IC- 29779; File Nos. S7-35-11

17 CFR Part 270

RIN 3235-AL03

Treatment of Asset-Backed Issuers under the Investment Company Act

AGENCY: Securities and Exchange Commission.

ACTION: Advance notice of proposed rulemaking; withdrawal.

SUMMARY: The Commission is considering proposing amendments to Rule 3a-7 under the Investment Company Act of 1940 ("Investment Company Act" or "Act"), the rule that provides certain asset-backed issuers with a conditional exclusion from the definition of investment company. Amendments to Rule 3a-7 that the Commission may consider could reflect market developments since 1992, when Rule 3a-7 was adopted, and recent developments affecting asset-backed issuers, including the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the Commission's recent rulemakings regarding the asset-backed securities markets. The Commission is withdrawing its 2008 proposal to amend Rule 3a-7, which was published at 73 FR 40124 (July 11, 2008).

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

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

- Use the Commission's Internet comment form (http://www.sec.gov/rules/concept.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-35-11 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 Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-35-11. 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 website (http://www.sec.gov/rules/concept.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 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Rochelle Kauffman Plesset, Senior Counsel, at (202) 551-6840 or Nadya Roytblat, Assistant Chief Counsel, at (202) 551-6825, Office of the Chief Counsel, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

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I. INTRODUCTION AND EXECUTIVE SUMMARY

Asset-backed issuers[1] typically meet the definition of investment company under the Investment Company Act, but generally cannot operate under certain of the Act's requirements and restrictions.[2] In 1992, the Commission adopted Rule 3a-7 under the Investment Company Act specifically to exclude from the definition of investment company certain asset-backed issuers that meet the rule's conditions.[3] These conditions were designed to incorporate then-existing practices in the asset-backed securities market that we believed served to distinguish

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1 We use the term "asset-backed issuer" in this release to refer generally to any issuer of fixed-income securities the payments on which depend primarily on the cash flows generated by a specified pool of underlying financial assets. *See also infra* section III.A.2.d.ii for a discussion of the definition of "asset-backed securities" under other federal securities laws.

2 *See infra* note 29.

3 17 CFR 270.3a-7.

asset-backed issuers from registered investment companies and addressed investor protection under the Investment Company Act.[4]

Rule 3a-7 includes several conditions that refer to credit ratings by nationally recognized statistical rating organizations ("NRSROs" or "rating agencies"). One such condition is that certain of the asset-backed issuer's fixed-income securities receive certain credit ratings by at least one rating agency. These conditions were included in Rule 3a-7 not principally as standards of credit-worthiness, but, because we believed that rating agencies, when providing a rating assessing the credit risk of an asset-backed issuer, evaluated whether the issuer was structured in a manner that also addressed investor protection under the Investment Company Act.[5]

The Dodd-Frank Act,[6] enacted in 2010, generally requires the Commission to review any references to or requirements regarding credit ratings in its regulations, remove these references or requirements and substitute other appropriate standards of credit-worthiness in place of the credit ratings.[7] Even though the ratings-related conditions in Rule 3a-7 generally were not intended to serve as standards of credit-worthiness, we are issuing this advance notice of

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4 The conditions also were intended to accommodate future innovations in the securitization market, consistent with investor protection. *See Exclusion from the Definition of Investment Company for Structured Financings*, Investment Company Act Release No. 19105 (Nov. 19, 1992) [57 FR 56248 (Nov. 27, 1992)] ("Adopting Release") at text accompanying n.8. Rule 3a-7 effectuated the recommendation made by the Division of Investment Management's staff in its report, *Protecting Investors: A Half Century of Investment Company Regulation*, The Treatment of Structured Finance under the Investment Company Act 1-101 (May 1992) ("Protecting Investors Report"). The Protecting Investors Report contains a discussion of the issues raised by asset-backed issuers under the Investment Company Act and the state of the asset-backed securities market prior to the Rule's adoption.

5 *See* Adopting Release, *supra* note 4 at n.42 and accompanying text. *See also infra* note 38.

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

7 Section 939A of the Dodd-Frank Act.

proposed rulemaking in response to these requirements and in light of market developments since Rule 3a-7 was adopted. We also are withdrawing our 2008 proposal to amend Rule 3a-7.[8]

The Dodd-Frank Act also directed the Commission to undertake a number of rulemakings related to the asset-backed securities market.[9] Prior to the passage of the Dodd-Frank Act, in April 2010, the Commission proposed comprehensive revisions to the offering process, disclosure, and reporting requirements for asset-backed securities under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[10] The Commission recognized that many of the problems giving rise to the recent financial crisis involved structured finance and proposed a number of changes designed to improve investor

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8 In 2008, the Commission proposed to replace the references to credit ratings in Rule 3a-7 with a prohibition on the sale of securities of issuers relying on Rule 3a-7 to anyone other than certain institutional investors ("retail sales prohibition"). *References to Ratings of Nationally Recognized Statistical Rating Organizations*, Investment Company Act Release No. 28327 (July 1, 2008) [73 FR 40124 (July 11, 2008)] ("2008 NRSRO Proposing Release") at nn.36-47 and accompanying text. Commenters generally opposed the retail sales prohibition, suggesting, among other things, that the retail sales prohibition would have unnecessarily precluded offerings to retail investors and impeded the liquidity and growth of the asset-backed securities market. *See, e.g.*, comment letter from Dechert LLP to the Commission (Sept. 5, 2008), File No. S7-19-08 ("Dechert Comment Letter"); comment letter from Mayer Brown LLP to Florence E. Harmon, Acting Secretary (Sept. 4, 2008), File No. S7-19-08; comment letter from the American Bar Association to Florence E. Harmon, Acting Secretary (Sept. 12, 2008), File No. S7-19-08. In a 2009 release, the Commission deferred consideration of this proposal. *See References to Ratings of Nationally Recognized Statistical Rating Organizations*, Investment Company Act Release No. 28940 (Oct. 5, 2009) [74 FR 52374 (Oct. 9, 2009)] at text following n.64. Based, in part, on the comments received, we have decided to withdraw from further consideration the amendments to Rule 3a-7 proposed in the 2008 NRSRO Proposing Release.

9 A summary of these Dodd-Frank Act provisions is available at http://www.sec.gov/spotlight/dodd-frank/assetbackedsecurities.shtml. *See also Proposed Rules for Nationally Recognized Statistical Rating Organizations*, Securities Exchange Act Release No. 64514 (May 18, 2011) [76 FR 33420 (June 9, 2011)] (proposal requiring third parties retained to conduct due diligence related to asset-backed securities to provide a certification containing specified information to the NRSRO that is producing a rating for the asset-backed securities); *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, Securities Act Release No. 9175 (Jan. 20, 2011) [76 FR 4489 (Jan. 26, 2011)] ("Section 943 Release") (adopting rules requiring securitizers of asset-backed securities to disclose the history of fulfilled and unfulfilled repurchase requests related to their outstanding asset-backed securities and disclosure by NRSROs of representations, warranties and enforcement mechanisms available to investors in an asset-backed securities offering); *Issuer Review of Assets in Offerings of Asset-Backed Securities*, Securities Act Release No. 9176 (Jan. 20, 2011) [76 FR 4231 (Jan. 25, 2011)] (adopting rules requiring issuers of asset-backed securities to conduct a review of the assets underlying those securities and make certain disclosures about those reviews).

10 *Asset-Backed Securities*, Securities Act Release No. 9117 (Apr. 7, 2010) [75 FR 23328 (May 3, 2010)] ("2010 ABS Proposing Release").

protection and promote more efficient asset-backed markets.[11] Among other things, the Commission proposed to amend: the disclosure requirements of Regulation AB to require that more information be provided to investors about the assets being securitized; the eligibility requirements for public offerings of asset-backed securities conducted through "shelf registration" by replacing the existing requirement that the securities receive an investment grade rating with new requirements; and the safe harbors under the Securities Act for exempt offerings and exempt resales of asset-backed securities.[12] In light of the requirements of the Dodd-Frank Act and the comments subsequently received on the 2010 ABS Proposing Release, the Commission has issued a release revising and re-proposing certain of the proposals in the 2010 ABS Proposing Release.[13] The 2011 ABS Re-proposal requests comment on whether, to be eligible for shelf registration under the Securities Act, an asset-backed issuer should, among other requirements, meet the conditions of Rule 3a-7.

The Commission also believes that it is appropriate to consider amending Rule 3a-7, among other things, to determine the role, if any, that credit ratings should continue to play in the context of Rule 3a-7. In the aftermath of the recent financial crisis, NRSROs' credit rating procedures and methodologies raised a number of concerns in light of the role the NRSROs played in determining credit ratings for securities collateralized by or linked to subprime residential mortgages, and the Commission has engaged in various regulatory initiatives to address these concerns.[14] The

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11 *Id.*

12 *Id. See infra* section III.A.2.d.

13 *Re-proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment*, Securities Act Release No. 9244 (July 26, 2011) [76 FR 47948 (Aug. 5, 2011)] ("2011 ABS Re-proposal").

14 *See, e.g.*, 2008 NRSRO Proposing Release, *supra* note 8. *See also* Summary Report of Issues Identified in the Staff's Examinations of Select Credit Rating Agencies (July 2008). The report can be accessed at http://www.sec.gov/news/studies/2008/craexamination070808.pdf.

potential amendments to Rule 3a-7 could include replacing references to credit ratings with conditions that are tailored to address Investment Company Act-related concerns. The Commission also is considering amending Rule 3a-7 to address two issues, detailed below, that have arisen relating to the potential Investment Company Act status of certain holders of securities of asset-backed issuers that rely on Rule 3a-7.

To assist the Commission in its review of the treatment of asset-backed issuers under the Investment Company Act, the Commission is issuing this advance notice of proposed rulemaking and soliciting broad public comment on these issues. The Commission also invites commenters to address any other issues relating to the treatment of asset-backed issuers, the protection of investors under the Investment Company Act and capital formation that they believe may warrant Commission attention.

II. BACKGROUND

A. Asset-Backed Issuers as Investment Companies

An issuer of asset-backed securities typically is a special purpose entity that acquires and holds a pool of income-producing financial assets and issues non-redeemable debt obligations or equity securities with debt-like characteristics ("fixed-income securities"), the payment of which depends primarily on the cash flow generated by the pooled financial assets. An asset-backed issuer that has more assets, or expects to receive more income, than needed to make full payment on the fixed-income securities also may sell interests in the residual or additional cash flow.[15]

15 For a more complete explanation of the structure of an asset-backed issuer and the roles of the various parties that may be involved in the organization and operation of the issuer, *see, e.g.*, 2010 ABS Proposing Release, *supra* note 13; Kravitt, *Securitization of Financial Assets*, (2d ed. 2009) ("Kravitt"); *Asset-Backed Securities*, Securities Act Release No. 8518 (Dec. 22, 2004) [70 FR 1506 (Jan. 7, 2005)] ("2004 ABS Release"); *Exclusion from the Definition of Investment Company for Certain Structured Financings*, Investment Company Act Release No. 18736 (May 29, 1992) [57 FR 23980 (June 5, 1992)] ("Proposing Release").

An asset-backed issuer typically meets the definition of investment company under Section 3(a)(1) of the Investment Company Act because it issues securities[16] and is engaged in the business of investing in, owning or holding financial assets that are securities[17] under the Investment Company Act.[18] With respect to investment companies generally, as set forth in Section 1(b) of the Act,[19] Congress was concerned, among other things, about companies that were: (i) organized, operated, managed, or their portfolio securities selected, in the interest of company insiders;[20](ii) issuing excessive amounts of senior securities;[21](iii) when computing the

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16 Section 2(a)(36) of the Investment Company Act broadly defines "security" as "any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

17 *See, e.g.*, SEC, *Report on the Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 328 (1966) (stating that notes representing the sales price of merchandise, loans to manufacturers, wholesalers, retailers and purchasers of merchandise or insurance, and mortgages and other interests in real estate are investment securities for purposes of the Investment Company Act). *See also* Protecting Investors Report, *supra* note 4, at n. 339 and accompanying text.

18 Section 3(a)(1)(A) of the Act defines an investment company as any issuer which "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities." Section 3(a)(1)(C) defines an investment company as any issuer which "is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities [as defined by Section 3(a)(2) of the Investment Company Act] having a value exceeding 40 per centum of the value of [its] total assets (exclusive of Government securities and cash items) on an unconsolidated basis" ("40% investment securities test"). Section 3(a)(2) of the Investment Company Act defines "investment securities" to include all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries that are not themselves (i) investment companies and (ii) are not relying on the private investment company exclusions of that Act. Asset-backed issuers typically meet the definition of investment company in Section 3(a)(1)(A) and/or Section 3(a)(1)(C). 15 U.S.C. 80a-3(a)(1). *See also infra* note 30 (discussing statutory exclusions from the definition of investment company that may be available to certain asset-backed issuers).

19 15 U.S.C. 80a-1(b).

20 A study conducted prior to the adoption of the Act documented numerous instances in which investment companies were managed for the benefit of their sponsors and affiliates to the detriment of investors. *Investment Trusts and Investment Companies: Hearings on S.3580 Before a Subcomm. of the Senate Comm. On Banking and Currency*, 3d Sess. 89 (1940) ("Investment Trusts Study"). Section 17 of the Investment Company Act prohibits certain transactions involving investment companies and their affiliates. 15 U.S.C. 80a-17(a). Other provisions of the Investment Company Act also effectively limit opportunities for overreaching by investment company sponsors and affiliates. *See, e.g.*, Section 10(f) of the Investment Company, which generally prohibits a registered investment

asset value of their outstanding securities, employing unsound or misleading methods, or not being subjected to adequate independent scrutiny;[22] and (iv) operating without adequate assets.[23] In addition, the Investment Company Act reflected concerns that the assets of investment companies were not adequately protected, with controlling persons of investment companies commingling the investment company's assets with their own and then proceeding to misappropriate them.[24]

Like most investment companies, asset-backed issuers typically have no employees and must rely for their operations on their sponsors, servicers and other persons, each of whom has its own separate and distinct set of financial and other interests. Furthermore, with the exception of the role typically assigned to the trustee, the sponsor, or a person affiliated with the sponsor, potentially could be responsible for most, if not all, of the operations of an asset-backed issuer.[25] This structure presents significant potential for conflicts of interest. Thus, for example, one Investment Company Act-related concern is the possibility of a sponsor intentionally

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company from knowingly purchasing, during the existence of any underwriting or selling syndicate, any security a principal underwriter of which is an affiliated person of the investment company. 15 U.S.C. 80a-10(f).

21 Prior to 1940, some investment companies were highly leveraged through the issuance of "senior securities" in the form of debt or preferred stock, which often resulted in the companies being unable to meet their obligations to the holders of their senior securities. *See id.* Excessive leverage also greatly increased the speculative nature of the common stock of the companies. *Id.* Section 18 of the Investment Company Act limits the ability of registered investment companies to engage in borrowing and to issue senior securities. 15 U.S.C. 80a-18.

22 Prior to 1940, investment companies often valued their portfolios inaccurately, resulting in unfair and discriminatory practices in the pricing of their securities. *See* Investment Trusts Study, *supra* note 20. The Investment Company Act governs the manner in which registered investment companies value their portfolios, including defining "value" in Section 2(a)(41), with respect to securities held by a registered investment company, to be (a) market value for securities for which market quotations are readily available or (b) for other securities or assets, fair value as determined in good faith by the company's board of directors. 15 U.S.C. 80a-2(a)(41).

23 *See* Investment Trusts Study, *supra* note 20.

24 *See, e.g.,* Investment Trusts Study, *supra* note 20. Prior to 1940, investment company assets were not adequately protected from misuse by investment company insiders. *Id.* In many cases, controlling persons of investment companies commingled the investment companies' assets with the investment advisers' assets and then proceeded to misuse the assets themselves. *Id.* Section 17(f) of the Investment Company Act and the rules thereunder set forth requirements with respect to the custody of investment company assets. 15 U.S.C. 80a-17(f). *See, e.g.,* Rule 17f-2 under the Investment Company Act governing custody of investments by a registered investment company. 17 CFR 270.17f-2.

25 *See, e.g.,* Proposing Release, *supra* note 15 at n.95 and accompanying text.

overvaluing assets or "dumping" into the asset-backed issuer assets that are insufficient to produce the cash flow needed to meet the issuer's obligations to its securities holders, contrary to representations made to investors.[26] Another Investment Company Act-related concern is that a sponsor potentially could substitute inferior assets for the assets transferred to the issuer at the time of securitization.[27] Still another Investment Company Act-related concern relates to the safeguarding of the issuer's assets and the cash flow derived from such assets from being jeopardized, among other things, by the servicer or the trustee commingling the assets and the cash flow with their own assets or by the servicer or trustee investing the issuer's cash flow in a speculative manner.[28]

B. Rule 3a-7

Although asset-backed issuers typically meet the definition of investment company, as a practical matter, they cannot operate under certain of the Investment Company Act's requirements and restrictions.[29] As a result, asset-backed issuers often rely on Rule 3a-7 under the Investment Company Act to be excluded from regulation under the Act.[30] The Commission

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26 *See, e.g., SEC v. Patrick Quinlan, et al.*, 2008 Fed. Sec. L. Rep. (CCH) ¶95,005 (E.D. Mich. Nov.7, 2008), *aff'd,* 373 Fed. Appx. 581 (6th Cir., 2010) (the Commission brought an enforcement action against the sponsor of a mortgage-backed issuer that placed in the issuer a large number of mortgages that the sponsor itself had originated whose loan-to-value ratios exceeded the maximum loan-to-value ratios stated in the issuer's prospectus, significantly increasing the riskiness of the investment).

27 *See* Protecting Investors Report, *supra* note 4 at text following n.281.

28 *See id.* at text following n.289.

29 For example, Section 17(a) of the Investment Company Act generally would prohibit the sponsor's sale of assets to the asset-backed issuer. 15 U.S.C. 80a-17(a). In addition, certain asset-backed issuers could not comply with Section 18 of the Act, which generally limits the extent to which registered investment companies may issue senior securities, including debt. 15 U.S.C. 80a-18. *See* Proposing Release, *supra* note 15 at n.36; Protecting Investors Report, *supra* note 4 at n.253 and accompanying text.

30 Certain asset-backed issuers alternatively may seek to rely on the exclusion from the definition of investment company set forth in Section 3(c)(5)(A), (B) or (C) of the Investment Company Act. 15 U.S.C. 80a-3(c)(5). *See infra* section III.C. The Commission today is issuing a concept release concerning companies that rely on Section 3(c)(5)(C). *Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments*, Investment Company Act Release No. 29778 (Aug. 31, 2011) (the "Section 3(c)(5)(C) Concept Release"). That release may be relevant to certain asset-backed issuers that rely on that Section. *See infra* section III.C.

adopted Rule 3a-7 in 1992 specifically to exclude from the definition of investment company certain asset-backed issuers that meet the rule's conditions.[31] These conditions were intended to reflect the structural and operational distinctions between registered investment companies and asset-backed issuers,[32] and incorporated what we believed to be then-existing practices in the asset-backed securities market that addressed investor protection under the Investment Company Act and promoted capital formation.[33] The conditions also were intended to accommodate future developments in the asset-backed securities market, consistent with investor protection.[34]

III. DISCUSSION

A. Revisiting Rule 3a-7

To rely on Rule 3a-7, an asset-backed issuer must issue fixed-income securities or other securities which entitle the holders to receive payments that depend primarily on the cash flow

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As yet another alternative, asset-backed issuers that privately offer and sell their securities may seek to rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act, commonly referred to as the "private investment company exclusions." 15 U.S.C. 80a-3(c)(1); 15 U.S.C. 80a-3(c)(7). Section 3(c)(1) generally excludes from the definition of investment company any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 investors and which is not making and does not presently propose to make a public offering of its securities. 15 U.S.C. 80a-3(c)(1). Section 3(c)(7) of the Investment Company Act generally excludes from the definition of investment company any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are certain sophisticated investors, called "qualified purchasers," and which is not making and does not at that time propose to make a public offering of its securities. 15 U.S.C. 80a-3(c)(7). *See* Section 2(a)(51) of the Investment Company Act (defining the term qualified purchaser). 15 U.S.C. 80a-2(a)(51). Section 3(c)(7) may be a particularly useful exclusion for asset-backed issuers that privately offer and sell their securities because, unlike Section 3(c)(1), it does not limit the number of investors that may hold the issuer's securities and many investors in asset-backed securities are large institutional investors that meet the definition of qualified purchaser under the Act. *See, e.g.*, Kravitt, *supra* note 15 at 12.03[D].

31 Prior to the adoption of Rule 3a-7, the Commission had issued approximately 125 orders under Section 6(c), the Investment Company's Act general exemptive provision, which provided exemptive relief to certain asset-backed issuers, primarily those holding mortgage-related assets. 15 U.S.C. 80a-6(c). *See, e.g.*, Mortgage Bankers Financial Corp. I, *et al.*, Investment Company Act Release Nos. 16458 (June 28, 1988), 53 FR 25226 (notice of application) and 16497 (July 25, 1988), 41 SEC Docket 814 (order); Shearson Lehman CMO, Inc., Investment Company Act Release Nos. 15796 (June 11, 1987), 52 FR 23246 (notice of application) and 15852 (July 2, 1987), 38 SEC Docket 1403 (order). The Commission has not issued any such orders since Rule 3a-7 was adopted in 1992.

32 For example, an issuer relying on Rule 3a-7 may not issue redeemable securities, because "investors could confuse the securities with those issued by open-end management investment companies." Proposing Release, *supra* note 15, at n. 61 and accompanying text.

33 Adopting Release, *supra* note 4 at text following n.8.

34 *Id.*

from eligible assets.[35] The rule provides that the issuer's fixed-income securities generally must be rated by at least one NRSRO in one of the four highest ratings categories.[36] At the time the rule was adopted, the Commission understood that NRSROs, in providing credit ratings for fixed-income securities of asset-backed issuers, typically expected the issuers to have certain structural safeguards.[37] The Commission viewed these safeguards as addressing investor protection under the Investment Company Act.[38]

For example, in providing a credit rating for certain asset-backed securities, the NRSROs, among other things, were understood to typically: review the specific assets to be transferred to the issuer or the method by which the assets were selected; expect an independent auditor to confirm that the asset pool was representative of the sponsor's portfolio; and evaluate limitations placed on the substitution of the issuer's assets and the reinvestment of the cash flow derived from the assets.[39] Such expected review by an NRSRO had the perceived benefit of mitigating

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35 Rule 3a-7(b)(1) defines eligible assets to be financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.

36 Rule 3a-7(a)(2). When Rule 3a-7 was adopted, almost all publicly offered fixed-income securities issued by asset-backed issuers were rated by at least one rating agency, with most issuing at least one class of fixed-income securities rated in one of the top two categories. *See* Protecting Investors Report, *supra* note 4 at nn. 187-188 and accompanying text. Rule 3a-7 contains an exception from the rating requirement that permits non-investment grade or unrated fixed-income securities to be sold to institutional accredited investors and any security, without regard to type or rating, to be sold to qualified institutional buyers or to persons involved in the organization or operation of the issuer and their affiliates, provided that the issuer and its underwriters use reasonable care to ensure that all excepted sales and resales are to such persons. *See* Rule 3a-7(a)(2). The exception reflected then-existing industry practice that subordinate tranches of fixed-income asset-backed securities issuances, which typically were not highly rated, if rated at all, and residual interests in the issuer, were placed with certain sophisticated investors. Proposing Release, *supra* note 15 at n.77 and accompanying text.

37 Adopting Release, *supra* note 4, at text following n. 42. As noted above, the recent financial crisis has exposed various problems with the ratings process and the NRSROs' procedures and methodologies. *See supra* note 14.

38 Adopting Release, *supra* note 4. The Commission also explained that the rating requirement also served as a means of distinguishing asset-backed issuers from registered investment companies. The Commission, however, emphasized that, "although ratings generally reflect evaluations of credit risk, the rating requirement [was] not intended to address investment risks associated with the credit quality of a financing." Adopting Release, *supra* note 4 at text following n.41.

39 Protecting Investors Report, *supra* note 4 at nn. 208-211 and accompanying text, n. 218 and accompanying text, and text following n.292 and prior to n.293.

opportunities for self-dealing and overreaching by the sponsor or other insiders of the asset-backed issuer.[40] In addition, the NRSROs were understood to analyze the potential performance of the issuer's assets, the risks related to the issuer's cash flow and the cash flow allocation with respect to the payment of the fixed-income securities. Such analysis was viewed as addressing potential concerns relating to misvaluation of the issuer's assets and inadequate asset coverage.[41] The NRSROs also were understood to review whether the asset-backed issuer's assets would be available in the event of the sponsor's insolvency, and evaluate the processes and controls regarding the custody of the issuer's assets and cash flow. Such review was viewed as addressing concerns relating to the safekeeping of the issuer's assets.[42]

Rule 3a-7 also imposes limitations on the acquisition and disposition of the eligible assets that were intended to help ensure that any changes in the issuer's assets would not adversely affect the outstanding fixed-income securities holders and guard against self-dealing and overreaching by the issuer's sponsor or servicer.[43] The restrictions also were intended to prevent activities that resemble the portfolio management practices employed by registered management investment companies.[44] Under the rule, an issuer generally may acquire additional eligible assets or dispose of such assets only if that action complies with the terms and conditions set forth in the issuer's organizational documents.[45] In addition, any acquisition or disposition of eligible assets may not result in a downgrading of the rating of the issuer's fixed-income

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40 *Id.* at text following n.292.

41 *Id.* at nn.212, 220-221and 293 and accompanying text.

42 *Id.* at nn.294-295 and accompanying text.

43 *See* Adopting Release, *supra* note 4 at n. 66 and accompanying text.

44 *Id.* at n.62 and accompanying text. *See also infra* section III.A.3. For example, Rule 3a-7 does not permit the acquisition or disposition of eligible assets for the primary purpose of recognizing gains or losses resulting from market changes. Rule 3a-7(a)(3)(iii).

45 Rule 3a-7(a)(3)(i).

securities.[46] The rule also does not permit the acquisition or disposition of eligible assets for the primary purpose of recognizing gains or losses resulting from market changes.[47]

Finally, the rule includes conditions addressing the safekeeping of the issuer's eligible assets and the cash flow derived from such assets. Among other things, the issuer generally must take reasonable steps to cause an independent trustee[48] to have a perfected security interest or ownership interest valid against any third parties in the eligible assets that principally generate the cash flow needed for payment on the fixed-income securities.[49] In addition, the cash flow derived from the eligible assets that is received by the servicer must be deposited periodically in a segregated account that is maintained or controlled by the independent trustee, "consistent with the rating of the outstanding fixed-income securities."[50] This reference to the rating reflected what the Commission understood to be the practice of NRSROs, in issuing the rating, to review the capability of the issuer's servicer to perform its duties, including the risk of loss from the servicer holding the cash flow derived from the eligible assets.[51]

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46 Rule 3a-7(a)(3)(ii). The Commission explained that tying the management of the issuer's eligible assets to the rating of the fixed-income securities addressed the danger of self-dealing, because any addition or removal of assets that adversely affected the fixed-income securities holders was understood to result in a downgrading of the issuer's outstanding fixed-income securities. *See* Adopting Release, *supra* note 4 at n.66 and accompanying text.

47 Rule 3a-7(a)(3)(iii).

48 Rule 3a-7(a)(4)(i) generally requires that the trustee be a bank that meets the requirements of Section 26(a)(1) of the Investment Company Act and that is not affiliated, as that term is defined in Rule 405 under the Securities Act, with the issuer or with any person involved in the organization or operation of the issuer, that does not offer or provide credit or credit enhancement to the issuer, and that executes an agreement or instrument concerning the issuer's securities containing provisions to the effect set forth in Section 26(a)(3) of the Investment Company Act, limiting when the trustee may resign. 15 U.S.C. 80a-26(a)(3).

49 Rule 3a-7(a)(4)(ii).

50 Rule 3a-7(a)(4)(iii).

51 *See* Proposing Release, *supra* note 15 at n.31. *See also* Adopting Release, *supra* note 4 at text following n.82; Kravitt, *supra* note 15 at 7.03[E].

1. Rating Requirements

As discussed above, Rule 3a-7 contains references to ratings in three of the rule's conditions. Specifically, an asset-backed issuer relying on Rule 3a-7 generally must have its fixed-income securities rated by at least one NRSRO in one of the four highest ratings categories.[52] In addition, any acquisition or disposition of eligible assets may not result in a downgrading of the rating of the issuer's fixed-income securities.[53] Finally, the cash flow derived from the eligible assets that is received by the servicer must be deposited periodically in a segregated account that is maintained or controlled by an independent trustee, "consistent with the rating of the outstanding fixed-income securities."[54] In each case, the reference to ratings was intended to be a type of proxy for the relevant investor protections afforded by the Investment Company Act.[55] The condition that the fixed-income securities be rated also was viewed as a means of distinguishing asset-backed issuers from most registered investment companies.[56]

The Commission is considering eliminating the references to ratings in Rule 3a-7. We question whether such references have served, as intended, as a proxy to address Investment Company Act-related concerns, and whether it continues to be appropriate for Rule 3a-7 to make use of ratings in this manner. Accordingly, we ask for comment on the type of analysis that rating agencies currently conduct in providing credit ratings for the fixed-income securities of asset-backed issuers, and the types of structural safeguards that rating agencies expect asset-backed issuers to have, that also address Investment Company Act-related

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52 Rule 3a-7(a)(2).

53 Rule 3a-7(a)(3)(ii).

54 Rule 3a-7(a)(4)(iii).

55 *See supra* note 38 and accompanying text.

56 *Id.*

concerns.[57] Please provide a full explanation of whether, and if so how, the actions and expectations of the rating agencies today mitigate the potential for the types of abuses otherwise addressed by the Investment Company Act.

- Do ratings today serve as a proxy for addressing Investment Company Act-related concerns? If so, are there mechanisms in place that help ensure that NRSROs conduct the type of analysis and review of asset-backed issuers' structures and operations that serve to address Investment Company Act-related concerns?

- Did the revelations concerning the NRSROs' processes, policies and methodologies arising out of the recent financial crisis also suggest that ratings failed to serve as a proxy for addressing Investment Company Act-related concerns?

- Even if the actions and expectations of the rating agencies with respect to asset-backed issuers today mitigate the potential for Investment Company Act-related concerns, does it continue to be appropriate to rely on ratings as a proxy for addressing Investment Company Act-related concerns in Rule 3a-7?

- Should some or all of the references to ratings be removed from the rule? Should the references to ratings be replaced with other conditions? What would be the economic impact of removing the references to ratings in Rule 3a-7 and of any suggested new conditions?

- Should Rule 3a-7 continue to require that the fixed-income securities be rated regardless of whether any other conditions are added to the rule? To the extent that the ratings requirements in the rule are perceived to be or are useful as a measure of credit-worthiness, what

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57 *See supra* section III.A.1 (describing the types of review we believed was conducted by the rating agencies when the rule was adopted).

substitute standards should the Commission consider adopting in accordance with Section 939A of the Dodd-Frank Act?[58] We ask commenters to fully explain their views.

We note that, as discussed in greater detail below, various provisions of the Dodd-Frank Act and Commission rules thereunder, as well as the 2010 ABS Proposing Release and 2011 ABS Re-proposal, set forth requirements relating to certain asset-backed issuers and certain persons involved in the organization and operation of asset-backed issuers, that may serve to address the same Investment Company Act-related concerns as those that underlie the references to ratings in Rule 3a-7.[59] As detailed below, we ask for comment on whether any such requirements should be included as conditions to the exclusion from the definition of investment company provided by Rule 3a-7.[60]

We also note that, although Rule 3a-7 generally states that fixed-income securities of an asset-backed issuer must be rated by at least one NRSRO in one of the four highest rating categories, the text of the rule does not require fixed-income securities of a Rule 3a-7 issuer to be rated, provided that the securities are sold and resold only to certain sophisticated investors.[61] We request comment on whether and, if so, to what extent, any issuer has relied on Rule 3a-7 to offer fixed-income securities to the sophisticated investors specified in the rule without any tranche of the issuer's fixed-income securities being rated in the categories specified in the rule. If so, please explain whether these securities were offered publicly or privately.

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58 *See supra* note 7 and accompanying text (Section 939A of the Dodd-Frank Act generally requires the Commission to review any references to or requirements regarding credit ratings in its regulations, remove these references or requirements and substitute other appropriate standards of credit-worthiness in place of the credit ratings).

59 *See infra* section III.A.2.d.

60 *Id.*

61 *See supra* note 36.

2. Possible New Conditions for Rule 3a-7

We ask for comment on the conditions that should be added to Rule 3a-7 to directly address investor protection under the Investment Company Act.[62] These investor protection issues generally can be characterized as falling into the following areas: (i) concerns about self-dealing by insiders, misvaluation of assets and inadequate asset coverage as they relate to the structure and operation of the asset-backed issuer; (ii) the benefits of an independent review of the asset-backed issuer's structure and intended operations in addressing these concerns; and (iii) preservation and safekeeping of the asset-backed issuer's eligible assets and cash flow.

Each of these investor protection issues is discussed in greater detail below. Although the Commission has identified these particular issues, the Commission requests and encourages commenters to provide both thoughts about the types of investor protection concerns under the Investment Company Act presented by asset-backed issuers and suggestions as to the types of conditions that should be included in Rule 3a-7 to address these concerns. We also ask for comment on the changes in the asset-backed securities market since 1992, whether such changes present other issues or concerns under the Investment Company Act that we have not described, and how Rule 3a-7 should address them. We ask that commenters fully explain their recommendations, including how any suggested conditions would directly address investor protection under the Investment Company Act, and well as how such suggestions might affect capital formation. We also ask commenters to provide suggested rule text.

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62 We note that this approach was suggested by a commenter that had responded to the Commission's request for comment in the 2008 NRSRO Proposing Release. *See* comment letter from Shearman & Sterling LLP (on behalf of its client Merrill Lynch Depositor Inc.) to Florence E. Harmon, Acting Secretary (Sept. 24, 2008), File Nos. S7-18-08 and S7-19-08 ("if the Commission feels it necessary that Rule 3a-7 be amended, our client feels that the Commission's proposal that the rating requirement be replaced with alternative specific requirements regarding abuses that the Investment Company Act is designed to address, such as self-dealing and overreaching by issuers, misvaluation of assets, and inadequate asset coverage, is worth further consideration by the Commission . . .").

a. Structure and Operation of the Issuer

In many respects, the Investment Company Act is generally intended to address the structural and operational integrity of an issuer in relation to the securities being issued.[63] In the context of an asset-backed issuer that may use the exclusion provided by Rule 3a-7, the concern is with the possibility of abusive practices, such as self-dealing and overreaching by insiders, misvaluation of assets, and inadequate asset coverage.[64] For example, the asset-backed issuer's sponsor, among other things, might potentially engage in intentional misvaluation of assets or in a form of "dumping" by transferring assets insufficient to produce the cash flow needed to meet the issuer's obligations to its securities holders, contrary to representations made to investors. In addition, once the securities are issued, any person involved in the operation of the issuer potentially might engage in activities that could adversely affect payment of the outstanding fixed-income securities. Such activities might include, for example, substituting assets in the pool after the time of securitization with lower quality assets, investing the issuer's cash flow in a speculative manner, or other activities that present potential conflicts of interest.

There are various approaches that the Commission could take to address these types of concerns in Rule 3a-7. The rule could impose specific requirements or limitations on the structure and operations of an asset-backed issuer relying on the rule in order to prevent these potential types of abuses from occurring. For example, the rule could specify the particular manner in which the issuer's assets should be selected and valued to avoid potential "dumping" of assets and misvaluation. The rule also could specify the particular manner in which the issuer's depositor and sponsor may structure the issuer to help guard against self-dealing and overreaching by these insiders. The rule further could prohibit any person involved in the

63 *See e.g., supra* notes 19-24 and accompanying text.

64 *See* Proposing Release, *supra* note 15, at nn. 69 and 70 and accompanying text.

operation of the issuer from engaging in specific activities that may adversely affect payment of the fixed-income securities consistent with their terms.

Alternatively, the rule could take a principles-based approach that would be less prescriptive. For example, among other things, the rule could require that the parameters of the issuer's organization and operations be set forth in its organizational documents, with the goal of mitigating potential opportunities for self-dealing and overreaching on the part of the issuer and any person involved in the organization or operation of the issuer. To this end, the rule could require that the issuer's organizational documents set forth: (i) the specific roles and responsibilities of any person involved in the organization or operation of the issuer; (ii) the specific terms and conditions pursuant to which the issuer may acquire or dispose of eligible assets; and (iii) policies and procedures that are reasonably designed to prevent insiders from engaging in activities that may adversely affect payment of the fixed-income securities after the securities are sold. We understand that the current industry practice of publicly-offered asset-backed issuers is to set forth the parameters of the issuer's organization and operations in the issuer's organizational documents,[65] with varying degrees of specificity.[66]

The Commission requests comment on the types of conditions that may be appropriate for Rule 3a-7 to provide structural and operational safeguards for asset-backed issuers that seek to rely on the rule.

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65 An issuer's organizational documents must be filed as exhibits to the registration statement. *See* Item 60 of Regulation S-K [17 CFR 229.60].

66 We note, for example, that Regulation AB generally requires asset-backed issuers to describe much of this information in their registration statements, although perhaps not with the same degree of specificity that could be required under this approach. *See, e.g.*, Item 1104(d) (requiring a description of the sponsor's material roles and responsibilities in its securitization program); Item 1107(b) (requiring a description of the permissible activities of the issuer); Item 1108(a)(1) (requiring a description of the roles, responsibilities and oversight requirements of the servicers involved in a transaction) [17 CFR 229.1104(d), 1107(b), 1108(a)(1)]. In addition, as discussed previously, under current Rule 3a-7, an issuer generally may acquire additional eligible assets or dispose of such assets only if that action complies with the terms and conditions set forth in the issuer's organizational documents. *See supra* note 45 and accompanying text.

- Is one of the possible approaches discussed above more consistent with investor protection than, or otherwise preferable to, the other? If so, which one and why? What would be the impact of such an approach on capital formation?

- What would be the potential economic impact of the approaches discussed above?

- If the rule were to impose specific requirements or limitations on the structure and operations of an asset-backed issuer relying on the rule, what should those requirements or limitations be, and what would be the likely benefits and costs of such requirements or limitations?

- Should the rule require an issuer's organizational documents to set forth the types of information suggested above? How would such a requirement change current practice?

- Rule 3a-7(a)(3)(i) currently provides that an issuer generally may acquire additional eligible assets or dispose of eligible assets only in accordance with the specific terms and conditions of the issuer's organizational documents. Should that condition be expanded to cover the initial transfer of eligible assets to the issuer at the time of securitization, in order to mitigate opportunities for dumping and other potential abuses by insiders that exist both at the time of the initial transfer of the assets to the issuer and over the course of the operation of the issuer? If the condition were so expanded, would it help mitigate such potential abuses?

- Are there other approaches that the Commission should consider that would adequately address Investment Company Act-related concerns such as self-dealing and overreaching, misvaluation, and inadequate asset coverage?[67] If so, what types of approaches, why and with what economic impact? We ask commenters to fully explain their views and, if appropriate, provide rule text and supporting data.

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[67] One approach to addressing these concerns might be to include a condition in Rule 3a-7 that provides for an independent third party review of the issuer's structure and intended operations. We discuss such a condition in the next section. *See infra* section III.A.2.b.

- Are there other Investment Company Act-related concerns that Rule 3a-7 should address besides self-dealing, misvaluation and inadequate asset coverage? If so, what are those concerns and how should the rule address them? For example, one of the Investment Company Act-related concerns is the pyramiding of investment companies.[68] Should Rule 3a-7 address this concern?[69] If so, why and how should the rule address it? Should the rule restrict the ability of an issuer relying on the rule to invest in other asset-backed issuers? If so, what restrictions should the rule impose?

b. Independent Review

The concept of independent oversight or independent review is fundamental to the regulatory framework of the Investment Company Act.[70] Registered investment companies typically rely for their structure and operations on third parties that have their own financial interests separate and distinct from those of the investment companies and their shareholders, presenting potential conflicts of interest that require independent oversight. The independent oversight in the case of registered management investment companies is provided by the company's board of directors, and in particular the independent board members, as required by the Act.[71]

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68 *See* Section 1(b)(4) of the Investment Company Act. *Cf. Fund of Funds Investments*, Investment Company Act Release No. 26198 (Oct. 1, 2003) ("The complex structures that resulted from pyramiding created additional problems for shareholders. These structures permitted acquiring funds to circumvent investment restrictions and limitations, and made it impossible for shareholders to understand who really controlled the fund or the true value of their investments.").

69 We note, for example, that the Financial Crisis Inquiry Commission found that investments by issuers of collateralized debt obligations ("CDOs) in other CDOs magnified total leverage and increased exposure to loss. Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Jan. 2011) at 132-134, 155. *See also The Report of the Counterparty Risk Management Policy Group III, Containing Systemic Risk: The Road to Reform* (Aug. 6, 2008) at 55 (discussing CDOs that invested in other CDOs).

70 *See generally* Section 1(b) of the Investment Company Act.

71 *See* Section 10 of the Investment Company Act governing the composition of a registered investment company's board of directors.

Asset-backed issuers are similar to registered investment companies in that they also typically rely for their structure and operations on third parties that have their own financial interests separate and distinct from those of the asset-backed issuers and their fixed-income securities holders.[72] We are considering whether to replace the rating condition currently contained in Rule 3a-7, in part, with a condition that would provide for an independent review of the asset-backed issuer and its intended operations prior to the sale of the fixed-income securities. Such a condition could require the asset-backed issuer to obtain an opinion from an independent evaluator that the independent evaluator reasonably believes, based on information available at the time the fixed-income securities are first sold and taking into account the characteristics of the securitized assets underlying the offering, that the asset-backed issuer is structured and would be operated in a manner such that the expected cash flow generated from the underlying assets, would likely allow the asset-backed issuer to have the cash flow at times and in amounts sufficient to service expected payments on the fixed-income securities. Such an opinion would not serve as a guarantee that the securitization will produce such cash flow. Alternatively, the rule could require the issuer itself to provide a similar certification in its offering documents, but to do so only after considering the views of an independent evaluator that has reviewed the structure and the intended operations of the issuer. For purposes of such a condition, potentially any independent person, including an NRSRO, that has the expertise and experience in the structuring or evaluating of asset-backed issuers and their securities, could serve as the independent evaluator.

We note that, in the 2011 ABS Re-proposal, we proposed replacing the investment grade ratings criterion for shelf eligibility for asset-backed securities offerings with a requirement that

72 *See supra* note 25 and accompanying text.

a certification be provided by either the chief executive officer of the depositor or the executive officer in charge of securitization of the depositor.[73] As we stated in the 2011 ABS Re-proposal, such a certification may cause these officials to review more carefully the disclosure and the transaction, and to participate more extensively in the oversight of the transaction. In the 2011 ABS Re-proposal, we also requested comment on whether an asset-backed issuer should have the flexibility to engage an independent evaluator to perform the review necessary to give the certification, and the type of opinion that the independent evaluator would provide.[74]

If Rule 3a-7 were to be amended to include a condition requiring independent review, the amendment would be premised on the need to address concerns arising under the Investment Company Act about self-dealing and overreaching by insiders.[75] Thus, the purpose of the independent review under Rule 3a-7 would be different from that which might be performed in connection with the certification requirement proposed in the 2011 ABS Re-proposal. Nevertheless, the scope of the review under any independent review provisions in the shelf eligibility conditions and those in Rule 3a-7 could be consistent so that one review could satisfy both purposes.[76]

We request comment on whether Rule 3a-7 should require an independent review of the structure and intended operations of the asset-backed issuer.

- Would such a review serve to address Investment Company Act-related concerns?

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73 As proposed, such certification would state, among other things, that based on the officer's knowledge, "taking into account the characteristics of the securitized assets underlying the offering, the structure of the securitization, including internal credit enhancements, and any other material features of the transaction, in each instance, as described in the prospectus, the securitization is designed to produce, but is not guaranteed by this certification to produce, cash flows at times and in amounts sufficient to service expected payments on the asset-backed securities offered and sold pursuant to the registration statement." *See* 2011ABS Re-proposal, *supra* note 13 at proposed Item 601(b)(36) of Regulation AB.

74 *See* 2011 ABS Re-proposal, *supra* note 13 at text following n. 58.

75 As discussed above, within the framework of the Investment Company Act, these concerns are addressed through independent review. *See supra* note 70 and accompanying text.

76 *See also infra* section III.A.2.d.

- What should be the scope of the independent review under Rule 3a-7? What should be the standard(s) for the conclusion(s) reached by the independent evaluator for purposes of Rule 3a-7?

- What should be the independence requirements for an entity to serve as an independent evaluator for purposes of Rule 3a-7? We note that the 2011 ABS Re-proposal requests comment on certain potential independence requirements for an independent evaluator, such as prohibitions on affiliation with the issuer or any person involved in the organization or operation of the issuer, on ownership of the issuer's securities or underlying assets, and on certain material business relationships.[77] Would similar requirements be appropriate in the context of Rule 3a-7?

- The 2011 ABS Re-proposal also requests comment on whether it would be appropriate to define an independent evaluator as a person that has the expertise and experience in the structuring or evaluating of asset-backed securities. Would this be an appropriate definition of an independent evaluator for purposes of Rule 3a-7?

- Should we impose any additional or different requirements on an independent evaluator? For example, should consideration be given to whether the independent evaluator is subject to federal regulation or how the independent evaluator is regulated?

- What steps should the asset-backed issuer be required to take to determine whether a prospective independent evaluator meets the qualifications to serve as an independent evaluator under Rule 3a-7? Should the asset-backed issuer be able to rely on a statement of the prospective independent evaluator, for example, that the prospective independent evaluator has

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77 2011 ABS Re-proposal, *supra* note 13 at nn.60-61and accompanying text.

the required expertise and experience? Should the asset-backed issuer perform some level of due diligence?

- What types of entities may likely serve as independent evaluators under Rule 3a-7? We are interested in particular in hearing from commenters that may meet the possible independent evaluator qualifications discussed above whether they might be interested in serving as independent evaluators if such a condition were to be included in Rule 3a-7, and if not, why not.

- Should rating agencies be allowed to serve as independent evaluators under Rule 3a-7? Why or why not?

- If an independent evaluator condition were to be included in Rule 3a-7, should the rule also require the asset-backed issuer to include the independent evaluator's opinion as an exhibit to its registration statement thereby requiring the independent evaluator to consent to being named as an "expert" in the registration statement and being subject to potential liability under Section 11 of the Securities Act?

- What would be the economic impact of including an independent evaluator condition in Rule 3a-7 and what would be the factors affecting the economic impact? Would the economic impact depend on whether the independent evaluator is subject to expert liability? If so, how? How may the risk of expert liability affect the willingness of an entity to serve as an independent evaluator and the price it may charge for its services?

- Is the alternative that the asset-backed issuer itself must provide a certification about its structure and intended operations, but only after considering the views of an independent evaluator, preferable? Why or why not?

- If Rule 3a-7 were to include an independent evaluator condition, would there be circumstances in which compliance with such condition may not be necessary for investor protection? For example, should such a condition not apply with respect to an asset-backed issuer that offers and sells its securities solely to investors that meet certain objective standards, such as being "qualified institutional buyers" within the meaning of Rule 144A under the Securities Act? If such a condition should not apply to certain asset-backed issuers, should such issuers be required to disclose in their offering documents that they are not complying with the independent evaluator condition and explain why? Should such issuers be subject to other, alternative conditions under Rule 3a-7 that would address Investment Company Act- related concerns, including self-dealing and overreaching by insiders?

- Are there other considerations that should factor into the Commission's determinations on the appropriateness and the details of an independent review in the context of Rule 3a-7? We ask commenters to fully explain their views and provide supporting data, if appropriate.

c. Preservation and Safekeeping of Eligible Assets and Cash Flow

Like registered investment companies, asset-backed issuers are pools of financial assets that are subject to the risk of misappropriation. In addition, unless the asset-backed issuer is structured appropriately, its assets and cash flow might not be insulated in the event of the sponsor's or depositor's bankruptcy or insolvency. The issuer's assets and cash flow also might be endangered if the servicer or trustee commingles them with its own assets. The availability of the issuer's cash flow to the fixed-income securities holders also could be endangered if the cash flow is invested in a speculative manner.

Rule 3a-7 contains several conditions designed to address the safekeeping of the issuer's eligible assets and the cash flow derived from such assets. Under the rule, the issuer must take reasonable steps to cause an independent trustee to have a perfected security interest or ownership valid against third parties in the eligible assets.[78] The rule also provides for the cash flow from such assets to be deposited periodically in a segregated account maintained or controlled by the independent trustee "consistent with the rating of the outstanding securities."[79] In addition, the rule's condition that the issuer's fixed-income securities generally receive a rating in one of the four highest rating categories also touches on concerns relating to the safekeeping of the issuer's assets and cash flow. For example, we understand that asset-backed securities often could not achieve an investment grade rating unless the issuer was structured in such a manner that the assets and cash flow are insulated in the event of the sponsor's or depositor's bankruptcy or insolvency.[80]

We ask for comment on whether Rule 3a-7 should be amended to strengthen the provisions relating to the preservation and safekeeping of the asset-backed issuer's assets and cash flow. For example, the current rule does not limit the practice of servicers commingling the cash flow of asset-backed issuers with their own assets for periods of time prior to transferring it to the trustee.[81] We ask for comment on whether such practice may be unnecessarily putting the cash flow at risk. The current rule also does not address the treatment of the cash flow when there is a timing mismatch between the receipt of collections from the eligible assets and the

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78 Rule 3a-7(a)(4)(ii).

79 Rule 3a-7(a)(4)(iii).

80 *See, e.g.*, Proposing Release, *supra* note 15 at n.33 and accompanying text.

81 Current Rule 3a-7(a)(4) differs significantly from the condition that was initially proposed. The Commission proposed that the cash flow derived from the eligible assets be transferred to the trustee within a reasonable period from the time of receipt. *See* Proposing Release, *supra* note 15 at nn.90-92 and accompanying text. The Commission explained that the proposed provision was intended to prohibit a servicer from commingling the cash flow with its own assets, arguing that "investor protection concerns outweigh any benefit resulting from the commingling of a servicer's assets with those of the issuer." *Id.* at text following n.92. Commenters argued that transferring the cash flow "within a reasonable period of time" was inconsistent with industry practice and that whether a servicer commingled the cash flow with its own assets, and if so, for how long, depended on the type of assets being securitized and the capabilities of the servicer's computer systems to track the cash flow. *See* Adopting Release, *supra* note 4 at n.77 and accompanying text.

distributions to the fixed-income securities holders. Are there other aspects of the rule we should consider amending in order to help preserve and protect the asset-backed issuer's assets and cash flow? If so, please provide specific suggestions for such amendments, including, where possible, suggested rule text.

We also note the irregularities that had recently surfaced that have caused difficulties in determining the ownership of certain mortgages that had been securitized.[82] As discussed, under Rule 3a-7, the issuer must take reasonable steps to cause an independent trustee to have a perfected security interest or ownership valid against third parties in the eligible assets.[83] We ask for comment on whether and how this requirement in Rule 3a-7 should be strengthened in light of these events.

We invite commenters to provide us with information about current practices with respect to the safekeeping of eligible assets under Rule 3a-7.

- Does the current rule contain safeguards that adequately protect the eligible assets?

- Should stronger safeguards be adopted with respect to these assets? If so, what should these safeguards be?

We also invite commenters to provide us with information about current practices under Rule 3a-7 with respect to the management of the cash flow that is derived from an asset-backed issuer's eligible assets.

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82 *See, e.g., November Oversight Report -- Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation*, Congressional Oversight Panel 19 (Nov. 16, 2010) ("Various commentators have begun to ask whether the poor recordkeeping and error-filled work exhibited in foreclosure proceedings, described above, is likely to have marked earlier stages of the process as well. If so, the effect could be that rights were not properly transferred during the securitization process such that title to the mortgage and the note might rest with another party in the process other than the trust.")

83 Rule 3a-7(a)(4)(ii).

- How long do servicers typically hold the cash flow prior to transferring the cash flow to the trustee? What are the benefits, if any, to servicers from holding the cash flow? What are the benefits and risks to asset-backed issuers from servicers holding the cash flow?

- We note that the rule does not specify that the servicer must keep the cash flow in a segregated account prior to transferring the cash flow to the trustee. Should such a condition be included in the rule and what would be its economic impact if included? Is the answer dependent on the time period that the servicer has, under the asset-backed issuer's organizational documents or otherwise, in which to transfer the cash flow to the trustee?

- Should the rule be amended to prescribe a time period in which the servicer must transfer the cash flow to the trustee and what would be the economic impact of such a provision? If so, what should that time period be? Commenters suggesting specific time periods should address the costs and benefits associated with their suggestions.

- Regulation AB requires that servicers provide an annual assessment of compliance with servicing criteria enumerated in Item 1121(d) of Regulation AB, so that investors may identify those aspects of standard servicing criteria that are in material compliance in order to better evaluate servicing responsibilities and performance and reliability of the information they receive.[84] In particular, servicers must assess compliance with the servicing criterion that payments on pool assets are deposited into the appropriate custodial bank accounts and related bank clearing accounts within no more than two business days of receipt, or such other number of days as specified in the transaction agreements.[85] Consistent with this provision, should the time period set forth in Rule 3a-7 be no more than two business days of

84 17 CFR 229.1122(d).

85 *See* Item 1122(d)(2)(i) of Regulation AB [17 CFR 229.1122(d)(2)(i)].

receipt? Why or why not? What would be the effect if the time period were greater than or less than two business days?

We are also interested in obtaining information about how the cash flow is invested under Rule 3a-7 and who receives the returns from such an investment.

- Should the rule contain a condition that restricts the manner in which the cash flow may be invested? If so, what should this condition provide?

- Should the rule limit who may receive the benefit of the returns of such investment? Why or why not? What economic benefits and costs would be associated with such a limitation?

As discussed previously, we understand that asset-backed securities often could not achieve an investment grade rating unless the issuer was structured in such a manner that the assets and cash flow are insulated in the event of the bankruptcy or insolvency of the sponsor or depositor.[86]

- Does our understanding hold true?

- Should the rule include a condition specifying that the eligible assets and the cash flow generated from such assets be available to pay the fixed-income securities consistent with their terms, notwithstanding the bankruptcy or insolvency of the sponsor or depositor?

- Should any such condition also extend to the bankruptcy of the servicer? Does the answer depend on whether the servicer needs to hold the eligible assets for servicing purposes and is not required to transfer the cash flow to the independent trustee immediately upon receipt? What would be the potential economic impact of so extending the condition?

[86] *See supra* note 80.

The Commission also requests comment on any other concerns relating to the safekeeping of the issuer's assets and cash flow that we have not contemplated under Rule 3a-7.

- If there are such concerns, what are they and how should the rule address them?
- Does the asset-backed market generally impose safeguards that are intended to ensure the safety of the issuer's eligible assets and cash flow? Should the rule reflect these safeguards? If so, what are the safeguards, how should they be reflected, and what would be the economic impact of reflecting them in the rule?

d. Other Possible Investor Protections

The exclusion from the definition of investment company provided by Rule 3a-7 is one of many regulations under the federal securities laws addressing asset-backed issuers. Asset-backed issuers also are subject to various regulations under the Securities Act and the Exchange Act. We recognize that there may be existing or proposed provisions under these other federal securities laws applicable to asset-backed issuers which, although intended for different purposes, also may help mitigate potential Investment Company Act-related concerns. Such provisions could be considered for inclusion in Rule 3a-7 in lieu of the rating condition.[87]

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87 We note that not all asset-backed issuers that rely on Rule 3a-7 are subject to the same provisions under the federal securities laws. For example, asset-backed issuers that rely on Rule 3a-7 may include those issuers that offer and sell their securities under an exemption from registration under the Securities Act or that are not subject to the Exchange Act reporting requirements. Therefore, if we determine that certain existing or proposed provisions under the federal securities laws help mitigate potential Investment Company Act-related concerns, such provisions may need to be included as conditions in Rule 3a-7 to ensure that all asset-backed issuers relying on the rule are subject to the same conditions, regardless of their status under the other federal securities laws.

i. Other Commission Rules

For example, Rule 193 under the Securities Act generally requires an asset-backed issuer to perform a review of the assets underlying any asset-backed securities that will be registered under the Securities Act that, at a minimum, provides reasonable assurance that the disclosure in the issuer's prospectus regarding the assets is accurate in all material respects.[88] Section 945 of the Dodd-Frank Act directed the Commission to enact Rule 193 so that due diligence was "re-introduced" into the offering process.[89] This provision, if included in Rule 3a-7, might help mitigate some of the concerns underlying the Investment Company Act, such as the "dumping" of assets and the potential opportunities for overreaching and self-dealing.

Similarly, as part of the 2011 ABS Re-proposal, we proposed to include, as part of the shelf eligibility requirements for asset-backed issuers, a requirement that the issuer's underlying transaction agreements provide for a "credit risk manager" to review the underlying assets in specified circumstances.[90] That proposal addresses concerns about enforceability of representations and warranties regarding the assets, but such a requirement also might serve to mitigate potential Investment Company Act abuses relating to misvaluation of assets and inadequate asset coverage for asset-backed securities and therefore could be considered for inclusion in Rule 3a-7.

As another example, we note that the Dodd-Frank Act added Section 27B to the Securities Act generally to prohibit an underwriter, placement agent, initial purchaser, sponsor, or any affiliate or subsidiary of any such entity, of an asset-backed security, as defined in the Exchange Act, from engaging in any transaction that would involve or result in any material

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[88] 17 CFR 230.193.

[89] *See* Section 943 Release, *supra* note 9.

[90] *See* 2011 ABS Re-proposal, *supra* note 13 at section II.B.1.b.

conflict of interest with respect to any investor in a transaction arising out of such activity for a period of one year after the date of the first closing of the sale of the asset-backed security.[91] This provision "prohibits firms from packaging and selling asset-backed securities to their clients and then engaging in transactions that create conflicts of interest between them and their clients."[92] To the extent that this provision also may help guard against certain of the Investment Company Act-related concerns, such as the potential for self-dealing and overreaching by insiders, it could be considered for incorporation into Rule 3a-7.

Yet another example of requirements under the federal securities laws concerning certain asset-backed issuers that may be considered for inclusion in Rule 3a-7 are the risk retention requirements for sponsors of asset-backed issuers, such as the requirements recently proposed by the Commission in a joint rulemaking with other federal regulators.[93] These requirements may be appropriate as conditions for issuers that wish to rely on Rule 3a-7, if they serve to mitigate the Investment Company Act-related concerns about self-dealing by insiders, misvaluation of assets, and the safekeeping of assets and cash flow.

We ask for comment on whether these or any other existing or proposed provisions under other federal securities laws applicable to asset-backed issuers also may help mitigate potential Investment Company Act-related concerns and could serve, in whole or in part, as substitutes for the references to ratings in Rule 3a-7. Commenters should be specific in identifying the relevant

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91 Section 621 of Dodd-Frank Act. The Dodd-Frank Act also directed the Commission to issue rules for the purpose of implementing this provision, and the prohibition described above takes effect only upon the effective date of such rules. *Id.*

92 Letter from Senators Jeffrey Merkley and Carl Levin to Commission Chairman Mary Schapiro, et al. (Aug. 3, 2010) ("Merkley-Levin Letter") at p. 1, available at http://www.sec.gov/comments/df-title-vi/conflicts-of-interest/conflictsofinterest-2.pdf .

93 *Credit Risk Retention,* Securities Exchange Act Release No. 64148 (Mar. 30, 2011) [76 FR 24090 (Apr. 29, 2011)].

provision and the Investment Company Act-related concern, and explaining how the provision may help mitigate the Investment Company Act-related concern.

ii. Eligibility to Use Rule 3a-7

Currently, any issuer generally may rely on Rule 3a-7 provided that it is in the business of purchasing or otherwise acquiring and holding "eligible assets," issues securities which entitle their holders to receive payments that depend primarily on the cash flow from the eligible assets, and meets the other conditions of the rule. When the Commission adopted Rule 3a-7, the Commission stated that the definition of "eligible assets" in Rule 3a-7 -- in part, "financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period" -- was based on the definition of "asset-backed security" under the Securities Act.[94] We understand that asset-backed commercial paper programs that issue securities in reliance on an exemption from registration under the Securities Act, and other asset-backed issuers that offer and sell their securities in reliance on an exemption from registration under the Securities Act, often rely on Rule 3a-7 to be excluded from regulation under the Investment Company Act. Conversely, an asset-backed issuer that cannot meet the conditions of Rule 3a-7 (and is unable to qualify for any other exclusion from regulation under the Investment Company Act, such as Section 3(c)(5), or

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94 *See* Adopting Release, *supra* note 4 at n.12 and accompanying text. Regulation AB generally defines "asset-backed security" as "a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders; provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases." *See* Item 1101(c)(1) of Regulation AB. Regulation AB considers certain types of master-trusts and issuers with prefunding periods and revolving accounts to be discrete pools of assets. *See* Item 1101(c)(3) of Regulation AB. In the 2010 April ABS Proposal, the Commission proposed to restrict the use of Regulation AB by master trust issuers backed by non-revolving assets, limit the number of years for revolving periods of non-revolving accounts from three years to one year, and decrease the limit on the amount of prefunding permitted by the prefunding exception from 50% to 10%. *See* 2010 ABS Proposing Release, *supra* note 10 at section IV. The definition of "asset-backed security" in Regulation AB also contains limits on the amounts of delinquent and non-performing assets in the asset pool. *See* Item 1101(c)(2). The shelf eligibility requirements on Form S-3 further limits the amount of delinquent assets and certain leases that may be held in the asset pool. *See* Form S-3.

register under the Act) generally may not register the issuance of its securities even if the issuer and its securities meet the other offering requirements under the Securities Act.

- We request comment on whether the requirements of Regulation AB or the shelf eligibility requirements may serve, in whole or in part, to address the Investment Company Act concerns underlying Rule 3a-7 and therefore be a basis for meeting some or all of the rule's conditions, including the rating condition and any conditions that may replace it. Should the conditions of Rule 3a-7 distinguish between issuers that meet the shelf eligibility requirements and those that do not? If so, why and how should the conditions differ? We ask commenters to be specific in their responses and to provide data and statistics, if possible.

- Would certain asset-backed issuers that currently are able to publicly offer their securities no longer be able to do so if Rule 3a-7 were limited to issuers that meet the shelf eligibility requirements? If so, please explain. With respect to such issuers, commenters also should address any alternative exclusion(s) from regulation under the Investment Company Act that may be available, and the advantages and disadvantages of the issuers' using these exclusions if Rule 3a-7 were not available to them. We ask commenters to provide data in support of their responses, if possible.

- Is our understanding correct that some asset-backed issuers that privately offer their securities rely on Rule 3a-7? If so, would certain of these issuers no longer be able to rely on Rule 3a-7 if the rule was limited in this manner? If not, why not? We also ask commenters to provide similar information and data about asset-backed issuers that rely on the private investment company exclusions from regulation under the Investment Company Act, and any alternative exclusion(s) from regulation under the Investment Company Act that may be available, and the advantages and disadvantages of the issuers' using these exclusions if

Rule 3a-7 were not available to them. The Commission also requests that commenters provide any available data about the sizes and types of asset-backed issuers that privately offer their securities that rely on Rule 3a-7.

- What would be the effect on the asset-backed securities market in general, on capital formation, and on investors if the availability of Rule 3a-7 were limited to issuers of asset-backed securities as defined in Regulation AB or included the further limitations found in the shelf eligibility requirements?

- Are there alternative approaches that the Commission should consider to an issuer's eligibility to use Rule 3a-7 that would address Investment Company Act-related concerns? Commenters that offer alternative approaches should be as specific as possible in explaining their approach and the effect such an approach would have on asset-backed issuers, on the asset-backed securities market in general, on capital formation, and on investors.

3. Standard for Acquisition and Disposition of Eligible Assets

With respect to the type and amount of activity related to the acquisition and disposition of an issuer's eligible assets that may take place under Rule 3a-7, the Commission has stated that Rule 3a-7 was intended to permit only those activities "that do not in any sense parallel typical 'management' of registered investment company portfolios."[95] Thus, according to the Adopting Release, permitted activities under the rule include selling or substituting eligible assets when documentation is defective or for nonconformity with representations or warranties, disposing of assets in default or in imminent default, and removing excess credit support.[96] We request comment on the management activities of asset-backed issuers under Rule 3a-7.

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95 *See supra* note 44 and accompanying text.

96 *See* Adopting Release, *supra* note 4 at n.68 and accompanying text.

- What changes, if any, should be made to the rule's conditions addressing the acquisition and disposition of eligible assets? What would be the economic impact of any such changes?

- Does the current rule adequately preclude activities "that do not in any sense parallel typical 'management' of registered investment company portfolios"? If not, should additional conditions be added to the rule that would limit the acquisition and disposition of the issuer's eligible assets, and if so, what types of conditions? What would be the economic impact of such conditions?

B. The Effect of the Exclusion Provided by Rule 3a-7

Current Rule 3a-7 excludes from the definition of investment company any issuer that meets the rule's conditions. The rule does not address how a holder of securities of a Rule 3a-7 issuer should treat those securities for purposes of determining the holder's own status under the Investment Company Act. In light of certain developments in the asset-backed securities markets in recent years, detailed below, we request comment whether we should consider limiting or clarifying the manner in which the exclusion provided by Rule 3a-7 may be used by certain holders of securities issued by Rule 3a-7 issuers.

1. Holders of an Asset-Backed Issuer's Securities

As a general matter, the status of an issuer under the Investment Company Act matters not only to the issuer itself, but also to the holders of the issuer's securities. A holder's own status under the Investment Company Act may depend on the investment company status of the issuers of securities that it owns.[97] When the Commission adopted Rule 3a-7, the Commission

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97 For example, the holder may be an investment company under Section 3(a)(1)(C) of the Investment Company if it owns or proposes to acquire investment securities, which generally include, among others, securities issued by an investment company, having a value exceeding 40% of the value of the holder's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. *See supra* note 30.

focused on providing an exclusion from regulation under the Act for the asset-backed issuer, and not on the manner in which such an exclusion may affect a holder of the asset-backed issuer's securities.

We are interested in better understanding the manner in which the exclusion provided by Rule 3a-7 affects the status under the Investment Company Act of various types of holders of securities issued by Rule 3a-7 issuers. For example, in the last decade, many asset-backed issuers that relied on Rule 3a-7 were established by companies that sought to capture, by holding the equity or residual interest in these issuers, the spread between the yield of the assets being securitized and the financing cost of the fixed-income securities being issued.[98] The potential for returns on such investments led to companies being established whose business focused on purchasing equity and residual interests in collateralized loan obligations ("CLOs") and CDOs of issuers that relied on Rule 3a-7.[99] The activities of some of these companies suggest that they are in the business of investing in securities.[100] However, because current Rule 3a-7 excludes issuers relying on the rule from the definition of investment company, such companies that

98 More generally, in 2007, for example, only approximately 11.5% of CDOs issued globally were issued to remove assets from the balance sheet of the originator. The rest of the CDO market consisted of arbitrage CDOs, which are CDOs that attempt to capture the difference between the yield of its assets and the financing costs of the CDO tranches. *See, e.g.*, Securities Industry and Financial Markets Association: Research at http://archives1.sifma.org/story.asp?id=2375 ("SIFMA").

99 *See, e.g.*, Jody Shenn, *Bear Stearns Funds Own 67 Percent Stake in Everquest (Update3)*, BLOOMBERG, May 11, 2007, http://www.bloomberg.com/apps/news?pid=newsarchive&sid= (describing various investment vehicles formed to invest in residual interests of CDOs).

100 In contrast, when Rule 3a-7 was adopted, most private sector sponsors of asset-backed issuers typically securitized financial assets that they themselves had originated to facilitate the financing and operation of their non-investment company businesses. For example, some sponsors securitized their financial assets in order to manage more effectively their loan portfolios and, in turn, their balance sheets. In addition, securitization allowed sponsors to gain access to alternative, usually cheaper, funding sources. Commercial banks and savings and loan associations also securitized financial assets to facilitate compliance with regulatory capital requirements. As the Commission noted when adopting Rule 3a-7, the purpose and operation of asset-backed issuers therefore were fundamentally different from investment companies. *See* Proposing Release, *supra* note 15 at n.18 and accompanying text; Protecting Investors Report, *supra* note 4 at nn.49-62 and accompanying text.

invest in Rule 3a-7 issuers may not meet the definition of investment company in the Investment Company Act.

Specifically, under the Investment Company Act, any company that holds 50% or more of the outstanding voting securities of an issuer may treat such issuer as its majority-owned subsidiary.[101] Securities of majority-owned subsidiaries that are not investment companies, in turn, are not "investment securities"[102] for purposes of determining whether the parent meets the definition of investment company in Section 3(a)(1)(C) of the Act. Since a Rule 3a-7 issuer is not an investment company by virtue of the exclusion provided by the rule,[103] any company that holds 50% or more of the outstanding voting securities of a Rule 3a-7 issuer may treat the Rule 3a-7 issuer as its majority-owned subsidiary and is not required to treat any of the securities issued by the Rule 3a-7 issuer as "investment securities" for purposes of determining the company's own status under Section 3(a)(1)(C) of the Investment Company Act. Such a company therefore may have virtually all of its assets invested in securities of Rule 3a-7 majority-owned subsidiaries and not meet the definition of investment company under Section 3(a)(1)(C).[104]

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101 Section 2(a)(24) of the Investment Company Act states that a "majority-owned subsidiary" of a person "means a company 50 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph, is a majority-owned subsidiary of such person." Section 2(a)(42) of the Act defines "voting security," in relevant part, to mean "any security presently entitling the owner or holder thereof to vote for the election of directors of a company."

102 *See supra* note 18.

103 *See* Rule 3a-7(a) ("Notwithstanding section 3(a) of the Act, any issuer who is engaged in the business of purchasing, or otherwise acquiring, and holding eligible assets (and in activities related or incidental thereto), and who does not issue redeemable securities will not be deemed to be an investment company . . .").

104 We note that, depending on the facts and circumstances, some of these companies may meet the definition of investment company in Section 3(a)(1)(A). *See supra* note 18. Companies that meet the definition of investment company in Section 3(a)(1)(A) are subject to the requirements of the Investment Company Act unless they meet an exclusion or an exemption, even if they do not meet the other definitions of investment company in Section 3(a)(1).

We also note that the idea of a company being in the business of investing in securities, even though the securities the company holds are those of its non-investment company majority-owned subsidiaries, is not novel. We have concluded, for example, that a company may be a "special situation investment company" that should be regulated under the Investment Company Act, even though the company holds securities of its majority-owned

If the exclusion provided by Rule 3a-7 specified that an issuer relying on Rule 3a-7 would be deemed an investment company for the limited purpose of the definition of "investment securities" in Section 3(a)(2)(C)(i) of the Investment Company Act, any company that holds 50% or more of the outstanding voting securities of a Rule 3a-7 issuer would be required to treat such securities, as well as any other securities of that Rule 3a-7 issuer, as "investment securities" for purposes of determining its own status under Section 3(a)(1)(C) of the Investment Company Act.[105] With respect to certain types of holders of securities issued by Rule 3a-7 issuers, such as companies discussed above whose business focused on establishing Rule 3a-7 subsidiaries to capture the spread between the yield of the assets being securitized and the financing cost of the fixed-income securities being issued, and which may be engaged in the business of investing in securities, such an approach may serve to more accurately reflect their status under Section 3(a)(1)(C) of the Investment Company Act and afford their investors the appropriate protections.

The Commission requests comment on the extent to which various types of holders of securities of Rule 3a-7 issuers use the exclusion to determine their own status under the Investment Company Act.

- What would be the potential economic impact if the exclusion from the definition of investment company provided by Rule 3a-7 were modified so that it did not extend to the definition of "investment securities" in Section 3(c)(1)(C)(i)?

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subsidiaries that are not investment securities. *See Certain Prima Facie Investment Companies*, Investment Company Act Release No. 10937 (Nov. 13, 1979) [44 FR 66608 (Nov. 20, 1979)] at nn.18-20 and accompanying text. A special situation investment company generally is a company that secures control of other companies primarily for the purpose of making a profit in the sale of the controlled companies' securities. *Id.*

105 *See supra* note 18. Under this approach, securities of a majority-owned subsidiary relying on Rule 3a-7 would be treated in the same manner as securities of a majority-owned subsidiary that is an investment company or that relies on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. *See supra* notes 18, 30.

- Would such a modification adversely affect those sponsors that form Rule 3a-7 issuers to facilitate the operation of their non-investment company business? Are such sponsors typically invested in their Rule 3a-7 majority-owned subsidiaries to such an extent that this approach would cause a sponsor to have more than 40% of its assets in investment securities and therefore fall within the definition of investment company in Section 3(a)(1)(C)?[106]

- Rule 3a-7 alternatively could be recast such that a Rule 3a-7 issuer would be an investment company but would be exempted from the Act's requirements, provided that the issuer meets the rule's conditions. Under this approach, because the asset-backed issuer would not be excluded from the definition of investment company, but exempted from the Investment Company Act, a holder of the issuer's securities would be required to treat such securities as "investment securities" for purposes of determining the holder's own status under the Act, as under the approach discussed above. Is this approach preferable? If so, why?

- Are there reasons not to modify the exclusion provided by Rule 3a-7 to address this issue? Please explain and, if possible, provide data in support of your responses.

2. Eligible Portfolio Company

The Commission also has become aware of an interest among business development companies ("BDCs") to sponsor and invest in securities of issuers relying on Rule 3a-7.

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[106] Sponsors that are banks, bank holding companies, broker-dealers, savings and loans and insurance companies are excluded from the definition of the Investment Company Act by Section 3(c) of the Investment Company Act and would be unaffected by a provision narrowing the effect of the exclusion provided by Rule 3a-7. In addition, other sponsors could conclude, based on an appropriate analysis of their primary business, that they are not investment companies pursuant to Section 3(b)(1) of the Investment Company Act or seek a Commission order under Section 3(b)(2) of that Act. Section 3(b)(1) of the Investment Company Act generally excludes an issuer from the definition of investment company in Section 3(a)(1)(C) of the Act if it is primarily engaged, directly or through wholly-owned subsidiaries, in a business other than investing, reinvesting, owning, holding or trading securities. Section 3(b)(2) of the Investment Company Act generally excludes from the definition of investment company in Section 3(a)(1)(C) of the Act any issuer which the Commission, upon application by the issuer, finds and by order declares to be primarily engaged in a business other than that of investing, reinvesting, owning, holding, or trading in securities either directly or through majority-owned subsidiaries or through controlled companies conducting similar type of businesses.

Congress established BDCs in 1980 as a type of closed-end investment company the primary purpose of which was to make capital more readily available to small, developing and financially troubled businesses.[107] To accomplish this purpose, Congress added a special set of provisions to the Investment Company Act that govern closed-end investment companies that elect BDC status.[108] In amending the Investment Company Act, Congress underscored that the new provisions would apply only to BDCs that are operated for the purpose of investing in the securities of certain issuers and that make available significant managerial assistance to those issuers.[109] Accordingly, the Investment Company Act generally prohibits a BDC from making any investment unless, at the time of the investment, at least 70% of the BDC's total assets (other than certain specified non-investment assets) are invested in securities of certain specified issuers ("70% basket").[110] The 70% basket includes, among other things, certain securities of "eligible portfolio companies," as defined by the Act.[111] Among other criteria, issuers qualifying as eligible portfolio companies must be organized under the laws of, and have their principal place of business in, the United States,[112] and must not meet the definition of investment company in

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107 Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275 (1980) (codified at scattered sections of the United States Code)("SBIIA").

108 *See* Sections 54-65 of the Investment Company Act.

109 *See* H.R. Rep. No. 1341, 96th Cong., 2d Sess. 22 (1980) ("BDC House Report").

110 Section 55(a) of the Investment Company Act. *See* BDC House Report, *supra* note 109 at 23 ("The restrictions are designed to assure that companies electing special treatment as [BDCs] are in fact those that [the SBIIA] is intended to aid – companies providing capital and assistance to small, developing or financially troubled businesses that are seeking to expand, not passive investors in large, well-established businesses."). BDCs may invest in certain other assets that would not count toward the 70% basket, provided that such investments are consistent with the overall purpose behind the BDC provisions of the Investment Company Act. *Id.* at 39-40.

111 Section 2(a)(46) of the Investment Company Act.

112 Section 2(a)(46)(A) of the Investment Company Act.

Section 3 of the Investment Company Act or be excluded from the definition of investment company under Section 3(c) of that Act.[113]

By virtue of the exclusion from the definition of investment company provided by Rule 3a-7, a BDC might seek to treat a Rule 3a-7 issuer as an eligible portfolio company, provided that certain other criteria are met.[114] As a general matter, the Commission presently does not believe that Rule 3a-7 issuers are the type of small, developing and financially troubled businesses in which Congress intended BDCs primarily to invest. Accordingly, the Commission requests comment on whether Rule 3a-7 should be amended to provide expressly that an issuer relying on Rule 3a-7 is an investment company for purposes of the definition of eligible portfolio company under the Investment Company Act.

- What would be the effect on BDCs if Rule 3a-7 were amended to expressly provide that an issuer relying on Rule 3a-7 is not an eligible portfolio company?
- What would be the effect on Rule 3a-7 issuers if Rule 3a-7 were amended to expressly provide that an issuer relying on Rule 3a-7 is not an eligible portfolio company?
- We understand that BDCs that invest in Rule 3a-7 issuers typically do not treat such issuers as eligible portfolio companies. Is our understanding correct? If not, please explain.

C. Asset-Backed Issuers Relying on Section 3(c)(5)

As noted above, certain asset-backed issuers rely on the exclusion from the definition of investment company in Section 3(c)(5) of the Investment Company Act rather than on Rule 3a-

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113 Section 2(a)(46)(B) of the Investment Company Act. Section 2(a)(46)(B) also includes as an eligible portfolio company a small BDC which is licensed by the Small Business Administration and which is a wholly-owned subsidiary of a BDC. In addition to meeting the requirements set forth in Sections 2(a)(46)(A) and 2(a)(46)(B), a company qualifying for eligible portfolio company status must also meet one of the criteria set forth in Section 2(a)(46)(C) or in Rule 2a-46 under the Investment Company Act.

114 *See* Section 55(a) of the Investment Company Act.

7.[115] Section 3(c)(5) was intended to exclude from the definition of investment company certain factoring, discounting and mortgage companies,[116] and did not specifically contemplate asset-backed issuers, which generally did not exist at the time Congress adopted the Investment Company Act in 1940.[117] Nevertheless, certain asset-backed issuers, including those that securitize retail automobile installment contracts, credit card receivables, trade receivables, boat loans or equipment leases, have sought to rely on the provisions of Section 3(c)(5).[118] In addition, many issuers of mortgage-backed securities have sought to rely on Section 3(c)(5). These asset-backed issuers include issuers of securities backed by whole residential mortgage loans and home equity loans (two of the most commonly securitized assets),[119] whole commercial mortgages, participated mortgage interests, and "whole pool certificates"[120] issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.

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115 *See supra* note 30 discussing the 3(c)(5)(C) Concept Release. Section 3(c)(5) excludes from the definition of investment company "[a]ny person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: (A) purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services; (B) making loans to manufacturers, wholesalers and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services; and (C) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate."

116 S. Rep. No. 1775, 76th Cong. 3d. 13 (1940); H.R. Rep. No. 2639, 76th Cong., 3d Sess. 12(1940); S. Rep. No. 184, 91st Cong., 1st Sess. 37 (1969); H.R. Rep. No. 1382, 91st Cong., 2d Sess. 17 (1970). *See* Proposing Release, *supra* note 15 at text following n.5 ("section 3(c)(5)] . . . originally was intended to exclude issuers engaged in the commercial finance and mortgage banking industries."). *See also* Section 3(c)(5)(C) Concept Release, *supra* note 30.

117 *See* Kravitt, *supra* note 15 at 12.03[G][4] ("The exceptions stated in Section 3(c)(5) predate by many years the securitization industry. The 'original intent' of the drafters of Section 3(c)(5) could not possibly have anticipated financial products such as collateralized mortgage obligations and receivables-backed securities. As with many of the Section 3 exceptions, issuers that do not, or arguably do not, fall within the original intent of the provisions have attempted to rely on the . . . exception.")

118 *See* Kravitt, *supra* note 15 at 12.03[G]; Protecting Investors Report, *supra* note 4 at n.261 and accompanying text. Note, however, that an asset-backed issuer that securitizes these types of assets may be unable to rely on these exclusions if the issuer's structure allows for the holding of cash or similar instruments in such amounts that the issuer may not be "primarily engaged" in holding the asset being securitized. *See* Kravitt, *supra* note 15 at 12.03[G].

119 *See* Kravitt, *supra* note 15 at 12.03[G].

120 A whole pool certificate is a security that represents the entire ownership interest in a particular pool of mortgage loans. *See* Protecting Investors Report, *supra* note 4 at n.267.

Unlike the exclusion provided by Rule 3a-7, the exclusion provided by Section 3(c)(5) is not subject to any conditions specifically addressing the Investment Company Act-related concerns presented by asset-backed issuers.[121] Whether an asset-backed issuer has the option of relying on Section 3(c)(5) as an alternative to Rule 3a-7 generally depends on whether the issuer is primarily engaged in purchasing or otherwise acquiring a particular type of financial assets.[122] Rule 3a-7, in contrast, was generally designed to encompass any asset-backed issuer that meets the rule's conditions, regardless of the type of financial assets that it holds.

When first considering Rule 3a-7 in 1992, the Commission noted that, absent a statutory amendment precluding asset-backed issuers from relying on Section 3(c)(5), asset-backed issuers that rely on that section and those that rely on Rule 3a-7 would be subject to somewhat disparate treatment based solely on the type of the financial assets that they held. Accordingly, when the Commission proposed Rule 3a-7 in 1992, it also requested comment on, among other things, whether it should seek statutory amendments to Section 3(c)(5) that would preclude asset-backed issuers from continuing to rely on the Section.[123] Most commenters then argued that it would be inappropriate to narrow the scope of Section 3(c)(5), at least until both the market and the Commission gained experience with Rule 3a-7.[124] In response to commenters' concerns, the Commission decided not to pursue any regulatory changes with respect to Section 3(c)(5) at that time.[125]

Now that the market and the Commission have gained almost twenty years of experience with Rule 3a-7, we believe that it is appropriate to revisit this issue as part of our review of the

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121 *See supra* section III.A. *See also supra* note 115.

122 *See supra* note 115.

123 Proposing Release, *supra* note 15 at section II.B.

124 Adopting Release, *supra* note 4 at n.88 and accompanying text.

125 *Id.* at text following n.89.

rule. We also believe that revisiting the ability of asset-backed issuers to rely on the exclusion provided by Section 3(c)(5) is appropriate in the aftermath of the recent financial crisis and the role that issuers of mortgage-backed securities have played in that crisis.[126] Accordingly, the Commission once again is seeking comment on whether Section 3(c)(5) should be amended to limit the ability of asset-backed issuers to rely on Section 3(c)(5).[127] The Commission also requests comment on whether it should engage in any rulemaking, consistent with Section 3(c)(5), that would define terms used in that section so as to limit its availability to those companies that are intended to be encompassed by the statutory exclusion. We also seek comment on whether are there any structural or operational reasons that make it necessary for certain asset-backed issuers to rely on Section 3(c)(5) rather than Rule 3a-7.

- If there are such structural or operational reasons, what are they?
- What types of asset-backed issuers rely on Section 3(c)(5)?
- What would be the effect on asset-backed issuers, the securitization market and on capital formation if asset-backed issuers could no longer rely on Section 3(c)(5)?
- Are there revisions to Rule 3a-7 that could be made to better facilitate asset-backed issuers' reliance on the rule rather than on Section 3(c)(5) and what would be the economic impact of such revisions?

Commenters also are requested to provide any other observations, suggestions and data on the interplay between Rule 3a-7 and Section 3(c)(5) today and as the asset-backed securities markets may develop in the future.

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126 *See generally* 2010 ABS Proposing Release, *supra* note 10.

127 *See also* Section 3(c)(5)(C) Concept Release, *supra* note 30; 2011 ABS Re-proposal, *supra* note 13 at n.110 and accompanying text (requesting comment on whether compliance with Rule 3a-7 should be one of the shelf eligibility requirements).

IV. General Request for Comment

In addition to the issues raised in this release, the Commission requests and encourages all interested persons to submit their views on any issues relating to the treatment of asset-backed issuers under the Investment Company Act. This release is not intended in any way to limit the scope of comments, views, issues or approaches to be considered. The Commission particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or issues raised in this release.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 31, 2011

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 270

Release No. IC-29778; File No. S7-34-11

RIN 3235-AL21

Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comments.

SUMMARY: The Securities and Exchange Commission ("Commission") and its staff ("Commission staff" or "staff") are reviewing interpretive issues under the Investment Company Act of 1940 ("Investment Company Act" or "Act") relating to the status under the Act of companies that are engaged in the business of acquiring mortgages and mortgage-related instruments and that rely on the exclusion from the definition of investment company in Section 3(c)(5)(C) of the Act (together, "mortgage-related pools"). This review is focusing, among others, on certain real estate investment trusts ("REITs"). To help facilitate this review, the Commission requests information about these companies and how Section 3(c)(5)(C) of the Act is interpreted by, and affects investors in, these companies. The Commission solicits commenters' views about the application of the Investment Company Act to mortgage-related pools, including suggestions on the steps that the Commission should take to provide greater clarity, consistency or regulatory certainty with respect to Section 3(c)(5)(C).

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

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

Electronic Comments:

Use the Commission's Internet comment form http://www.sec.gov/rules/concept.shtml); or send an e-mail to rule-comments@sec.gov. Please include File No. S7-34-11 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 Street, NE Washington, D.C. 20549-1090.

All submissions should refer to File No. S7-34-11. This file number should be included on the subject line if e-mail is used. To help process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/concept.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without charge; 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: Rochelle Kauffman Plesset, Senior Counsel, at (202) 551-6840, or Nadya Roytblat, Assistant Chief Counsel, at (202) 551-6825, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

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I. INTRODUCTION AND EXECUTIVE SUMMARY

The Commission and staff are reviewing interpretive issues relating to the status of mortgage-related pools under the Investment Company Act.[1] Companies that are engaged in the business of acquiring mortgages and mortgage-related instruments, and that issue securities, generally hold assets that are securities under the Investment Company Act and typically meet the definition of investment company under the Act.[2] While some such companies register as

1 Certain companies that are engaged in the business of acquiring mortgages and mortgage-related instruments are issuers of mortgage-backed securities that may rely on Section 3(c)(5)(C). Such issuers are not included in the term "mortgage-related pools" as it is used in this release. *See infra* note 5 and accompanying text.

2 Section 3(a)(1)(A) of the Investment Company Act defines an investment company as any issuer which "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities." 15 U.S.C. 80a-3(a)(1)(A). Section 3(a)(1)(C) defines an investment company as any issuer which "is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities [as that term is defined in the Act] having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on a unconsolidated basis." 15 U.S.C. 80a-3(a)(1)(C). A company that issues securities and is primarily engaged in investing in, owning, or holding mortgages and mortgage-related instruments typically meets one, if not both, of these definitions. *See, e.g.*, SEC, Report on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong. 2d Sess. 328 (1966) ("PPI Report") (stating that mortgages and other interests in real estate are investment securities for purposes of the Act).

Section 2(a)(36) of the Investment Company Act broadly defines "security" as "any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, investment companies under the Act,[3] many seek to rely on Section 3(c)(5)(C) of the Act, which generally excludes from the definition of investment company any person who is primarily engaged in, among other things, "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate."[4] The exclusion provided by Section 3(c)(5)(C) sometimes also is used by issuers of mortgage-backed securities, whose reliance on this statutory provision is discussed in a companion release.[5]

Section 3(c)(5)(C) of the Act was enacted in 1940 to exclude from regulation under the Investment Company Act companies that were engaged in the mortgage banking business and that did not resemble, or were not considered to be, issuers that were in the investment company business.[6] Since that time, as the mortgage markets have evolved and expanded, a wide variety of companies, many of them unforeseen in 1940, have relied upon Section 3(c)(5)(C).[7] The

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in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

3 According to industry statistics derived from Lipper's LANA Database, as of June 30, 2011, there were 23 series of registered open-end investment companies with total assets of $70.6 billion that invested "at least 65% of their assets in Government National Mortgage Association securities." In addition, as of that date, there were 34 series of registered open-end investment companies with total assets of $26.6 billion, and 11 registered closed-end investment companies with total assets of $1.8 billion, that invested "at least 65% of their assets in mortgages/securities issued or guaranteed as to principal and interest by the U.S. government and certain federal agencies."

4 15 U.S.C. 80a-3(c)(5)(C). Section 3(c)(5) excludes from the definition of investment company "[a]ny person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: (A) Purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services; (B) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services; and (C) purchasing or otherwise acquiring mortgages and other liens on and interest in real estate."

5 *Treatment of Asset-Backed Issuers under the Investment Company Act*, Investment Company Act Release No. 29779 (Aug. 31, 2011) ("3a-7 Companion Release").

6 *See infra* note 38 and accompanying text.

7 Some companies that privately place their securities may instead rely on the private investment company exclusions set forth in Sections 3(c)(1) and 3(c)(7) of the Act. Section 3(c)(1) of the Investment Company Act excludes from the definition of investment company any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 investors and which is not making and does not presently propose to make a public offering of its securities. 15 U.S.C. 80a-3(c)(1). Section 3(c)(7) of the Investment Company Act excludes from the definition of investment company any issuer whose outstanding securities are

statutory exclusion from the definition of investment company provided by Section 3(c)(5)(C) does not have an extensive legislative history and has not been comprehensively addressed by the Commission. Section 3(c)(5)(C) has been addressed in staff no-action letters on a case-by-case basis.[8]

In light of the evolution of mortgage-related pools and the development of new and complex mortgage-related instruments, the Commission is reviewing interpretive issues relating to the status of mortgage-related pools under the Investment Company Act and whether mortgage-related pools potentially are making judgments about their status under the Act without sufficient Commission guidance. It appears that some types of mortgage-related pools might interpret the statutory exclusion provided by Section 3(c)(5)(C) in a broad manner, while others might interpret the exclusion too narrowly, suggesting that there may be confusion among some mortgage-related pools about when the exclusion applies. The Commission also is concerned that the staff no-action letters that have addressed the statutory exclusion in Section 3(c)(5)(C) may have contained, or led to, interpretations that are beyond the intended scope of the exclusion and inconsistent with investor protection. The Commission is concerned that certain types of mortgage-related pools today appear to resemble in many respects investment companies such as closed-end funds and may not be the kinds of companies that were intended to be excluded from

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owned exclusively by persons who, at the time of acquisition of such securities, are "qualified purchasers" as defined in the Act and which is not making and does not at that time propose to make a public offering of its securities. 15 U.S.C. 80a-3(c)(7).

8 This release includes extensive discussion of staff no-action letters; accordingly the Commission notes that its discussion of staff statements is provided solely for background and to facilitate comment on issues that the Commission might address. The discussion is in no way intended to suggest that the Commission has adopted the analysis, conclusions or any other portion of the staff statements discussed here. Staff no-action letters are issued by the Commission staff in response to written requests regarding the application of the federal securities laws to proposed transactions. Many of the staff no-action letters are "enforcement-only" letters, in which the staff states whether it will recommend enforcement action to the Commission if the proposed transaction proceeds in accordance with the facts, circumstances and representations set forth in the requester's letter. Other staff no-action letters provide the staff's interpretation of a specific statute, rule or regulation in the context of a specific situation. *See Informal Guidance Program for Small Entities,* Investment Company Act Release No. 22587 (Mar. 27, 1997).

regulation under the Act by Section 3(c)(5)(C). Therefore, the Commission believes that both investors and mortgage-related pools may benefit from the Commission's comprehensive review of the status of mortgage-related pools under the Investment Company Act and from any resulting guidance.

Accordingly, the Commission is requesting data and other information from the public about mortgage-related pools and soliciting views about the application of Section 3(c)(5)(C) of the Investment Company Act to mortgage-related pools, including steps that the Commission might take in this area. The Commission's goals in this effort are to: (1) be consistent with the Congressional intent underlying the exclusion from regulation under the Act provided by Section 3(c)(5)(C); (2) ensure that the exclusion is administered in a manner that is consistent with the purposes and policies underlying the Act, the public interest, and the protection of investors; (3) provide greater clarity, consistency and regulatory certainty in this area; and (4) facilitate capital formation.

II. COMPANIES THAT RELY ON SECTION 3(c)(5)(C)

A. Overview

By its terms, Section 3(c)(5)(C),[9] excludes from the definition of investment company "[a]ny person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged . . . [in the business of] purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." Many different types of companies that engage in a variety of businesses rely on this exclusion.[10] Such companies include: those that originate and hold

[9] Section 3(c)(5) was initially enacted in 1940 as Section 3(c)(6). Congress redesignated the provision as Section 3(c)(5) in 1970. Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 (1970) (codified as amended 15 U.S.C. 80a-3(c)(5)).

[10] *See infra* note 13.

mortgages and participations of mortgages that they originated; companies engaged in the business of acquiring from affiliates or third parties mortgages and mortgage-related instruments (such as mortgage participations, mezzanine loans and mortgage-backed securities); companies that invest in real estate, mortgages and mortgage-related instruments; and companies whose primary business is to invest in so-called agency securities[11] and other mortgage-backed securities.[12]

Companies that rely on the exclusion in Section 3(c)(5)(C) are structured and operated in various ways. Nevertheless, it appears that several general observations about mortgage-related pools can be made.[13]

Many, if not most, mortgage-related pools are corporations or business trusts that have elected to be treated as REITs for purposes of their tax status under the Internal Revenue Code.[14] Special tax provisions for REITs were created by Congress in 1960 as a means to make available to retail investors opportunities to invest in income-producing real estate and real estate-related

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[11] Agency securities are mortgage-backed securities issued by the government-sponsored enterprises, Government National Mortgage Association (Ginnie Mae), Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac).

[12] A summary review by the staff of filings under the Securities Exchange Act of 1934 ("Exchange Act") of issuers identifying themselves as REITs suggests that, as of April 2011, there were approximately 49 REITs that had disclosed that they were primarily engaged in the business of holding mortgages and/or mortgage-related instruments, with most indicating that they or their subsidiaries were relying on Section 3(c)(5)(C). Of these companies, 15 stated that they were primarily engaged in the business of acquiring agency securities and other types of mortgage-backed securities. The staff's review also identified 57 companies that had disclosed in their Exchange Act filings that they were investing in both (i) real estate, and (ii) mortgages and mortgage-related instruments, with 28 of such companies suggesting that they or their subsidiaries may be relying on Section 3(c)(5)(C). This review did not include those companies that have not elected to be treated as REITs under the Internal Revenue Code but may nevertheless be relying on the Section 3(c)(5)(C) exclusion.

[13] The Commission's information about mortgage-related pools discussed in this release is derived primarily from the staff's review of registration statements filed under the Securities Act of 1933 ("Securities Act") and periodic reports filed under the Exchange Act, to the extent that these filings discuss whether a company is relying on Section 3(c)(5)(C). Information available to the Commission is further limited by the fact that companies that rely on Section 3(c)(5)(C) also include companies that privately place their securities without registering under the Securities Act and companies that may not be subject to the periodic reporting requirements under the Exchange Act. The description of mortgage-related pools provided in this section of the release relates primarily to companies that make filings with the Commission under the Securities Act and the Exchange Act, and is based on these filings.

[14] The REIT provisions are set forth in Sections 856 through 859 of the Internal Revenue Code. 26 U.S.C. 856-859.

assets.[15] In a REIT structure, investor assets are pooled together to acquire, or provide financing for, various types of income-producing real estate interests that are selected and managed by professional asset managers. Like most registered investment companies, companies that qualify for REIT status typically seek pass-through tax treatment. To achieve this tax benefit, a company electing REIT status must comply with restrictions and limitations set forth in the Internal Revenue Code.[16]

Although mortgage-related pools may utilize a variety of investment strategies, most mortgage-related pools use leverage to magnify their returns.[17] For example, some mortgage-related pools that primarily hold agency securities and other mortgage-backed securities operate using a business model that depends on the use of leverage, with their profits, if any, generated by the spread between the cost of borrowing and the return on holdings purchased with the proceeds from such borrowing.[18] According to data provided by the National Association of

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15 *See, e.g.* Real Estate Investment Trusts, H.R. Rep. No. 2020, 86th Cong. 2nd Sess. 3-4 (1960). REITs may be classified into one of three categories. The National Association of Real Estate Investment Trusts ("NAREIT") generally defines equity REITS to be companies that own and operate income-producing real estate, and mortgage REITs to be companies that lend money directly to real estate owners and their operators, or indirectly through the acquisition of loans or mortgage-backed securities. *See* NAREIT, *The REIT Story: and Introduction to the Benefits of Investing in Real Estate Stocks*, REIT.com (Feb. 2011). Hybrid REITs generally are companies that use the investment strategies of both Equity REITs and Mortgage REITs. As noted above, mortgage REITs and some Hybrid REITs typically seek to rely on Section 3(c)(5)(C). *See supra* note 12. Equity REITs that hold fee interests directly typically do not invest in securities to such an extent as to fall within the definition of investment company under the Investment Company Act. *See supra* note 2.

16 These requirements generally provide that: (1) the company distribute at least 90% of its taxable income in dividends to its shareholders annually; (2) at least 75% of the company's total assets on the last day of each quarter of the company's taxable year consist of real estate assets (including interests in real property, interests in mortgages on real property and shares of other REITs), cash and cash items, and government securities; and (3) the company derive at least 75% of its gross income during the past year from, among other things, rents from real property, interest on obligations secured by mortgages on real property or on interests in real property, and 95% of its gross income from the same assets that qualify for the 75% test or from dividends or interest from any source. In addition to the asset and income tests and the 90% dividend distribution requirements, the Internal Revenue Code requires a company that elects REIT status to: be a corporation, trust, or association; be managed by one or more trustees or directors; have transferable shares; have a minimum of 100 shareholders; have no more than 50% of its shares held by five or fewer individuals; and not engage in certain prohibited transactions. *See supra* note 14.

17 *See, e.g.,* Peter C. Beller, *Bet Against the Fed, Buy Mortgage REITs,* Forbes.com, Jan. 25, 2010; *Anthracite Capital Files Chapter 7*, REITwrecks.com (Mar. 15, 2010).

18 *See, e.g.,* Vivian Marino, *Some REITS Have a Contrarian Flavor*, NY Times.com, Mar. 29, 2009.

Real Estate Investment Trusts ("NAREIT"), as of September 30, 2010, the debt ratio of publicly traded Mortgage REITs averaged 83.5%, a debt-to-equity ratio of nearly five to one.[19] In contrast, as of June 30, 2010, the debt-to-equity ratio of registered closed-end investment companies that use borrowings was generally less than one quarter to one.[20]

B. Management Style and Corporate Governance

Some mortgage-related pools are internally managed and have their own employees to carry out the administrative, investment and other activities necessary to operate the companies. Other mortgage-related pools have few, if any, employees and instead rely on separate advisory entities for the day-to-day operations of the companies. These advisory entities often are the mortgage-related pool's sponsor (typically, a real estate investment firm, an investment management firm, a private equity manager or other similar company that sponsors REITs, hedge funds and/or private equity funds) or an affiliate of the sponsor. An adviser of an externally managed mortgage-related pool is compensated by the company through a variety of different compensation schemes, which may include a performance or incentive fee. Regardless

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19 NAREIT REITWatch: A Monthly Statistical Report on the Real Estate Investment Trust Industry (Apr. 2011). NAREIT calculates the debt ratio by dividing the total debt outstanding in a REIT sector by that REIT sector's total market capitalization. Total capitalization equals the sum of total debt plus implied market capitalization.

20 *See* Thomas J. Herzfeld, Survey of Closed-End Fund Leverage, Investor's Guide to Closed-End Funds (Oct. 2010). We compared REITs to registered closed-end investment companies because, as discussed below, certain mortgage-related pools have characteristics similar to such registered companies. *See infra* section II.C.

We note that certain REITs follow the North American Securities Administrators Association's Statement of Policy Regarding Real Estate Investment Trusts ("NASAA Guidelines"), which generally state that the maximum level of borrowings (in relation to the company's net asset value) should not exceed 300% without "a satisfactory showing that a higher level of borrowing is appropriate" and that any borrowing in excess of that level must be approved by a majority of the company's independent trustees and disclosed to shareholders. NASAA Guidelines at V.J. *See infra* note 22. We understand from filings made by mortgage-related pools under the Securities Act and the Exchange Act that other mortgage-related pools may specify in their organizational documents the level of leverage that they may use, although that level often may be increased with the approval of a majority of the company's board of directors or trustees, and still others may use leverage up to any level deemed appropriate by their investment advisers.

of whether they are internally or externally managed, most mortgage-related pools have boards of directors or trustees to oversee the companies' management.

Many mortgage-related pools list and trade their securities on a national securities exchange and, like other public companies listed on a national securities exchange, must comply with the exchange's listing and maintenance requirements, including corporate governance rules. Such rules require, among other things, that a majority of the members of the company's board of directors or trustees be independent of its management.[21] Other mortgage-related pools do not list and trade their securities on a national securities exchange and may not be subject to any such corporate governance rules. Many non-exchange traded REITs, however, are structured in accordance with the NASAA Guidelines, as well as any applicable regulations of the states in which they sell their shares.[22] Among other things, the NASAA Guidelines provide for a REIT to have a board of trustees that has a majority of independent members.[23]

C. Similarities to Traditional Investment Companies

Some mortgage-related pools today have characteristics similar to, and may operate like, traditional investment companies. For example, both mortgage-related pools and traditional investment companies pool investor assets to purchase securities and provide investors with professional asset management.[24] Like traditional investment companies, mortgage-related pools may be internally or externally managed, with externally managed mortgage-related pools

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21 *See, e.g.,* Section 303A of the New York Stock Exchange Listed Company Manual.

22 Most states require non-exchange traded REITs to comply with the provisions of the NASAA Guidelines, although certain states have adopted their own guidelines. *See supra* note 20. *See, e.g.,* Foss, *et al., Real Estate Investment Trusts Handbook,* §4:1 (2009-2010 ed).

23 NASAA Guidelines at III.B. The NASAA Guidelines also address: a REIT's issuing certain securities, including redeemable securities; minimum suitability requirements; leverage concerns; potential conflicts of interests (such as providing for a majority of a REIT's board of trustees, including a majority of its independent trustees, to approve transactions between the REIT and its affiliates); and annual reports to shareholders. NASAA Guidelines at III., V.,VI.

24 Like registered investment companies, many mortgage-related pools publicly offer their securities to both retail and institutional investors.

typically having few, if any, employees, and instead relying on their investment advisers, which may be their sponsors or the sponsors' affiliates, to operate the companies.[25] Like investment advisers to traditional investment companies, investment advisers to mortgage-related pools typically are compensated with an asset-based fee.[26] Some mortgage-related pools invest in the same types of assets as registered investment companies and private investment funds.[27] Finally, some mortgage-related pools are perceived by investors and the media as being investment vehicles and not as companies that are engaged in the mortgage banking business.[28]

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25 In addition, as discussed previously, both registered investment companies that seek to avoid corporate taxation and mortgage-related pools that elect REIT status must distribute at least 90% of their income to investors annually so as to avoid corporate taxation. *See supra* note 16 and accompanying text.

26 Investment advisers to mortgage-related pools also may receive incentive-based fees of a type that is prohibited for investment advisers to registered investment companies under the Investment Advisers Act of 1940 ("Advisers Act"), but typically charged by investment advisers to hedge funds and certain other private investment companies. *See* Section 205 of the Advisers Act. 15 U.S.C. 80b-5. An investment adviser to a mortgage-related pool may be required to register under the Advisers Act. *See generally* Section 203 of the Advisers Act and Commission rules thereunder.

27 For example, many mortgage-related pools and registered investment companies, including money market funds, invest in agency securities. According to the Federal Reserve, as of March 31, 2011, registered investment companies (not including money market funds) held \$800.8 billion (or 10.5%), and money market funds held \$373.4 billion (or 4.9%), of outstanding "agency-and GSE-backed securities," defined as issues of federal budget agencies (such as those for TVA), issues of government-sponsored enterprises (such as Fannie Mae and FHLB) and agency- and GSE-backed mortgage pool securities issued by Ginnie Mae, Fannie Mae, Freddie Mac and the Farmers Home Administration. In contrast, REITs held \$191.1 billion (or 2.5%) of such securities. Federal Reserve Statistical Release, *Flow of Funds Accounts of the United States: Flows and Outstandings First Quarter 2011* (June 9, 2011). As noted previously, certain registered investment companies focus their investments on the same types of assets as mortgage-related pools that primarily hold agency securities and other mortgage-backed securities. *See supra* note 3. In addition, in recent years, some hedge funds and offshore funds have been investing in the same types of assets as some mortgage-related pools. *See, e.g., Hedge Funds Investing in Delinquent Mortgages,* MSNBC.com (July 30, 2008).

28 For example, a number of mortgage REITs appear to have been formed with the intent of targeting retail investors who may be unable to make the high minimum investments often required of large bond funds. *See A.D. Pruitt, Mortgage REITs on a Tear as High Yields Fuel Demand,* Wall St. J. (Apr. 13, 2011). Press reports have also characterized some such companies as investment vehicles. *See, e.g.,* Jonathan Weil, *Hedge Fund Instant IPO Tests the New Complacency,* Bloomberg.net (Jun. 18, 2009) ("PennyMac is a hedge fund dressed up as a real estate investment trust"). *See also* Nathan Vardi, *High-Profile Investor Sues Carlyle Group,* Forbes.com (July 13, 2009) ("Michael Huffington, the wealthy former Republican congressman from California, is suing the Carlyle Group and its co-founder, David Rubenstein, over misrepresentations and deceptions Huffington claims they made regarding his \$20 million investment loss in Carlyle Corp., Carlyle's failed . . . mortgage fund.").

With respect to investment companies, the Investment Company Act[29] seeks to prevent such companies from, among other things, (i) employing unsound or misleading methods, or not receiving adequate independent scrutiny, when computing the asset value of their investments or their outstanding securities;[30] (ii) engaging in excessive borrowing and issuing excessive amounts of senior securities;[31] and (iii) being organized, operated, managed, or having their portfolio securities selected, in the interests of company insiders.[32] In addition, the Investment Company Act seeks to protect the assets of investment companies, including imposing custody controls and preventing controlling persons of an investment company from commingling the investment company's assets with their own and misappropriating them.[33]

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29 *See, e.g.,* Section 1(b) of the Investment Company Act (setting forth findings and declaration of policy). 15 U.S.C. 80a-1(b).

30 The Investment Company Act places significant emphasis on the manner in which a registered investment company must value its portfolio. *See, e.g.*, Section 2(a)(41) of the Act. 15 U.S.C. 80(a)-2(a)(41) (defining "value," with respect to securities held by a registered investment company, to be (a) market value for securities for which market quotations are readily available or (b) for other securities or assets, fair value as determined in good faith by the company's board of directors).

31 Prior to 1940, some investment companies were highly leveraged through the issuance of "senior securities" in the form of debt or preferred stock, which often resulted in the companies being unable to meet their obligations to the holders of their senior securities. *See generally Investment Trusts and Investment Companies: Report of the Securities and Exchange Commission* (1940) ("Investment Trusts Study"). Excessive leverage also greatly increased the speculative nature of the common stock of the companies. *Id.* Section 18 of the Investment Company Act limits the ability of registered investment companies to engage in borrowing and to issue senior securities. 15 U.S.C. 80a-18.

32 A study conducted prior to the adoption of the Act documented numerous instances in which investment companies were managed for the benefit of their sponsors and affiliates to the detriment of investors. *See* Investment Trusts Study, *supra* note 31. Section 17 of the Investment Company Act prohibits certain transactions involving investment companies and their affiliates. 15 U.S.C. 80a-17(a). Other provisions of the Investment Company Act also effectively limit opportunities for overreaching by investment company sponsors and affiliates. *See, e.g.*, Section 10(f) of the Investment Company, which generally prohibits a registered investment company from knowingly purchasing, during the existence of any underwriting or selling syndicate, any security a principal underwriter of which is an affiliated person of the investment company. 15 U.S.C. 80a-10(f).

33 *See, e.g.,* Investment Trusts Study, *supra* note 31. Prior to 1940, investment company assets were not adequately protected from misuse by investment company insiders. *Id.* In many cases, controlling persons of investment companies commingled the investment companies' assets with the investment advisers' assets and then proceeded to misuse the assets themselves. *Id.* Section 17(f) of the Investment Company Act and the rules thereunder set forth requirements with respect to the custody of investment company assets. 15 U.S.C. 80a-17(f). *See, e.g.*, Rule 17f-2 under the Investment Company Act governing custody of investments by a registered investment company. 17 CFR 270.17f-2.

We are concerned that some mortgage-related pools, as pooled investment vehicles, may raise the potential for the same types of abuses, such as deliberate misvaluation of the company's holdings,[34] extensive leveraging,[35] and overreaching by insiders.[36] The Commission also has brought a number of enforcement cases, for example, in which controlling persons of companies that hold mortgage-related assets used such companies' assets to further their own interests.[37]

D. Request for Comment

The Commission is interested in learning more about mortgage-related pools. Accordingly, commenters are requested to provide information about companies that rely on Section 3(c)(5)(C) of the Act, including, among other things, the various types of such

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[34] For example, the Commission has brought an enforcement action against the management of a company that had, among other things, improperly recorded mortgages that had decreased in value at cost rather than at market value in order to avoid writing down certain mortgages held for resale, thereby adversely affecting the company's income and equity. *See SEC v. Patrick Quinlan,* 2008 Fed. Sec. L. Rep. (CCH) ¶95,005 (E.D. Mich. Nov.7, 2008), *aff'd,* 373 Fed. Appx. 581 (6th Cir. 2010).

[35] For example, an offshore fund that held mortgage-backed securities reportedly had a 32:1 leverage ratio (borrowing against the security of the mortgage-backed securities), so that when the mortgage-backed securities lost value, the fund could not service its debts, resulting in lenders seizing the fund's assets. *See, e.g.,* Nathan Vardi, *High-Profile Investor Sues Carlyle Group,* Forbes.com (July 13, 2009).

[36] For example, the Commission brought a settled administrative proceeding against a former chief executive officer of both a publicly held REIT and its manager (which owned approximately 52% of the REIT) who had used his significant influence on the advisory services provided by the REIT manager to cause the REIT, its manager and other related parties together to purchase over a million shares of a publicly traded company over a 13-month period, representing 16.1% of the total shares of that company. These purchases accounted for approximately 54% of the total trading volume in the company's stock during that period, and on some days these parties purchased all of the company's stock that traded that day. Although no entity itself purchased more than 5% of the company's securities, the Commission determined that given the interrelationships that existed, the REIT and others constituted a "group" for purposes of Section 13(d), and that a Schedule 13D should have been filed. *See In the Matter of Basic Capital Management Inc., et al.,* Exchange Act Release No. 46538 (Sept. 24, 2002). This case illustrates how a mortgage-related pool insider has the potential to influence the management of the company's assets for the insider's benefit.

[37] *See, e.g., SEC v. Pittsford Capital Income Partners LLC, et al.,* No. 06-6353 (W.D.N.Y. Aug. 23, 2007), *aff'd,* 305 Fed. Appx. 694 (2d. Cir. 2008) (persons that controlled certain real estate investment companies sold to senior citizens engaged in a fraudulent scheme involving, among other things, transfers of large amounts of money from the companies to entities in which the controlling persons had significant personal interests); *SEC v. Global Express Capital Real Estate Investment Fund I et al.,* No. 03-1514 (Nev. Mar. 28, 2006), *aff'd in part, rev'd and remanded in part,* 289 Fed. Appx.183 (9th Cir. 2008) (a Ponzi-like scheme which purported to pool investor funds to purchase interests in mortgage loans and trust deeds); *SEC v. LandOak Securities, LLC, et al.,* No. 3:08-209 (E.D. Tenn., Mar. 29, 2011) (persons that controlled a mortgage company misappropriated funds due to the company's investors).

companies; how such companies are operated, including their strategies for the acquisition and management of their holdings; the types of investors that invest in such companies; and the roles of such companies in the mortgage markets. We ask commenters to discuss the differences, if any, between companies that originate mortgages and then continue to hold all or portions of those mortgages, and companies that only invest in mortgages and mortgage-related instruments. The Commission also invites commenters to provide the same type of information about any similar companies that do not rely on Section 3(c)(5)(C) and to explain whether they are registered under the Act or rely on another exclusion or exemption and, if so, which exclusion or exemption. The Commission is interested in obtaining information about both public (exchange-traded and non-exchange traded) and privately offered mortgage-related pools and similar companies. The Commission also requests that commenters provide any other information about mortgage-related pools they believe is relevant to the Commission's review of the status of such companies under the Investment Company Act.

We also ask commenters for their views on the apparent similarities between certain mortgage-related pools and traditional investment companies. We ask commenters to describe any key operational or structural characteristics of mortgage-related pools that serve to distinguish them from traditional investment companies regulated under the Investment Company Act. The Commission requests that commenters provide any other information that may be relevant to evaluating the similarities and differences between mortgage-related pools and investment companies.

Finally, we request comment on the types of potential abuses that the Investment Company Act was intended to prevent that might be associated with mortgage-related pools. We also are interested in learning about any existing safeguards in the structure and operations of mortgage-related pools that may address concerns similar to those addressed by the Investment Company Act. Commenters also are invited to comment on whether certain concerns addressed by the Investment Company Act may not be relevant to mortgage-related pools and the reasons why. Commenters also should discuss whether, and to what extent, such potential abuses are addressed by any industry practices or other regulatory schemes that may be applicable to mortgage-related pools.

III. THE EXCLUSION PROVIDED BY SECTION 3(c)(5)(C)

A. Legislative and Administrative Background

Section 3(c)(5) originally was intended to exclude from the definition of investment company, among other things, companies that did not resemble, or were not considered to be, issuers that were in the investment company business.[38] In 1970, Congress amended Section 3(c)(5) to prohibit any issuer relying on the exclusion from issuing redeemable securities. According to the legislative history, certain companies that had been relying on Section 3(c)(5)

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[38] *See, e.g.,* H.R. Rep. No. 2639, 76th Cong., 3d Sess. 12(1940) ("Subsection (c) specifically excludes . . . companies dealing in mortgages. . ."); H.R. Rep. No. 1382, 91st Cong., 2d Sess. 17 (1970) ("Although the companies enumerated. . . have portfolios of securities in the form of . . . mortgages and other liens on and interests in real estate, they are excluded from the act's coverage because they do not come within the generally understood concept of a conventional investment company investing in stocks and bonds of corporate issuers") ("1970 House Report"). *See also* PPI Report, *supra* note 2 at 328 ("Section 3(c)(6) provides for an exclusion from the definition of investment company for companies primarily engaged in the . . . real estate businesses. Although these companies are engaged in acquiring . . . mortgages and other interests in real estate – thus acquiring investment securities, such activities are generally understood not to be within the concept of a conventional investment company which invests in stocks and bonds of corporate issuers"); *Exclusion from the Definition of Investment Company for Certain Structured Financings,* Investment Company Act Release No. 18736 (May 29, 1992) ("Proposing Release to Rule 3a-7") at text following n.5 ("section 3(c)(5)] . . . originally was intended to exclude issuers engaged in the commercial finance and mortgage banking industries.").

As initially enacted by Congress in 1940, Section 3(c)(5) was limited to companies that did not issue face-amount certificates of the installment type or periodic payment plan certificates, in response to the abuses found prior to 1940 in the sale of these types of securities by certain companies, including those of the type that would have otherwise been excluded by this provision. *See generally Investment Trusts and Investment Companies: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 3580,* 76th Cong., 3d. at 182 (1940) (statement of David Schenker). The prohibition on issuing face-amount certificates also may have been added to ensure that Investors Syndicate, a face-amount certificate company that held real estate and mortgage interests, would not be able to rely on Section 3(c)(5)(C) and instead be required to register under the Investment Company Act, as detailed in the Investment Trusts Study, *supra* note 31, at Ch. II of Companies Issuing Face Amount Installment Contracts (1940).

sought to capitalize on the popularity of mutual funds by issuing redeemable securities.[39] Because Section 3(c)(5) was not intended to cover those companies that fell within the generally understood concept of a traditional investment company,[40] the 1970 amendment sought to ensure that companies that structured themselves like mutual funds would be subject to regulation under the Investment Company Act, regardless of the types of securities that they held.[41]

In 1960, the Commission addressed Section 3(c)(5)(C) in a release that discussed the applicability of the federal securities laws to REITs.[42] In the 1960 Release, the Commission, among other things, stated that a REIT may fall within the definition of investment company under the Investment Company Act but, depending on the characteristics of its assets and the nature of the securities it issues, the REIT may be able to rely on Section 3(c)(5)(C).[43] In the 1960 Release, the Commission also generally stated that the applicability of the Section 3(c)(5)(C) exclusion could be determined only on the basis of the facts and circumstances of the particular REIT. The Commission further stated, however, that any REIT that invested "exclusively in fee interests in real estate or mortgages or liens secured by real estate" could rely on the Section 3(c)(5)(C) exclusion, provided that the REIT also met the exclusion's other criteria with respect to the nature of the securities it issued.[44] The Commission explained that a REIT might not qualify for the exclusion if it "invested to a substantial extent in other real estate investment trusts . . . or in companies engaged in the real estate business or in other securities."[45]

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39 *See, e.g.,* 1970 House Report, *supra* note 38 at 17; PPI Report, *supra* note 2 at 328-329.

40 *See supra* note 38.

41 *See, e.g.,* 1970 House Report, *supra* note 38.

42 *Real Estate Investment Trusts*, Investment Company Act Release No. 3140 (Nov. 18, 1960) ("1960 Release") (discussing Section 3(c)(6)(C), which was subsequently redesignated as Section 3(c)(5)(C)). *See supra* note 9.

43 *Id.*

44 *Id.*

45 *Id.*

The Commission has not specifically addressed the scope of Section 3(c)(5)(C) since the 1960 Release.[46]

B. Commission Staff No-Action Letters and Other Interpretations

As noted above, Section 3(c)(5)(C) generally excludes from the definition of investment company any person who is primarily engaged in, among other things, "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." The staff, in providing guidance on this exclusion, generally has focused on whether at least 55% of the issuer's assets will consist of mortgages and other liens on and interests in real estate (called "qualifying interests")[47] and the remaining 45% of the issuer's assets will consist primarily of real estate-type interests.[48] The staff generally has viewed the following types of assets as qualifying interests:

- Assets that represent an <u>actual</u> interest in real estate or are loans or liens fully secured by real estate. Thus, the staff generally took the position that an issuer

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46 The Commission testified before Congress in 1983 and 1984 concerning the applicability of the Investment Company Act to issuers of some mortgage-related securities in connection with legislation that became the Secondary Mortgage Market Enhancement Act of 1984. Statement of the Securities and Exchange Commission Submitted to the Subcommittee on Housing and Urban Affairs, U.S. Senate, on S. 1821 (Sep. 27, 1983) ("The Commission believes that the Investment Company Act offers important protections to investors in entities coming within the definition of the term 'investment company' that should not be sacrificed lightly, even in the name of an objective as worthwhile as enhancing the private secondary mortgage market").

In the Proposing Release to Rule 3a-7, issued in 1992, the Commission discussed the reliance on Section 3(c)(5) by certain private sector issuers of asset-backed securities, including mortgage-backed securities. *See* Proposing Release to Rule 3a-7, *supra* note 38. In that release, the Commission requested comment on whether Section 3(c)(5) should be amended to prevent such issuers from continuing to rely on this exclusion, because such issuers could instead rely on Rule 3a-7. In response to commenters' arguments, including that it would be inappropriate to narrow the scope of Section 3(c)(5) until both the market and the Commission gained experience with Rule 3a-7, the Commission decided not to pursue any legislative changes with respect to Section 3(c)(5) at that time. *See Exclusion from the Definition of Investment Company for Structured Financings*, Investment Company Act Release No. 19105 (Nov. 19, 1992) [57 FR 56248 (Nov. 27, 1992)] ("Adopting Release to Rule 3a-7"). In the 3a-7 Companion Release, the Commission once again is seeking comment on whether Section 3(c)(5) should be amended to limit the ability of asset-backed issuers to rely on this exclusion. 3a-7 Companion Release, *supra* note 5.

47 *See, e.g.*, Salomon Brothers, Inc., SEC Staff No-Action Letter (June 17, 1985).

48 *See, e.g.*, Citytrust, SEC Staff No-Action Letter (Dec. 19, 1990); Greenwich Capital Acceptance Inc., SEC Staff No-Action Letter (Aug. 8, 1991) (issuer represented its intention to invest at least 25% of its total assets in real estate-type interests (subject to reduction to the extent that the issuer invested more than 55% of its total assets in qualifying interests) and no more than 20% of its total assets in miscellaneous investments).

may treat as qualifying interests such assets as mortgage loans fully secured by real estate, fee interests in real estate, second mortgages secured by real property, deeds of trust on real property, installment land contracts and leasehold interests secured solely by real property.[49]

- Assets that can be viewed as being the functional equivalent of, and provide their holder with the same economic experience as, an actual interest in real estate or a loan or lien fully secured by real estate. Thus, the staff took the position that a Tier 1 real estate mezzanine loan, under certain conditions, may be considered a qualifying interest if the loan may be viewed as being the functional equivalent of, and provide its holder with the same economic experience as, a second mortgage.[50]

Consistent with the view the Commission expressed in the 1960 Release, the staff has taken the position that an issuer that is primarily engaged in the business of holding interests in the nature of a security in another person engaged in the real estate business, generally may not rely on Section 3(c)(5)(C).[51] Thus, securities issued by REITs, limited partnerships, or other

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49 *See, e.g.*, United States Property Investment N.V., SEC Staff No-Action Letter (May 1, 1989) (mortgage loan secured exclusively by real estate in which the value of the real estate was equal or greater than the note evidencing the loan); Division of Investment Management, SEC, *The Treatment of Structured Finance Under the Investment Company Act,* Protecting Investors: A Half Century of Investment Company Regulation (1992) Ch. 1 ("Protecting Investors Report") at n. 345 and accompanying text (mortgage loan in which 100% of the principal amount of each loan was fully secured by real estate at the time of origination and 100% of the market value of the loan was fully secured by real estate at the time of acquisition); United Bankers, SEC Staff No-Action Letter (Mar. 23, 1988) (fee interests in real estate); The State Street Mortgage Co., SEC Staff No-Action Letter (July 17, 1986) (second mortgages); First National Bank of Fremont, SEC Staff No-Action Letter (Nov. 18, 1985) (deeds of trust on real property); American Housing Trust I, SEC Staff No-Action Letter (May 21, 1988) (installment land contracts); Health Facility Credit Corp., SEC Staff No-Action Letter (Feb. 6, 1985) (leasehold interests).

50 *See* Capital Trust Inc., SEC Staff No-Action Letter (May 24, 2007).

51 *See* 1960 Release, *supra* note 42. *See also* Urban Land Investments Inc., SEC Staff No-Action Letter (Nov. 4, 1971); The Realex Capital, SEC Staff No-Action Letter (Mar. 19, 1984); M.D.C. Holdings, SEC Staff No-Action Letter (May 5, 1987). The staff also has stated its view that an issuer that is engaged primarily in purchasing or otherwise acquiring participations or fractionalized interests in individual or pooled mortgages or deeds of trust would not qualify to rely on Section 3(c)(5)(C) because such participations and interests are in the nature of a

entities that invest in real estate, mortgages or mortgage-related instruments, or that are engaged in the real estate business, generally are not considered by the staff to be qualifying interests. In two particular circumstances, however, the staff expressed the view that certain interests in another person engaged in the real estate business may be regarded as qualifying interests:

- The staff has expressed the view that "whole pool certificates" that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae ("agency whole pool certificates") provide the holder with the same economic experience as an investor who purchases the underlying mortgages directly, and therefore would be qualifying interests;[52] and

- The staff has expressed the view that certain subordinate participations in commercial real estate first mortgage loans, called B-Notes, have a number of attributes that, when taken together, may allow them to be classified as an interest in real estate rather than an interest in the nature of a security issued by a person that is engaged in the real estate business.[53]

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security in another person engaged in the real estate business. MGIC Mortgage Corp., SEC Staff No-Action Letter (Oct. 6, 1972 and Aug. 1, 1974); M.D.C Holdings, SEC Staff No-Action Letter (May 5, 1987).

52 *See* Protecting Investors Report, *supra* note 49 at n.267. A whole pool certificate is a security that represents the entire ownership interest in a particular pool of mortgage loans. *Id. See also* American Home Finance Corp. (pub. avail. Apr. 9, 1981).

53 Capital Trust Letter, SEC Staff No-Action Letter (Feb. 3, 2009) ("Capital Trust B-Note Letter"). The Capital Trust B-Note Letter was intended to clarify the staff's earlier statements with respect to mortgage participations as qualifying interests. In prior letters, the staff had expressed the view that a trust that held certain participation interests in construction period mortgage loans acquired from mortgage lenders may rely on Section 3(c)(5)(C), concluding that each mortgage participation interest held by the trust was an interest in real estate because the participation interest was in a mortgage loan that was fully secured by real property and the trustee had the right by itself to foreclose on the mortgage securing the loan in the event of default. *See, e.g.* Northwestern Ohio Building and Construction Trades Foundation, SEC Staff No-Action Letter (Apr. 20, 1984); Baton Rouge Building and Construction Industry Foundation, SEC Staff No-Action Letter (Aug. 31, 1984). Although the Capital Trust B-Note Letter specifically did not withdraw the prior staff no-action letters, it noted the staff's view that, while the right to foreclose is an important attribute to consider when determining whether an asset should be considered a qualifying interest, other attributes of the asset also need to be considered when making such a determination.

Finally, the staff has expressed the view that certain mortgage-related instruments that were not treated as qualifying interests may be treated as real estate-type interests. In the staff's view, such instruments would include loans in which at least 55% of the fair market value of each loan was secured by real estate at the time the issuer acquired the loan,[54] and agency partial pool certificates.[55]

Some mortgage-related pools have determined that certain other assets constitute qualifying assets for purposes of that exclusion. For example, we understand that mortgage-related pools generally treat bridge loans, certain construction and rehabilitation loans, wrap-around mortgage loans and investments in distressed debt as qualifying interests, provided that the loans are fully secured by real estate. We also understand that some mortgage-related pools have determined to treat a convertible mortgage (which is a mortgage plus an option to purchase the underlying real estate) as two assets -- a mortgage loan (treated as a qualifying interest provided that it is fully secured by real estate) and an option to purchase real estate (which is assigned an independent value and treated as a real estate-type interest).

With respect to certain other mortgage-related instruments, there appears to be a degree of uncertainty or differing views among mortgage-related pools as to the availability of the Section 3(c)(5)(C) exclusion. For example, it appears that some mortgage-related pools that invest in certificates issued by pools that hold whole loans and participation interests in loans that are secured by commercial real estate ("CMBS") limit the amount of CMBS that they hold,

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54 NAB Asset Corp., SEC Staff No-Action Letter (June 20, 1991).

55 The staff has expressed the view that, while an agency partial pool certificate (which is a certificate that represents less than the entire ownership interest in a mortgage pool) is not a qualifying interest because it is more akin to being an investment in the securities of an issuer holding mortgages rather than an investment directly in the underlying mortgages, such asset may be treated as a real estate-type interest for purposes of determining whether an issuer may rely on Section 3(c)(5)(C). *See, e.g.*, Nottingham Realty Securities, SEC Staff No-Action Letter (Apr. 19, 1984); Protecting Investors Report, *supra* note 49 at n.268 and accompanying text.

treating such assets as real estate-type interests under Section 3(c)(5)(C), whereas others treat certain CMBS as qualifying interests.

C. Request for Comment on the Current Interpretation of Section 3(c)(5)(C)

As the discussion above indicates, the exclusion from the definition of investment company provided by Section 3(c)(5)(C) does not have an extensive legislative history, has not been comprehensively addressed by the Commission, and generally has been addressed in staff no-action letters only on a case-by-case basis. The evolution of mortgage-related pools and the development of new and complex mortgage-related instruments have led us to be concerned that mortgage-related pools are making judgments about their status under the Investment Company Act without sufficient Commission guidance.[56] It appears that some types of mortgage-related pools might interpret the statutory exclusion provided by Section 3(c)(5)(C) in a broad manner, while others might interpret the exclusion too narrowly. The Commission also is concerned that the staff no-action letters that have addressed the statutory exclusion in Section 3(c)(5)(C) may have contained, or led to, interpretations that are beyond the intended scope of the exclusion and inconsistent with investor protection. The Commission is concerned that certain types of companies today appear to resemble in many respects management investment companies that are registered under the Act and may not be the kinds of companies that were intended to be excluded from regulation under the Act by Section 3(c)(5)(C).

The Commission requests comment from mortgage-related pools, investors, and the public on the current state of guidance and interpretation concerning Section 3(c)(5)(C). The

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56 In this regard we note that most mortgage-related pools, when publicly offering their securities, disclose in their registration statements that their determinations whether they may rely on the Section 3(c)(5)(C) exclusion will be based on staff no-action letters and Commission guidance and, where such guidance does not exist, on their own judgments. Such companies also state that there can be no assurance that the Commission staff will concur with their views, or that the laws governing the Investment Company Act status of mortgage-related pools, or the guidance provided by the Commission or its staff, will not change in a manner that would not adversely affect their operations.

Commission is interested in learning from mortgage-related pools and their legal counsel about any difficulties they may have encountered in determining the status of such companies under the Investment Company Act. Are we correct that there is uncertainty or differing views among companies as to the availability of the Section 3(c)(5)(C) exclusion? If so, please explain and provide specific examples. Do commenters believe that the exclusion provided by Section 3(c)(5)(C) is generally being used consistent with the purposes and policies underlying that provision and investor protection? Do commenters believe that certain mortgage-related pools may be giving too broad an interpretation to this statutory exclusion? If so, does such broad interpretation result in companies that resemble traditional investment companies avoiding regulation under the Act and, if so, is it inconsistent with the purposes and policies underlying that provision and investor protection? Do commenters believe that certain companies may be giving too narrow an interpretation to this statutory exclusion? Commenters are requested to provide detailed explanations of their views, including specific examples, if appropriate.

We noted above that companies generally determine whether they are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate, based on whether at least 55% of the company's assets consist of qualifying interests and the remaining 45% of the company's assets consist primarily of real estate-type interests. Is this an appropriate approach to determining an issuer's primary engagement for purposes of Section 3(c)(5)(C)? Is it a difficult determination to make? Is the approach too broad or, conversely, too narrow in terms of identifying the types of companies that are able to rely on the exclusion, consistent with legislative intent? Does this approach lead certain companies to invest their assets in a different manner than they otherwise would in accordance with their business model, in order to have the certainty of being able to rely on Section 3(c)(5)(C)? Are there companies that have concluded that they do not qualify for the exclusion in Section 3(c)(5)(C)? If so, how did such companies address their status under the Investment Company Act? Commenters are requested to comment on their experiences in this area, including the economic impact of this approach.

With respect to the staff no-action letters, we ask for comment on whether any of the staff's analysis relating to the determination of whether an asset is a "lien on or interest in real estate" for purposes of Section 3(c)(5)(C) would be relevant in formulating Commission guidance for today's mortgage-related pools. Commenters should identify any such staff position and explain its relevance. For example, should certain mortgage participations be treated as interests in real estate and, if so, what types of participations and why? Is a company whose primary business activity consists of holding mortgage participations, the type of entity that should be excluded from the definition of investment company? Why or why not, and does it matter what type(s) of participations the company holds? If participations are to be treated as interests in real estate, what features should be considered in making a determination about such assets? For example, should the right to foreclose be considered an important attribute, even though such right only exists if the underlying mortgage defaults?[57] Commenters are encouraged to discuss the costs and benefits of their recommendations.

We also request comment on the view that the Commission should take concerning agency whole pool certificates under Section 3(c)(5)(C). Should the Commission revisit the staff's view that agency whole pool certificates may be treated as interests in real estate?[58]

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57 *See supra* note 53.

58 The Commission issued a similar request for comment in 1992. *See* Proposing Release to Rule 3a-7, *supra* note 38 at n.103 and accompanying text. That request for comment stemmed from the Protecting Investors Report, issued in 1992, in which the staff discussed whether it should reconsider its position with respect to agency whole pool certificates, noting that an agency whole pool certificate holder does not have the same economic experience as an investor who holds the underlying mortgages because of the agency guarantee, which increases the certificates'

Should we view a company whose primary business consists of investing in agency whole pool certificates – or other mortgage-backed securities – as the type of entity that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C) or not? What would be the economic impact of the Commission adopting a position that would not treat agency whole pool certificates as interests in real estate? Commenters should explain how such companies are similar to, or differ from, traditional investment companies that invest in similar assets, and how any such similarities or differences should affect the status of such companies under the Investment Company Act.

Finally, we ask for comment generally on whether guidance is needed with respect to other mortgage-related instruments. If so, which instruments and what should that guidance provide? We note in particular the differing approaches taken by certain mortgage-related pools as to the appropriate treatment of certain types of CMBS for purposes of determining a company's ability to rely on Section 3(c)(5)(C). Should the Commission provide guidance with respect to these mortgage-related instruments, what should that guidance address, and what would be the potential economic impact of this guidance? We also request comment on whether a company whose primary business consists of investing in CMBS, or any other type of mortgage-backed security, is the type of entity that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C).

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liquidity. Protecting Investors Report, *supra* note 49 at text following n.346. Commenters strongly urged the staff not to withdraw its position, arguing that agency whole pool certificates are interests in real estate because certificate holders receive payment streams that reflect payments on the underlying mortgages. Commenters also argued that withdrawal of the position could result in some REITs and mortgage bankers that held these instruments becoming subject to the Investment Company Act. In response to commenters' concerns at that time, the staff ultimately decided not to withdraw its position. Adopting Release to Rule 3a-7, *supra* note 46 at nn. 90-92 and accompanying text.

IV. Request for Comment on Possible Commission Action

The Commission requests comment on what steps, if any, it should take to provide greater clarity, consistency or regulatory certainty regarding the status of mortgage-related pools under the Investment Company Act. The Commission potentially could engage in rulemaking (such as a safe harbor or definitional rule), issue an interpretive release, and/or provide exemptive relief to address mortgage-related pools and the scope of Section 3(c)(5)(C), or take no further action at this time. Commenters are encouraged to discuss the benefits and costs of each such option.

Commenters are asked to address whether a test could be devised that would differentiate companies that are primarily engaged in the real estate and mortgage banking business from those companies that resemble traditional investment companies. If commenters believe that such a test is appropriate, the Commission is interested in commenters' views as to the factors that would be suitable in such a test, the benefits and costs associated with any suggested test, and the effect that any suggested test may have on investor protection, competition, efficiency and capital formation.

Section 3(c)(5)(C) suggests that one factor that must be considered when determining whether a company is primarily engaged in the business set forth in Section 3(c)(5)(C) is the composition of the company's assets. Would it be helpful for the Commission to define the term "liens on and other interests in real estate" for purposes of Section 3(c)(5)(C)? If so, how should the Commission define that term? For example, in light of the reference to "mortgages" in Section 3(c)(5)(C), should the term "liens on and interests in real estate" also be defined to include only those assets that are directly related to real estate, rather than include, for example, interests in a mortgage or in a pool or other entity that holds real estate? The Commission requests comment on the advantages and disadvantages of defining the term "liens on and interests in real estate" in this manner. If commenters believe that a broader definition of the term "liens on and interests in real estate" is more appropriate, the Commission requests comment on the principles or concepts that could be used to craft such a definition. Commenters are encouraged to discuss the benefits and costs of alternative definitions.

In addition to the composition of a company's assets, other factors may help to differentiate companies that are primarily engaged in the real estate and mortgage banking business from those companies that resemble traditional investment companies. What are such other factors? Should a company also look to its sources of income in determining its "primary business" under Section 3(c)(5)(C)? [59] Should factors such as the company's historical development, the activities of its officers, directors and employees, and its public representations also be considered in determining the company's primary business under Section 3(c)(5)(C)? Are there factors that may be potentially indicative of a company's non-investment company business? For example, are there any types of business activities or types of business expenses that differentiate such a company from an investment company?[60] Commenters are urged to be specific in their responses.

IV. GENERAL REQUEST FOR COMMENT

In addition to the issues raised or mentioned in this release, the Commission requests and encourages all interested persons, including investors in mortgage-related pools, to submit their

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[59] *See, e.g.,* Section 3(c)(6) of the Investment Company Act. 15 U.S.C. 80a-3(c)(6). We note that the Internal Revenue Code's REIT provisions contain an asset and income test. *See supra* note 16.

[60] *See e.g.,* Rule 3a-8 under the Investment Company Act (addressing the status under the Act of certain research and development companies based on, among other things, their research and development expenses, the activities of their officers, directors and employees, their public representations of policies, and their historical development). 17 CFR 270.3a-8.

views on any other issues relating to the status of such companies under the Investment Company Act. The Commission particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or issues raised in this release.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 31, 2011

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 271

[Release No. IC-29776; File No. S7-33-11]

RIN: 3235-AL22

Use of Derivatives by Investment Companies under the Investment Company Act of 1940

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comments.

SUMMARY: The Securities and Exchange Commission (the "Commission") and its staff are reviewing the use of derivatives by management investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act" or "Act") and companies that have elected to be treated as business development companies ("BDCs") under the Act (collectively, "funds"). To assist in this review, the Commission is issuing this concept release and request for comments on a wide range of issues relevant to the use of derivatives by funds, including the potential implications for fund leverage, diversification, exposure to certain securities-related issuers, portfolio concentration, valuation, and related matters. In addition to the specific issues highlighted for comment, the Commission invites members of the public to address any other matters that they believe are relevant to the use of derivatives by funds. The Commission intends to consider the comments to help determine whether regulatory initiatives or guidance are needed to improve the current regulatory regime for funds and, if so, the nature of any such initiatives or guidance.

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

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/concept.shtml);
- Send an e-mail to rule-comments@sec.gov; 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 S7-33-11. This file number should be included on the subject line if comments are submitted by e-mail. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/concept.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. Therefore, you should only submit information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Edward J. Rubenstein, Senior Special Counsel, or Michael S. Didiuk, Senior Counsel, at (202)-551-6825, Office of Chief Counsel, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5030.

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VII. GENERAL REQUEST FOR COMMENT

* * *

I. INTRODUCTION

The activities of funds, including their use of derivatives, are regulated extensively under the Investment Company Act,[1] Commission rules, and Commission guidance.[2] Derivatives may be broadly described as instruments or contracts whose value is based upon, or derived from, some other asset or metric (referred to as the "underlier," "underlying," or "reference asset").[3]

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1 15 U.S.C. 80a. All statutory references to the Investment Company Act are to 15 U.S.C. 80a, and, unless otherwise stated, all references to rules under the Investment Company Act are to Title 17, Part 270 of the Code of Federal Regulations [17 CFR 270]. All references to the Securities Act of 1933 (the "Securities Act") are to 15 U.S.C. 77a, and, unless otherwise stated, all references to rules under the Securities Act are to Title 17, Part 230 of the Code of Federal Regulations [17 CFR 230]. All references to the Securities Exchange Act of 1934 (the "Exchange Act") are to 15 U.S.C. 78a, and, unless otherwise stated, all references to rules under the Exchange Act are to Title 17, Part 240 [17 CFR 240].

2 The staff has also issued no-action and other letters that relate to fund use of derivatives. In addition to Investment Company Act provisions, funds using derivatives must comply with all other applicable statutory and regulatory requirements, such as other federal securities law provisions, the Internal Revenue Code (the "IRC"), Regulation T of the Federal Reserve Board ("Regulation T"), and the rules and regulations of the Commodity Futures Trading Commission (the "CFTC"). *See also* Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (the "Dodd-Frank Act"), *available at* http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

3 *See, e.g., Board Oversight of Derivatives*, Independent Directors Council Task Force Report (July 2008) ("2008 IDC Report") at 1, 3, *available at* http://www.ici.org/pdf/ppr_08_derivatives.pdf. *See also Mutual Funds and Derivative Instruments*, Division of Investment Management Memorandum transmitted by Chairman Levitt to Representatives Markey and Fields (Sept. 26, 1994) ("1994 Report") at text accompanying n. 1 ("[t]he term 'derivative' is generally defined as an instrument whose value is based upon, or derived from, some underlying index, reference rate (*e.g.*, interest rates or currency exchange rates), security, commodity, or other asset."), and at n. 2 (the "term 'derivative' generally is used to embrace forward contracts, futures, swaps, and options"), *available at* http://www.sec.gov/news/studies/deriv.txt; John C. Hull, *Options, Futures, and Other Derivatives* (7th ed. 2009) ("Hull") at 1, 779 ("A *derivative* can be defined as a financial instrument whose value depends on (or derives from) the values of other, more basic underlying variables," and a derivative is an "instrument whose price depends on, or is derived from, the price of another asset") (italics in original); rule 3b-13 under the Exchange Act, which defines "eligible OTC derivative instrument," and rule 16a-1(c) under the Exchange Act, which defines "derivative securities;" section 5200(b) of the Revised Statutes of the United States [12 U.S.C. 84(b)] (as amended by section 610(a)(3) of the Dodd-Frank Act, *supra* note 2), which

As detailed below,[4] funds employ derivatives for a variety of purposes, including to increase leverage to boost returns, gain access to certain markets, achieve greater transaction efficiency, and hedge interest rate, credit, and other risks.[5] At the same time, derivatives can raise risk management issues for a fund relating, for example, to leverage, illiquidity (particularly with respect to complex OTC derivatives), and counterparty risk, among others.[6]

The dramatic growth in the volume and complexity of derivatives investments over the past two decades, and funds' increased use of derivatives,[7] have led the Commission and its staff

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defines a "derivative transaction" to include "any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets."

4 For a definition, and examples of types, of derivatives, *see infra* Section I.B.

5 *See* 2008 IDC Report, *supra* note 3, at 8-11. *See also infra* Section I.B.

6 *See* 2008 IDC Report, *supra* note 3, at 12-13. *See also Mutual Fund Derivative Holdings: Fueling the Need for Improved Risk Management*, JPMorgan Thought Magazine (Summer 2008) ("2008 JPMorgan Article"), *available at* http://www.jpmorgan.com/cm/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1158494213964&blobheader=application%2Fpdf&blobnocache=true&blobheadername1=Content.

7 While complete data concerning the nature of derivatives activities of funds is unavailable, for a partial snapshot of derivatives activity by selected fund complexes *see Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations*, Investment Company Institute ("ICI") Comment Letter to the CFTC at 18 (Apr. 12, 2011), *available at* http://www.ici.org/pdf/25107.pdf. *See also, e.g.*, Tim Adam and Andre Guettler, *The Use of Credit Default Swaps by U.S. Fixed-Income Mutual Funds*, FDIC Ctr. for Fin. Research, Working Paper No. 2011-01, (Nov. 19, 2010) ("Adam and Guettler Article"), *available at* http://www.fdic.gov/bank/analytical/cfr/2011/wp2011/CFR_WP_2011_01.pdf (study of the use of credit default swaps ("CDS") by the largest 100 U.S. corporate bond funds between 2004 and 2008 reflects an increase from about 20% of funds using credit default swaps in 2004 to 60% of funds using them in 2008; among CDS users, the average size of CDS positions (measured by their notional values) increased from 2% to almost 14% of a fund's NAV over the same period, with the CDS positions representing less than 10% of NAV for most funds, but with some funds exceeding this level by a wide margin, particularly in 2008; CDS are predominantly used to increase a fund's exposure to credit risks (net sellers of CDS) rather than to hedge credit risk (net buyers); the frequency of credit default swap usage by the largest bond funds is comparable to that of most hedge funds), *available at* http://www.fdic.gov/bank/analytical/cfr/2011/wp2011/CFR_WP_2011_01.pdf; *Assess the Risks: Key Strategies for Overseeing Derivatives*, Board IQ at 1 (Jan. 15, 2008) ("In recent years, the use of derivatives by mutual funds has soared."), *available at*

to initiate a review of funds' use of derivatives under the Investment Company Act.[8] The staff generally has been exploring the benefits, risks, and costs associated with funds' use of derivatives. The staff also has been exploring issues relating to the use of derivatives by funds such as: whether current market practices involving derivatives are consistent with the leverage, concentration, and diversification provisions of the Investment Company Act; whether funds that rely substantially upon derivatives, particularly those that seek to provide leveraged returns, maintain and implement adequate risk management and other procedures in light of the nature and volume of their derivatives investments; whether funds' boards of directors are providing appropriate oversight of the use of derivatives by the funds; whether existing rules sufficiently address matters such as the proper procedures for a fund's pricing and liquidity determinations regarding its derivatives holdings; whether existing prospectus disclosures adequately address the particular risks created by derivatives; and whether funds' derivative activities should be subject to any special reporting requirements.

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http://www.interactivedata.com/uploads/BoardIQ1207.pdf; 2008 JPMorgan Article, *supra* note 6.

8 In a press release issued in March 2010, the Commission announced that the staff was conducting a review to evaluate the use of derivatives by mutual funds, registered exchange-traded funds ("ETFs"), and other investment companies. The press release indicated that the review would examine whether and what additional protections are necessary for those funds under the Investment Company Act. The press release further indicated that pending completion of this review, the staff would defer consideration of exemptive requests under the Act relating to ETFs that would make significant investments in derivatives. *See* SEC Press Release 2010-45, *SEC Staff Evaluating the Use of Derivatives by Funds* (Mar. 25, 2010) ("2010 Derivatives Press Release"), *available at* http://www.sec.gov/news/press/2010/2010-45.htm. As part of the staff's review to evaluate fund use of derivatives, and to further enhance its knowledge of how funds are using, and managing their use of, derivatives, the staff met with industry groups as well as with some fund complexes that use OTC derivatives. The staff also reviewed fund disclosures relating to the use of derivatives and their risks. In addition, the staff considered *The Report of the Task Force on Investment Company Use of Derivatives and Leverage*, Committee on Federal Regulation of Securities, ABA Section of Business Law (July 6, 2010) ("2010 ABA Derivatives Report"), *available at* http://meetings.abanet.org/webupload/commupload/CL410061/sitesofinterest_files/DerivativesTF_July_6_2010_final.pdf.

A. Purpose and Scope of the Concept Release

The goal of the Commission's and staff's review is to evaluate whether the regulatory framework, as it applies to funds' use of derivatives, continues to fulfill the purposes and policies underlying the Act and is consistent with investor protection. The purpose of this concept release is to assist with this review and solicit public comment on the current regulatory regime under the Act as it applies to funds' use of derivatives. We intend to use the comments to help determine whether regulatory initiatives or guidance are needed to improve the current regulatory regime and the specific nature of any such initiatives.[9]

A fund that invests in derivatives must take into consideration various provisions of the Investment Company Act and Commission rules under the Act. The fund must consider the leverage limitations of section 18 of the Investment Company Act, which governs the extent to which a fund may issue "senior securities."[10] A fund's use of derivatives also may raise issues under Investment Company Act provisions governing diversification,[11] concentration,[12] investing

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9 Section 2(c) of the Investment Company Act provides that "[w]henever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is consistent with the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

10 *See* sections 18(a)(1) and 18(f)(1) of the Investment Company Act. *See also Securities Trading Practices of Registered Investment Companies*, Investment Company Act Release No. 10666 (Apr. 18, 1979) ("Release 10666") [44 FR 25128 (Apr. 27, 1979)], and *Registered Investment Company Use of Senior Securities–Select Bibliography* ("Senior Security Bibliography"), *available at* http://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm (prepared by the staff). *See also* discussion *infra* at Section II. (Derivatives under the Senior Securities Restrictions of the Investment Company Act).

11 *See* sections 5(b)(1) and 13(a)(1) of the Investment Company Act. *See also infra* discussion at Section III. (Derivatives under the Investment Company Act's Diversification Requirements).

12 *See* sections 8(b)(1)(E) and 13(a)(3) of the Investment Company Act. *See also* Form N-1A, Item 4(a), instruction 4 to Item 9(b)(1), and Item 16(c)(1)(iv); Form N-2, Item 8.2.b (2), and Item 17.2.e. *See also infra* discussion at Section V. (Portfolio Concentration).

in certain types of securities-related issuers,[13] valuation,[14] and accounting and financial statement reporting,[15] among others,[16] as well as under applicable disclosure provisions.[17]

Derivatives generally entail the potential for leveraged future gains and/or losses that may significantly impact the overall risk/reward profile of a fund. Applying the Act's provisions relating to diversification, concentration, and investments in securities-related issuers, among others, may require determining what value to assign to the derivative and which of the derivative's multiple exposures should be measured for purposes of the relevant provision. This determination may be complex because there are at least two potential measures of the "value"[18]

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13 *See* section 12(d)(3) of the Investment Company Act and rule 12d3-1 thereunder. *See also infra* discussion at Section IV. (Exposure to Securities-Related Issuers Through Derivatives).

14 *See* section 2(a)(41) of the Investment Company Act. *See also Restricted Securities*, Investment Company Act Release No. 5847 (Oct. 21, 1969) [35 FR 19989 (Dec. 31, 1970)] ("ASR 113"), *available at* http://www.sec.gov/rules/interp/1969/ic-5847.pdf; *Accounting for Investment Securities by Registered Investment Companies*, Investment Company Act Release No. 6295 (Dec. 23, 1970) [35 FR 19986 (Dec. 31, 1970)] ("ASR 118"), *available at* http://www.sec.gov/rules/interp/1970/ic-6295.pdf. *See also infra* discussion at Section VI. (Valuation of Derivatives).

15 *See generally* section 30(e) of the Investment Company Act.

16 *See, e.g.*, Investment Company Act provisions relating to custody (section 17(f) and related rules), and fund names (section 35(d) and rule 35d-1). Also, an open-end fund should consider the effect that the use of derivatives may have on the liquidity of the fund's portfolio. For general guidance on liquidity and open-end funds, *see, e.g., Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145*, Investment Company Act Release No. 17452 (Apr. 23, 1990) [55 FR 17933 (Apr. 30, 1990)], *available at* http://www.sec.gov/rules/final/1990/33-6862.pdf. *See also Revisions of Guidelines*, Investment Company Act Release No. 18612 (Mar. 12, 1992) [57 FR 9828 (Mar. 20, 1992)], *available at* http://www.sec.gov/rules/other/1992/33-6927.pdf.

17 *See, e.g.*, section 8(b) of the Investment Company Act, and Items 4(a), 4(b), 9(b), 9(c), and 16(b) of Form N-1A. Certain derivatives-related disclosure issues were discussed in a 2010 staff letter to the ICI. *See Derivatives-Related Disclosures by Investment Companies*, Letter from Barry D. Miller, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Karrie McMillan, General Counsel, ICI (July 30, 2010) ("2010 Staff Derivatives Disclosure Letter"), *available at* http://www.sec.gov/divisions/investment/guidance/ici073010.pdf.

18 The Bank for International Settlements (the "BIS") reports gross market values (positive and negative) for open derivative contracts, which are defined as "the sums of the absolute values of all open contracts with either positive or negative replacement values evaluated at market prices prevailing at the reporting date. Thus, the gross positive market value of a dealer's outstanding

of a derivative for purposes of applying various provisions of the Act: the current market value or fair value reflecting the price at which the derivative could be expected to be liquidated; and the notional amount reflecting the contract size (number of units per contract) multiplied by the current unit price of the reference asset on which payment obligations are calculated.[19] In

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contracts is the sum of the replacement values of all contracts that are in a current gain position to the reporter at current market prices . . . The gross negative market value is the sum of the values of all contracts that have a negative value on the reporting date. . . ." *Guide to the International Financial Statistics*, Bank for International Settlements (July 2009) ("BIS Guide") at 31, *available at* http://www.bis.org/statistics/intfinstatsguide.pdf. *See also* Sarah Sharer Curley and Elizabeth Fella, *Where to Hide? How Valuation of Derivatives Haunts the Courts – Even After BAPCPA*, 83 Am. Bankr. L.J. 297, 298-99 (Spring 2009)("In a simple interest rate swap... [t]he value of the swap is the net difference between the present value of the payments each party expects to receive and the present value of the payments each party expects to make. The value is generally zero to each party at the inception of the swap, and becomes positive to one party and negative to the other depending on what direction the interest rates move."); *CFTC Glossary, Mark-to-Market Definition, available at* http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm (stating that marking to market is accomplished for a futures or option contract by "calculating the gain or loss in each contract position resulting from changes in the price of the contracts at the end of each trading session. These amounts are added or subtracted to each account balance.").

19 The BIS describes "notional amounts outstanding" as "a reference from which contractual payments are determined in derivatives markets." BIS Guide, *supra* note 18, at 30. "Notional value" can be defined as "the value of a derivative's underlying assets at the spot price." In the case of an options or futures contract, the notional value is the number of units of an asset underlying the contract, multiplied by the spot price of the asset. *See* www.investorwords.com/5930/notional-value.htm. The "spot price" of a derivative's underlying asset is the asset's price for immediate delivery, *i.e.*, in the current market, in contrast with the asset's future or forward price. *See, e.g.*, Hull, *supra* note 3, at 789. "Notional value" is also defined as "the underlying value (face value), normally expressed in U.S. dollars, of the financial instrument or commodity specified in a futures or options on futures contract." *See CME Group Glossary, available at* http://www.cmegroup.com/education/glossary.html. "'Notional principal' or 'notional amount' of a derivative contract is a hypothetical underlying quantity upon which interest rate or other payment obligations are computed." ISDA Online Product Descriptions and Frequently Asked Questions at http://www.isda.org/educat/faqs.html#7. *See also* Hull, *supra* note 3, at 786 ("Notional principal" is the "principal used to calculate payments in an interest rate swap. The principal is 'notional' because it is neither paid nor received"); Frank J. Fabbozzi, et al., *Introduction to Structured Finance*, at 27 (2006) ("[In an interest rate swap] [t]he dollar amount of the interest payments exchanged is based on some predetermined dollar principal, which is called the *notional amount*.") (italics in original); 2010 ABA Derivatives Report, *supra* note 8, at n.11 (noting that the term "notional amount" is used differently by different people in different contexts, but is used, in the Report, to refer to "the nominal or face amount that is used to calculate payments made on a particular instrument, without regard to whether its obligation under the instrument could be netted against the obligation of another party to pay the fund under the instrument.").

addition, derivatives often create exposures to multiple variables, such as the credit of a counterparty as well as to a reference asset on which the derivative is based.

The Commission or its staff, over the years, has addressed a number of issues relating to derivatives on a case-by-case basis. The Commission now seeks to take a more comprehensive and systematic approach to derivatives-related issues under the Investment Company Act. In particular, in this release the Commission discusses and seeks comment on the following issues, among others, relating to funds' use of derivatives:[20]

- the attendant costs, benefits and risks;
- the application of the Act's prohibitions and restrictions on senior securities and leverage;
- the application of the Act's prohibition on investments in securities-related issuers;
- the application of the Act's provisions concerning portfolio diversification and concentration; and
- the application of the Act's provisions governing valuation of funds' assets.

In addition to the specific issues highlighted for comment, the Commission invites members of the public to address any other matters that they believe are relevant to the use of derivatives by funds.

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20 The Commission recognizes that there are other significant derivatives-related issues under the Investment Company Act that this release does not address, such as disclosure-related issues, which the Commission may consider at a later date.

B. Background Concerning the Use of Derivatives by Funds

As noted above, derivatives may be broadly defined to include instruments or contracts whose value is based upon, or derived from, some reference asset. Reference assets can include, for example, stocks, bonds, commodities, currencies, interest rates, market indices, currency exchange rates, or other assets or interests, in virtually endless variety.[21]

Derivatives are often characterized as either exchange-traded or OTC.[22] Exchange-traded derivatives – such as futures, certain options,[23] and options on futures[24] – are standardized contracts traded on regulated exchanges, such as the Chicago Mercantile Exchange and the Chicago Board Options Exchange. OTC derivatives – such as swaps,[25] non-exchange traded

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21 For example, the reference asset of a Standard & Poor's ("S&P") 500 futures contract is the S&P 500 index. 2008 IDC Report, *supra* note 3, at Appendix C at C5.

22 *See, e.g.,* Robert W. Kolb & James A. Overdahl, *Financial Derivatives,* at 21 (2010) ("Kolb & Overdahl").

23 An option is the right to buy or sell an asset. There are two basic types of options, a "call option" and a "put option." A call option gives the holder the right (but does not impose the obligation) to buy the underlying asset by a certain date for a certain price. The seller, or "writer," of a call option has the obligation to sell the underlying asset to the holder if the holder exercises the option. A put option gives the holder the right (but does not impose the obligation) to sell the underlying asset by a certain date for a certain price. The seller, or "writer," of a put option has the obligation to buy from the holder the underlying asset if the holder exercises the option. The price that the option holder must pay to exercise the option is known as the "exercise" or "strike" price. The amount that the option holder pays to purchase an option is known as the "option premium," "price," "cost," or "fair value" of the option. For a basic explanation of options, *see, e.g.,* Hull, *supra* note 3, at 6-8, 179-236, and Kolb & Overdahl, *supra* note 22, at 13-16.

24 Options on futures generally trade on the same exchange as the relevant futures contract. When a call option on a futures contract is exercised, the holder acquires from the writer a long position in the underlying futures contract plus a cash amount equal to the excess of the futures price over the strike price. When a put option on a futures contract is exercised, the holder acquires a short position in the underlying futures contract plus a cash amount equal to the excess of the strike price over the futures price. *See, e.g.,* Hull, *supra* note 3, at 184, 341-54, and 782.

25 A "swap" is generally an agreement between two counterparties to exchange periodic payments based upon the value or level of one or more rates, indices, assets, or interests of any kind. For example, counterparties may agree to exchange payments based on different currencies or interest rates. *See generally, e.g.,* Kolb & Overdahl, *supra* note 22, at 11-13; Hull, *supra* note 3, at 147-73. *See also* section 3(a)(69) of the Exchange Act for the definition of "swap" (using the definition in section 1a of the Commodity Exchange Act, 7 U.S.C. 1a (the "CEA")); section 3(a)(68) of the Exchange Act for the definition of "security-based swap;" section 721(a)(3) of the

options, and combination products such as swaptions[26] and forward swaps[27] – are contracts negotiated and entered into outside of an organized exchange. Unlike exchange-traded derivatives, OTC derivatives may be significantly customized, and may not be guaranteed by a central clearing organization. OTC derivatives that are not centrally cleared, therefore, may involve greater counterparty credit risk, and may be more difficult to value, transfer, or liquidate than exchange-traded derivatives.[28] The Dodd-Frank Act and Commission rules thereunder seek to establish a comprehensive new regulatory framework for two broad categories of derivatives – swaps and security-based swaps – designed to reduce risk, increase transparency, and promote market integrity within the financial system.[29]

Dodd-Frank Act, *supra* note 2, for the definition of "cleared swap;" and section 721(a)(12) of the Dodd-Frank Act for the definition of "foreign exchange swap." *See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement;" Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* Securities Act Release No. 9204 (Apr. 29, 2011) [76 FR 29818 (May 23, 2011)] ("Swap Definition Release"), *available at* http://www.sec.gov/rules/proposed/2011/33-9204.pdf.

26 A "swaption" is an option to enter into an interest rate swap where a specified fixed rate is exchanged for a floating rate. *See, e.g.,* Hull, *supra* note 3, at 172, 658-62, 790.

27 A forward swap (or deferred swap) is an agreement to enter into a swap at some time in the future. *See* Swap Definition Release, *supra* note 25, at n. 147. *See also, e.g.,* Hull, *supra* note 3, at 171, 779 ("deferred swap").

28 An OTC derivative may be more difficult to transfer or liquidate than an exchange-traded derivative because, for example, an OTC derivative may provide contractually for non-transferability without the consent of the counterparty, or may be sufficiently customized that its value is difficult to establish or its terms too narrowly drawn to attract transferees willing to accept assignment of the contract, unlike most exchange-traded derivatives.

29 The Dodd-Frank Act, *supra* note 2, was signed into law on July 21, 2010. The Dodd-Frank Act mandates, among other things, substantial changes in the OTC derivatives markets, including new clearing, reporting, and trade execution mandates for swaps and security-based swaps, and both exchange-traded and OTC derivatives are contemplated under the new regime. *See* Dodd-Frank Act sections 723 (mandating clearing of swaps) and 763 (mandating clearing of security-based swaps). Some of these changes will require Commission action through rulemaking to become effective. *See Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps,* Exchange Act Release No. 64678 (June 15, 2011) [76 FR 36287 (June 22, 2011)], *available at* http://www.sec.gov/rules/exorders/2011/34-64678.pdf. For summaries of other recent, pending, and future Commission and staff initiatives relating to derivatives, *see, e.g., Testimony on Enhanced Oversight after the Financial Crisis: The Wall Street Reform Act at One-*

A common characteristic of most derivatives is that they involve leverage.[30] Certain derivatives investments entered into by a fund, such as futures contracts, swaps, and written options, create obligations, or potential indebtedness, to someone other than the fund's shareholders, and enable the fund to participate in gains and losses on an amount that exceeds the fund's initial investment.[31] Other derivatives entered into by a fund, such as purchased call options, provide the economic equivalent of leverage because they convey the right to a gain or loss on an amount in excess of the fund's investment but do not impose a payment obligation on the fund above its initial investment.[32]

Year, by Chairman Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission, before the United States Senate Committee on Banking, Housing and Urban Affairs (July 21, 2011), *available at* http://www.sec.gov/news/testimony/2011/ts072111mls.htm. *See also, e.g.*, http://www.sec.gov/spotlight/dodd-frank/accomplishments.shtml#derivatives; http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#07-12-12; http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#08-12-11; http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#01-06-12; http://www.sec.gov/news/press/2011/2011-137.htm; http://www.sec.gov/rules/other/2011/34-64926.pdf; and http://www.sec.gov/spotlight/dodd-frank/derivatives.shtml.

30 The Commission has stated that "[l]everage exists when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return." Release 10666, *supra* note 10, at n. 5.

31 The leverage created by such an arrangement is sometimes referred to as "indebtedness leverage." 1994 Report, *supra* note 3, at 22.

32 This type of leverage is sometimes referred to as "economic leverage." *See* 1994 Report, *supra* note 3, at 23 ("Other derivatives provide the economic equivalent of leverage because they display heightened price sensitivity to market fluctuations . . . such as changes in stock prices or interest rates. In essence, these derivatives magnify a fund's gain or loss from an investment in much the same way that incurring indebtedness does."). The 1994 Report gives a leveraged inverse floating rate bond, with an interest rate that moves inversely to a benchmark rate, as another example of an instrument that displays economic leverage. *See also* 2010 ABA Derivatives Report, *supra* note 8, at 20-21 (discussion of "implied" or "economic" leverage"). For additional discussion of the leveraging effects of derivatives (not limited to "economic leverage"), *see* 2010 ABA Derivatives Report, *supra* note 8, at 8-9. *See also* 2008 IDC Report, *supra* note 3, at 3 ("Market participants are able to acquire exposure (either long or short) to a large dollar amount of an asset (the notional value) with only a small down payment, enabling parties to shift risk more efficiently and with lower costs. The leverage inherent in these instruments magnifies the effect of changes in the value of the underlying asset on the initial amount of capital invested. For example, an initial 5% collateral deposit on the total value of the commodity would result in 20:1 leverage, with a potential 80% loss (or gain) of the collateral in

Funds use derivatives to implement their investment strategies, and to manage risk.[33] A fund may use derivatives to gain, maintain, or reduce exposure to a market, sector, or security more quickly and/or with lower transaction costs and portfolio disruption than investing directly through the securities markets. At the same time, use of derivatives may entail risks relating, for example, to leverage, illiquidity (particularly with respect to complex OTC derivatives), and counterparty risk, among others.[34] A fund's use of derivatives presents challenges for its investment adviser and board of directors to ensure that the derivatives are employed in a manner consistent with the fund's investment objectives, policies, and restrictions, its risk profile, and relevant regulatory requirements, including those under federal securities laws. With respect to some primary types of reference assets, funds may use derivatives for the following purposes, among others:

- Currency derivatives.[35] A fund may use currency derivatives to increase or decrease exposure to specific currencies, to hedge against adverse impacts on the

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response to a 4% movement in the market price of the underlying commodity.").

33 2008 IDC Report, *supra* note 3, at 7-11. A fund may also use derivatives to hedge current portfolio exposures (for example, when a fund's portfolio is structured to reflect the fund's long-term investment strategy and its investment adviser's forecasts, interim events may cause the fund's investment adviser to seek to temporarily hedge a portion of the portfolio's broad market, sector, and/or security exposures). Industry participants believe that derivatives may also provide a more efficient hedging tool than reducing exposure by selling individual securities, offering greater liquidity, lower round-trip transaction costs, lower taxes, and reduced disruption to the portfolio's longer-term positioning. *See id.* at 11.

34 *See, e.g.*, 2008 IDC Report, *supra* note 3, at 12-13. *See also* 2008 JPMorgan Article, *supra* note 6.

35 *See* Swap Definition Release, *supra* note 25, at II.C.1, for a description of certain currency derivatives (foreign exchange swaps, foreign exchange forwards, foreign currency options, non-deliverable forwards, currency swaps, and cross-currency swaps). The 2010 ABA Derivatives Report, *supra* note 8 at 6-7, gives as examples of currency derivatives forward currency contracts, currency futures contracts, currency swaps, and options on currency futures contracts. As a general matter, futures, forwards, swaps, and options can all be used to increase or decrease exposures to reference currencies. A fund's investment adviser selects the particular instrument

fund's portfolio caused by currency fluctuations, and to seek additional returns. For example, currency derivatives can provide a hedge against the risk that a fund's investment in a foreign debt security will decline in value because of a decline in the value of the foreign currency in which the foreign debt security is denominated.[36] Funds also may use currency derivatives to hedge against a rise in the value of a foreign currency, or may use "cross-currency" hedging or "proxy" hedging when, for instance, it is difficult or expensive to hedge a particular currency against the U.S. dollar.[37] Apart from hedging, funds may use currency derivatives to seek returns on the basis of anticipated changes in the relative values of two currencies.[38]

- <u>Interest rate derivatives.</u>[39] A fund may use interest rate derivatives to modify its exposure to the gains or losses arising from changes in interest rates and to seek enhanced returns. For example, a fund may use an interest rate swap to hedge against the risk of a decline in the prices of bonds owned by a fund due to rising

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based on the level and type of exposure the adviser seeks to obtain and the costs that are associated with the particular instrument.

36 For example, if a fund enters into a short currency forward (which obligates the fund to sell the currency at a future date, at a predetermined price, and in the currency in which the foreign debt security is denominated), the fund's exposure to a decline in the value of the currency is reduced. *See* 2010 ABA Derivatives Report, *supra* note 8, at 6.

37 For example, a fund may use a forward contract on one foreign currency (or a basket of foreign currencies) to hedge against adverse changes in the value of another foreign currency (or basket of currencies). *See id.*

38 *Id.* at 7.

39 Interest rate derivatives include interest rate or bond futures, Eurodollar futures, caps, floors, overnight indexed swaps, interest rate swaps, and options on futures and swaps. *See, e.g., id. See also* Swap Definition Release, *supra* note 25, at III.B.1 (briefly describing interest and other monetary rate swaps, and discussing that when payments exchanged under a Title VII (of the Dodd-Frank Act) instrument are based solely on the levels of certain interest rates or other monetary rates that are not themselves based on securities, the instrument would be a swap but not a security-based swap.).

interest rates. Similarly, a fund could shorten the duration of its portfolio by selling futures contracts on U.S. Treasury bonds or notes, or Eurodollar futures. Apart from hedging, a fund might use interest rate derivatives to seek to enhance its returns based on its investment adviser's views concerning future movements in interest rates or changes in the shape of the yield curve.[40]

- Credit Derivatives.[41] Credit derivatives allow a fund to assume an investment position concerning the likelihood that a particular bond, or a group of bonds, will be repaid in full upon maturity. When a fund purchases credit protection, it pays a premium to a counterparty in return for which the counterparty promises to pay the fund if a bond or bonds default or experience some other adverse credit event. When a fund sells (or writes) credit protection, the fund agrees to pay a counterparty if a bond or bonds default or experience some other adverse credit event, in exchange for the receipt of a premium from the protection purchaser. A fund may purchase credit protection using credit derivatives to hedge against particular risks that are associated with a bond that it owns, such as the risk that the bond issuer will default, a rating agency will downgrade the bond or the credit of the counterparty, or the risk that credit "spread" will increase.[42] A fund may sell (or write) credit protection to enhance its income and return by the amount of

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40 For example, if a fund's investment adviser believes that the London Interbank Offered Rate ("LIBOR") will decrease compared to a federal funds rate, the adviser could enter into an interest rate swap whereby the fund would be obligated to make payments based upon the application of LIBOR to an agreed notional amount in exchange for payments from the counterparty based upon the application of the federal funds rate to the notional amount. 2010 ABA Derivatives Report, *supra* note 8, at 7.

41 Credit derivatives include single-name and index-linked (or basket) credit default swaps. *See, e.g.*, *id.* at 7-8. For additional description of CDS, *see* Swap Definition Release, *supra* note 25, at III.G.3.

42 *See* 2010 ABA Derivatives Report, *supra* note 8, at 7.

the payment that it receives for providing such protection, or to obtain some investment exposure to the reference asset (that is, the underlying bond), without owning the bond. The Commission understands that selling protection may be more cost effective than an outright purchase of a bond.[43]

- Equity Derivatives.[44] Funds may use equity derivatives to enhance investment opportunities (for example, by using foreign index futures to obtain exposure to a foreign equity market). Equity derivatives also can be used by funds as an income-producing strategy by, for example, selling equity call options on a particular security owned by the fund.[45] A fund also may use equity derivatives (usually stock index futures) to "equitize" cash.[46]

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43 *See id.* at 8. The 2010 ABA Derivatives Report, *supra* note 8, at 8, also observes that "a fund could write a CDS, offering credit protection to its counterparty. In doing so the fund gains the economic equivalent of owning the security on which it wrote the CDS, while avoiding the transaction costs that would have been associated with the purchase of the security."

44 Equity derivatives include equity futures contracts, options on equity futures contracts, equity options, and various kinds of equity-related swaps (such as a total return swap on an equity security). *See, e.g., id.* at 8.

45 By selling the options, a fund can earn income (in the form of the premium received for writing the option) while at the same time permitting the fund to sell the underlying equity securities at a targeted price set by the fund's investment adviser. *See, e.g., id.*

46 As an example of "equitizing" cash, the 2010 ABA Derivatives Report, *supra* note 8, at 8, states that:

> [W]hen a fund has a large cash position for a short amount of time, the fund can acquire long futures contracts to retain (or gain) exposure to the relevant equity market. When the futures contracts are liquid (as is typically the case for broad market indices), the fund can eliminate the position quickly and frequently at lower costs than had the fund actually purchased the reference equity securities.

C. Request for Comment

The Commission generally requests data and comment on the types of derivatives used by funds, the purposes for which funds use derivatives, and whether funds' use of derivatives has undergone or may be undergoing changes and, if so, the nature of such changes. The Commission specifically requests comment on the following:

- What are the costs and benefits to funds from the use of derivatives? What are the factors that influence those costs and benefits? What are the risks to funds from investing in derivatives? What role does or could collateral used in derivatives transactions play in mitigating the concerns relating to the use of derivatives? Please be specific and provide data or statistics, if possible.
- Do different types of funds use different types of derivatives or use derivatives for different purposes? If so, what are the differences in the types of funds that account for the differences in their use of derivatives? For example, do BDCs use derivatives in a manner different from other funds and, if so, how and what are the differences?
- How do ETFs use derivatives? Do they use derivatives for the same purposes that other open-end funds use them? Does an ETF's use of derivatives raise unique investor protection concerns under the Investment Company Act?

II. DERIVATIVES UNDER THE SENIOR SECURITIES RESTRICTIONS OF THE INVESTMENT COMPANY ACT

In this section, the Commission discusses the limitations on senior securities imposed by section 18 of the Investment Company Act, summarizes related Commission and staff guidance, discusses certain alternative approaches, and highlights issues for comment.

A. Purpose, Scope, and Application of the Act's Senior Securities Limitations

1. Statutory Restrictions on Senior Securities and Related Commission Guidance

The protection of investors against the potentially adverse effects of a fund's issuance of "senior securities"[47] is a core purpose of the Investment Company Act.[48] Congress' concerns underlying the limitations in section 18 included, among others: (i) potential abuse of the purchasers of senior securities;[49] (ii) excessive borrowing and the issuance of excessive amounts of senior securities by funds which increased unduly the speculative character of their junior securities;[50] and (iii) funds operating without adequate assets and reserves.[51] To address these concerns, section 18(f)(1) of the Investment Company Act prohibits an open-end fund[52] from issuing or selling any "senior security" other than borrowing from a bank, and unless it maintains 300% "asset coverage."[53] Section 18(a)(1) of the Investment Company Act prohibits a closed-

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47 Section 18(g) of the Investment Company Act defines "senior security," in part, as "any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness," and "any stock of a class having priority over any other class as to the distribution of assets or payment of dividends." The definition excludes certain limited temporary borrowings.

48 *See, e.g.,* Investment Company Act sections 1(b)(7), 1(b)(8), 18(a), and 18(f). *See also, e.g.,* 1994 Report, *supra* note 3, at 20-22.

49 *See* Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess., pt. 1, 265-78 (1940) ("Senate Hearings"). *See also* 1994 Report, *supra* note 3, at 21 (describing the practices in the 1920s and 1930s that gave rise to section 18's limitations on leverage, and specifically discussing the potential abuse of senior security holders).

50 *See* section 1(b)(7) of the Investment Company Act. *See also, e.g.,* Release 10666, *supra* note 10, at n. 8.

51 *See* section 1(b)(8) of the Investment Company Act; Release 10666, *supra* note 10, at n. 8.

52 Section 5(a)(1) of the Investment Company Act defines "open-end company" as "a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer."

53 "Asset coverage" of a class of securities representing indebtedness of an issuer generally is defined in section 18(h) of the Investment Company Act as "the ratio which the value of the total assets of such issuer, less all liabilities and indebtedness not represented by senior securities,

end fund[54] from issuing or selling any "senior security that represents an indebtedness" unless it has at least 300% "asset coverage."[55]

In a 1979 General Statement of Policy (Release 10666), the Commission considered the application of section 18's restrictions on the issuance of senior securities to reverse repurchase agreements, firm commitment agreements, and standby commitment agreements.[56] The Commission concluded that such agreements, while not securities for all purposes,[57] may involve the issuance of senior securities and "fall within the functional meaning of the term 'evidence of

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bears to the aggregate amount of senior securities representing indebtedness of such issuer."

54 Section 5(a)(2) of the Investment Company Act defines "closed-end company" as "any management company other than an open-end company."

55 Section 18(a)(1)(A). A BDC is also subject to the limitations of section 18(a)(1)(A) to the same extent as if it were a closed-end investment company except that the applicable asset coverage amount is 200%. *See* Investment Company Act section 61(a)(1).

56 As described in Release 10666, *supra* note 10, in a typical reverse repurchase agreement, the fund transfers possession of a debt security, often to a broker-dealer or a bank, in return for a percentage of the market value of the security ("proceeds"), but retains record ownership of, and the right to receive interest and principal payments on, the security. At a stated future date, the fund repurchases the security and remits to the counterparty the proceeds plus interest. *Id.* at nn. 2-3 and accompanying text. A firm commitment agreement (also known as a "when-issued security" or a "forward contract") is a buy order for delayed delivery in which a fund agrees to purchase a debt security from a seller (usually a broker-dealer) at a stated future date, price, and fixed yield. *Id.* at text accompanying n. 12. A standby commitment agreement is a delayed delivery agreement in which a fund contractually binds itself to accept delivery of a debt security with a stated price and fixed yield upon the exercise of an option held by the counterparty to the agreement at a stated future date. *Id.* at discussion of "Standby Commitment Agreements."

57 Release 10666, *supra* note 10, at "The Agreements as Securities" discussion. The Commission notes, however, that the Investment Company Act's definition of the term "security" is broader than the term's definition in other federal securities laws. *Compare* section 2(a)(36) of the Investment Company Act with sections 2(a)(1) and 2A of the Securities Act and sections 3(a)(10) and 3A of the Exchange Act. For example, the definition of "security" in the Investment Company Act includes any "evidence of indebtedness," which is not included in the definition of "security" in section 3(a)(10) of the Exchange Act. Further, the Commission has interpreted the term "security" in light of the policies and purposes underlying the Act. For example, the brief for the United States as Amicus Curiae in *Marine Bank v. Weaver*, No. 80-1562, 1980 U.S. Briefs 1562 (Oct. Term, 1980) (July 29, 1981) ("Marine Bank v. Weaver Amicus Brief") stated that the issue of whether a particular instrument is a "security" depends on the context, including the statute being applied, and further stated that the Investment Company Act "presents a significantly different context" (*i.e.*, the regulation of the operation and management of investment companies) than the context of the Securities Act and the Exchange Act (*i.e.*, the issuance or trading of such securities). Marine Bank v. Weaver Amicus Brief at 38, 40.

indebtedness' for purposes of section 18 of the Act," which generally would include "all contractual obligations to pay in the future for consideration presently received."[58] Further, the Commission stated that "trading practices involving the use by investment companies of such agreements for speculative purposes or to accomplish leveraging fall within the legislative purposes of Section 18."[59] The Commission also explained that:

> [l]everage exists when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return.... Through a reverse repurchase agreement, an investment company can achieve a return on a very large capital base relative to its cash contribution. Therefore, the reverse repurchase agreement is a highly leveraged transaction.[60]

Leveraging of a fund's portfolio through the issuance of senior securities "magnifies the potential for gain or loss on monies invested and, therefore, results in an increase in the speculative character of the investment company's outstanding securities."[61] Each of the agreements discussed by the Commission in Release 10666 – the reverse repurchase agreement, the firm commitment agreement, and the standby commitment agreement – "may be a substantially higher risk investment" than direct investment in the underlying securities "because of the additional risk of loss created by the substantial leveraging in each agreement, and in light of the volatility of interest rates in the marketplace."[62]

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58 Release 10666, *supra* note 10, at "The Agreements as Securities" discussion.

59 *Id.*.

60 *Id.* at n. 5 (citation omitted).

61 *Id.* at text accompanying n. 5.

62 *Id.* at discussion of "The Agreements as Securities." The Commission also stated that, "[t]he gains and losses from the transactions can be extremely large relative to invested capital; for this reason, each agreement has speculative aspects. Therefore, it would appear that the independent investment decisions involved in entering into such agreements, which focus on their distinct risk/return characteristics, indicate that, economically as well as legally, the agreements should be treated as securities separate from the underlying Ginnie Maes for purposes of Section 18 of the

In Release 10666, the Commission further stated that, although reverse repurchase agreements, firm commitment agreements, and standby commitment agreements are functionally equivalent to senior securities, these and similar arrangements nonetheless could be used by funds in a manner that would not warrant application of the section 18 restrictions. The Commission noted that in circumstances involving similar economic effects, such as short sales of securities by funds, our staff had determined that the issue of section 18 compliance would not be raised if funds "cover" senior securities by maintaining "segregated accounts."[63] The Commission stated that the use of segregated accounts "if properly created and maintained, would limit the investment company's risk of loss."[64] To avail itself of the segregated account approach, a fund could establish and maintain with the fund's custodian a segregated account containing liquid assets, such as cash, U.S. government securities, or other appropriate high-grade debt obligations, equal to the indebtedness incurred by the fund in connection with the senior security ("segregated account approach").[65] The amount of assets to be segregated with respect to reverse repurchase agreements lacking a specified repurchase price would be the value of the proceeds received plus accrued interest; for reverse repurchase agreements with a specified repurchase price, the amount of assets to be segregated would be the repurchase price; and for firm and standby commitment agreements, the amount of assets to be segregated would

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Act." *Id.*

63 Release 10666, *supra* note 10, at text accompanying n. 15.

64 *Id.* at discussion of "Segregated Account."

65 The Commission stated that, under the segregated account approach, the value of the assets in the segregated account should be marked to the market daily, additional assets should be placed in the segregated account whenever the total value of the account falls below the amount of the fund's obligation, and assets in the segregated account should be deemed frozen and unavailable for sale or other disposition. *See id.* The Commission also cautioned that as the percentage of a fund's portfolio assets that are segregated increases, the fund's ability to meet current obligations, to honor requests for redemption, and to manage properly the investment portfolio in a manner consistent with stated its investment objective may become impaired. *Id.*

be the purchase price.[66] As the Commission stated in Release 10666, the segregated account functions as "a practical limit on the amount of leverage which the investment company may undertake and on the potential increase in the speculative character of its outstanding common stock," and "will assure the availability of adequate funds to meet the obligations arising from such activities."[67]

2. Staff No-Action Letters Concerning the Segregated Account Approach[68]

Following the Commission's issuance of Release 10666, the Commission staff issued more than twenty no-action letters to funds concerning the maintenance of segregated accounts or otherwise "covering" their obligations in connection with certain senior securities, primarily interest rate futures, stock index futures, and related options.[69]

In a 1987 no-action letter issued to two Dreyfus funds, the staff summarized and expanded upon the methods by which, in its view, obligations could be covered by funds

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66 *Id.*

67 *Id.*

68 This release includes extensive discussion of staff no-action letters; accordingly the Commission notes that its discussion of staff statements is provided solely for background and to facilitate comment on issues that the Commission might address. The discussion is in no way intended to suggest that the Commission has adopted the analysis, conclusions or any other portion of the staff statements discussed here. Staff no-action letters are issued by the Commission staff in response to written requests regarding the application of the federal securities laws to proposed transactions. Many of the staff no-action letters are "enforcement-only" letters, in which the staff states whether it will recommend enforcement action to the Commission if the proposed transaction proceeds in accordance with the facts, circumstances and representations set forth in the requester's letter. Other staff no-action letters provide the staff's interpretation of a specific statute, rule or regulation in the context of a specific situation. *See Informal Guidance Program for Small Entities,* Investment Company Act Release No. 22587 (Mar. 27, 1997).

69 *See* "No-Action Letters and Releases from 1982–1985 Regarding Covering Futures and Options" at Senior Security Bibliography, *supra* note 10. (Certain of these letters also addressed the use of when-issued bonds, currency forwards, and other senior securities.)

transacting in futures, forwards, written options, and short sales.[70] The staff provided no-action assurance that the Dreyfus funds could:

- cover a long position in a futures or forward contract, or a written put option, by establishing a segregated account (not with a futures commission merchant or broker) containing cash or certain liquid assets equal to the purchase price of the contract or the strike price of the put option (less any margin on deposit); and
- cover short positions in futures or forward contracts, sales of call options, and short sales of securities by establishing a segregated account (not with a futures commission merchant or broker) with cash or certain liquid assets that, when added to the amounts deposited with a futures commission merchant or a broker as margin, equal the market value of the instruments or currency underlying the futures or forward contracts, call options, and short sales (but are not less than the strike price of the call option or the market price at which the short positions or short sales were established).[71]

The staff also provided no-action assurance that the Dreyfus funds could cover these transactions by owning, or holding the right to obtain, the instrument or cash that the fund has obligated itself to deliver. For example:

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70 Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC Staff No-Action Letter (June 22, 1987) ("Dreyfus no-action letter" or "Dreyfus Letter"), *available at* http://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm.

71 *But see* Robertson Stephens Investment Trust, SEC Staff No-Action Letter (Aug. 24, 1995), *available at* http://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm (the staff agreed not to recommend enforcement action where the value of the segregated account, to cover a short position in a security, was equal to the daily (fluctuating) market price of the security sold short (less certain amounts pledged with the broker as collateral), even if the value of the segregated account was less than the price at which the short position was established).

- a fund could cover a long position in a futures or forward contract by purchasing a put option on the same futures or forward contract with a strike price as high or higher than the price of the contract held by the fund; and
- a fund could cover a written put option by selling short the instruments or currency underlying the put option at the same or higher price than the strike price of the put option or, alternatively, by purchasing a put option with the strike price the same or higher than the strike price of the put option written by the fund.

The Commission staff has also discussed the types of assets that may be segregated and the manner in which, in the staff's view, segregation may be effected. In Release 10666, the Commission stated that the assets eligible to be included in segregated accounts should be "liquid assets," such as cash, U.S. government securities, or other appropriate high grade debt obligations. In a 1996 staff no-action letter issued to Merrill Lynch Asset Management, the staff took the position that a fund could cover its derivatives-related obligations by depositing any liquid asset, including equity securities and non-investment grade debt securities, in a segregated account.[72] In the Merrill Lynch no-action letter, the staff explained that, in the staff's view, segregating any type of liquid asset would be consistent with the purposes underlying the asset segregation approach because it would place a practical limit on the amount of leverage that a fund may undertake and on the potential increase in the speculative character of its outstanding shares.[73] With respect to the manner in which segregation may be effected, the Commission staff

72 Merrill Lynch Asset Management, L.P., SEC Staff No-Action Letter (July 2, 1996) ("Merrill Lynch no-action letter" or "Merrill Lynch Letter"), *available at* http://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm.

73 *Id.* The staff noted that "the type of asset placed in the segregated account would have no effect on the maximum amount of leverage that a fund can assume."

took the position that a fund could segregate assets by designating such assets on its books, rather than establishing a segregated account at its custodian.[74]

Asset segregation practices with respect to other derivatives investments have not been addressed by the Commission, or by the staff in no-action letters.[75] Certain swaps, for example, that settle in cash on a net basis, appear to be treated by many funds as requiring segregation of an amount of assets equal to the fund's daily mark-to-market liability, if any.[76] Similarly, some funds have disclosed that they segregate only their daily, mark-to-market liability, if any, with respect to futures and forward contracts that are contractually required to cash-settle.[77]

B. Alternative Approaches to the Regulation of Portfolio Leverage

1. The Current Asset Segregation Approach

As noted above, the segregated account approach serves both to limit a fund's potential leverage and to provide a source of payment of future obligations arising from the leveraged transaction. In determining the amount of assets required to be segregated to cover a particular instrument, the Commission and its staff have generally looked to the purchase or exercise price of the contract (less margin on deposit) for long positions and the market value of the security or other asset underlying the agreement for short positions, measured by the full amount of the

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74 *See* Dear Chief Financial Officer Letter from Lawrence A. Friend, Chief Accountant, Division of Investment Management (Nov. 7, 1997), *available at* http://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm.

75 Our discussion of current and past industry practices is not intended to indicate any Commission approval or disapproval of those practices.

76 *See, e.g.*, 2010 ABA Derivatives Report, *supra* note 8, at 13-14.

77 For a discussion of asset segregation practices involving futures and forwards that are contractually required to cash-settle, *see, e.g.*, *id.* at 14-15.

reference asset, *i.e.*, the notional amount of the transaction rather than the unrealized gain or loss on the transaction, *i.e.*, its current mark-to-market value.[78]

The segregated account approach has drawn criticism on several grounds. For example, we understand that some industry participants argue that the segregated account approach calls for an instrument-by-instrument assessment of the amount of cover required, further arguing that this may create uncertainty about the treatment of new products, and that new product development will inevitably lead to circumstances in which available guidance does not specifically address each new instrument subject to section 18 constraints. Other industry participants have argued that the staff's application of the segregated account approach results in differing treatment of arguably equivalent products.[79]

Others have argued that, with respect to the amount to be segregated, both notional amount and a mark-to-market amount have their limitations.[80] For example, for many futures contracts, the notional amount may, as a practical matter, exceed the maximum loss or total risk

78 *See* Release 10666, *supra* note 10, at discussion of "Segregated Account" (with regard to each reverse repurchase agreement that lacks a specified repurchase price, the fund should maintain in a segregated account "liquid assets equal in value to the proceeds received on any sale subject to repurchase plus accrued interest. If the reverse repurchase agreement has a specified repurchase price, the investment company should maintain in the segregated account an amount equal to the repurchase price, which price will already include interest charges." With regard to each firm commitment agreement, the fund should maintain in a segregated account "liquid assets equal in value to the purchase price due on the settlement date under the . . . agreement." With regard to each standby commitment agreement, the fund should maintain in a segregated account "liquid assets equal in value to the purchase price under the . . . agreement.").

79 They argue, for example, that a physically-settled and a cash-settled future or forward are equivalent products, and that segregation of the delivery obligation amount for a physically-settled future or forward, and segregation of the generally smaller mark-to-market liability amount for a cash-settled future or forward, constitutes different treatment of equivalent products. *See* the 2010 ABA Derivatives Report, *supra* note 8, at 14-15 for a discussion of cash-settled futures and forwards and the asset segregation treatment of those products.

80 *Id.* at 16-17.

on the contract.[81] Consequently, it is argued with respect to such derivatives that segregation of assets equal to the notional amount may limit the use of such derivative products and strategies that could potentially benefit funds and their investors. Conversely, it is argued that segregation of an amount equal to only the daily, mark-to-market liability, if any, with respect to cash-settled derivatives,[82] may fail to take into account potential future losses on such instruments. Consequently, it is argued that segregation of this amount may understate the risk of loss to the fund, permit the fund to engage in excessive leveraging, fail to adequately set aside sufficient assets to cover the fund's ultimate exposure, and, therefore, perhaps not adequately fulfill the purposes underlying the segregated account approach and section 18.[83]

The significant disparity between these two widely recognized measures – notional amount and mark-to-market amount – is illustrated by data relevant to actual swap positions held by funds. A recent study of the use of credit default swaps ("CDS") by a group of the 100 largest US corporate bond funds analyzed data relevant to the notional amount and "book value," *i.e.*, unrealized gains and losses, of the funds' CDS positions during the period 2004 through

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81 *See* BIS Guide, *supra* note 18, at 30, commenting in the context of OTC derivatives that "[n]ominal or notional amounts outstanding provide a measure of market size and a reference from which contractual payments are determined in derivatives markets. However, with the partial exception of credit default swaps, such amounts are generally not those truly at risk. The amounts at risk in derivatives contracts are a function of the price level and/or volatility of the financial reference index used in the determination of contract payments, the duration and liquidity of contracts and the creditworthiness of counterparties."

82 This is also a concern with respect to the coverage of short sales.

83 *See* 2010 ABA Derivatives Report, *supra* note 8, at 15 ("reducing the amount of assets subject to segregation increased the practical ability of funds to engage in derivatives on an increasing scale"), and at 16 (where only the mark-to-market liability, if any, is segregated, "a fund's exposure under a derivative contract could increase significantly on an intraday basis, resulting in the segregated assets being worth less than the fund's obligations (until the fund is able to place additional assets in the segregated account . . . .). To the extent that a fund relying on the Merrill Lynch Letter segregates assets whose prices are somewhat volatile, this 'shortfall' could be magnified.").

2008.[84] Among the 65 funds in the sample group that used CDS sometime between 2004 and 2008, the total notional amount of CDS positions increased from an average of $103 million per fund in 2004 to an average of $632 million in 2008. The mean total notional amount of a fund's CDS positions relative to its net asset value ("NAV") increased from 2% to almost 14%.[85] At three funds, the notional amounts of CDS positions held in 2008 exceeded those funds' NAVs. During the same period, reported CDS book losses (*i.e.*, unrealized losses) remained, on average, less than 1% of a fund's NAV.[86]

Critics of the notional and mark-to-market standards often advocate use of a more complex analysis of the risk of a fund's investments, including its derivatives positions, such as Value at Risk ("VaR") or another methodology for assessing the probability of portfolio losses.[87] VaR and other alternative approaches are discussed in the following section.

2. Other Approaches

The 2010 ABA Derivatives Report observed that the "the basic framework as articulated in Release 10666 has worked very well" as applied to funds' derivatives investments,[88] but "there are open issues and inconsistencies in the current [Commission] and staff guidance regarding the

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84 Adam and Guettler Article, *supra* note 7.

85 *Id.* at 12.

86 *Id.* at 13.

87 *See, e.g.*, 2010 ABA Derivatives Report, *supra* note 8, at 18. As discussed *infra*, some non-U.S. regulatory schemes have incorporated VaR or comparable methodologies in their approach to derivatives. *See, e.g.*, *CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS*, Committee of European Securities Regulators (July 28, 2010) ("CESR's Global Exposure Guidelines"), *available at* http://www.esma.europa.eu/popup2.php?id=7000. *See also* Henry T.C. Hu, *The New Portfolio Society, SEC Mutual Fund Disclosure, and the Public Corporation Model*, 60 BUS. LAW. 1303 (2005) (advocating disclosure by funds of VaR data). We note that the Commission has permitted VaR to be used by certain registrants in other circumstances. For example, the Commission permits certain registered broker-dealers to use VaR models to compute net capital charges. *See, e.g.*, Exchange Act rule 15c3-1f.

88 2010 ABA Derivatives Report, *supra* note 8, at 16.

application of Section 18 of the 1940 Act to transactions in derivatives."[89] Accordingly, the 2010 ABA Derivatives Report states that the Commission "should issue revised guidance in this area, which would set forth an approach to segregation that would cover all types of derivative instruments in a comprehensive manner."[90] The 2010 ABA Derivatives Report, however, considers comprehensive guidance unlikely to be achievable, given that any generalized approach will likely fail to take into account significant variations in individual transactions. Consequently, in lieu of comprehensive guidance concerning the asset segregation approach, the 2010 ABA Derivatives Report proposes an alternative approach pursuant to which individual funds would establish their own asset segregation standards for derivative instruments that involve leverage within the meaning of Release 10666. Under this approach, each fund would be required to adopt policies and procedures that would include, among other things, minimum asset segregation requirements for each type of derivative instrument, taking into account relevant factors such as the specific context of the transaction. In developing these standards, fund investment advisers could take into account a variety of risk measures, including VaR and other quantitative measures of portfolio risk, and would not be limited to the notional amount or mark-to-market standards. These minimum "Risk Adjusted Segregated Amounts" would be reflected in policies and procedures that would be subject to approval by the fund's board of directors and disclosed (including the principles underlying the Risk Adjusted Segregated Amounts for different types of derivatives) in the fund's statement of additional information.[91]

The challenge of designing a regulatory standard by which leverage can be measured and limited effectively also has drawn the attention of regulators in jurisdictions around the globe.

89 *Id.* at 15.

90 *Id.* at 17.

91 *Id.* at 18.

Internationally, limitations on leveraged exposure take a variety of forms, including maximum exposure limitations, asset segregation requirements, and other measures. In the context of maximum exposure or leverage limitations, the notional or principal amount of the reference asset underlying the derivative has commonly been used as a conservative measure of the exposure created by derivatives. In addition to limitations on aggregate positions or leveraged exposure, some regulatory frameworks include restrictions on concentrated exposures to individual counterparties and some provide for specialized funds that may assume derivatives exposure exceeding otherwise applicable limits.

The Committee of European Securities Regulators ("CESR") (which, as of January 1, 2011, became the European Securities and Markets Authority, or "ESMA"), conducted an extensive review and consultation concerning exposure measures for derivatives used by Undertakings for Collective Investment in Transferable Securities ("UCITS"), investment vehicles authorized for sale to retail investors. In 2010, CESR's Global Exposure Guidelines for UCITS were issued,[92] addressing implementation of the European Commission's 2009 revised UCITS Directive.[93] Under the revised UCITS Directive, UCITS are permitted to engage in derivatives investments subject to a "global exposure" limitation, under which the derivatives exposure of a UCITS may not exceed the total net value of the UCITS' portfolio.[94] CESR's Global Exposure Guidelines extensively address the calculation of derivatives exposure under

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92 *See supra* note 87. In order for CESR's Global Exposure Guidelines to be binding and operational in a particular EU Member State, the Member State must adopt them. To date, it appears that a few EU Member States, *e.g.*, Ireland and Luxembourg, have adopted them.

93 *See* Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities ("2009 Directive"), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:en:PDF.

94 *Id.* at Article 51(3) at 62 ("The exposure is calculated taking into account the current value of the underlying assets, the counterparty risk, future market movements and the time available to liquidate the positions").

the "global exposure" limit and define two permissible, alternative methods for this purpose: (i) the "commitment" approach; and (ii) the advanced risk measurement method to measure maximum potential loss, such as the VaR approach.[95]

The commitment approach is a method for standard derivatives that uses the market value of the equivalent position in the underlying asset but may be "replaced by the notional value or the price of the futures contract where this is more conservative."[96] CESR's Global Exposure Guidelines incorporates a schedule of derivative investments and their corresponding conversion methods to be used in calculating global exposure.[97] The conversion method to be used depends on the derivative.[98]

The second method is VaR or a comparably sophisticated risk measurement method, designed to measure the maximum potential loss due to market risk rather than leverage.[99] When using the VaR approach to calculate global exposure, either the relative VaR approach or the

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95 *See* CESR's Global Exposure Guidelines, *supra* note 87. The CESR's Global Exposure Guidelines note that the "use of a commitment approach or VaR approach or any other methodology to calculate global exposure does not exempt UCITS from the requirement to establish appropriate internal risk management measures and limits." *Id.* at 5. In addition, with respect to the selection of the methodology used to measure global exposure, CESR's Global Exposure Guidelines note that the "commitment approach should not be applied to UCITS using, to a large extent and in a systematic way, financial derivative instruments as part of complex investment strategies." *Id.* at 6.

96 *See id.* at 7.

97 *See id.* at 7-12.

98 *Id.* at 8. For example, for bond futures, the applicable conversion method is the number of contracts multiplied by the notional contract size multiplied by the market price of the cheapest-to-deliver reference bond. For plain vanilla fixed/floating interest rate and inflation swaps, the applicable conversion method is the market value of the underlier (though the notional value of the fixed leg may also be applied). *Id.* For foreign exchange forwards, the prescribed conversion method is the notional value of the currency leg(s). *Id.* at 9. With respect to non-standard derivatives, where it is not possible to convert the derivative into the market value or notional value of the equivalent underlying asset, CESR's Global Exposure Guidelines note that "an alternative approach may be used provided that the total amount of the derivatives represent a negligible portion of the UCITS portfolio." *Id.* at 7.

99 *Id.* at 22 ("More particularly, the VaR approach measures the maximum potential loss at a given confidence level (probability) over a specific time period under normal market conditions.")

absolute VaR approach may be used.[100] Under the relative VaR approach, the VaR of the portfolio cannot be greater than twice the VaR of an unleveraged reference portfolio.[101] The absolute VaR approach limits the maximum VaR that a UCITS can have relative to its NAV, and as a general matter, the absolute VaR is limited to 20 percent of the UCITS NAV.[102]

In addition to the global exposure limitation, CESR's Global Exposure Guidelines subject UCITS to "cover rules" for investments in financial derivatives.[103] Under these cover rules, UCITS should, at any given time, be capable of meeting all its payment and delivery obligations incurred by financial derivatives' investments, and cover should form part of the UCITS' risk management process.[104] More specifically, in the case of a derivative that provides, automatically or at the counterparty's choice, for physical delivery of the underlier, the UCITS should hold: (i) the underlier in its portfolio, or, if the underlier is deemed to be sufficiently liquid, (ii) cash or other liquid assets on the condition that these other assets (after applying appropriate haircuts), held in sufficient quantities, may be used at any time to acquire the underlier that is to be delivered.[105] In the case of a derivative that provides, automatically or at

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100 *Id.* at 23. A global exposure calculation using the VaR approach should consider all the positions in the UCITS' portfolio. *Id.* at 22. The VaR approach measures the probability of risk of loss rather than the amount of leverage in portfolio. *Id.* at 22. The absolute VaR of a UCITS cannot be greater than 20% of its NAV. *Id.* at 26. For both VaR approaches, the calculation must have a "one-tailed confidence interval of 99%," a holding period of one month (20 business days), an observation period of risk factors of at least one year (unless a shorter observation period is justified by a significant increase in price volatility), at least quarterly updates, and at least daily calculation. *Id.* at 26. UCITS employing the VaR approach are required to conduct a "rigorous, comprehensive and risk-adequate stress testing program." *Id.* at 30-34.

101 CESR's Global Exposure Guidelines note that the relative VaR approach does not measure leverage of the UCITS' strategies but instead allows the UCITS to double the risk of loss under a given VaR model. *Id.* at 24.

102 *Id.* at 25-26.

103 *Id.* at 40.

104 *Id.*

105 *Id.*

the UCITSs choice, for cash settlement, the UCITS should hold enough liquid assets after appropriate haircuts to allow the UCITS to make the contractually required payments.[106]

Singapore has adopted a bifurcated approach similar to that applicable under CESR's Global Exposure Guidelines for UCITS. The Monetary Authority of Singapore (the "MAS") requires that the risks of derivatives used by investment companies are "duly measured, monitored and managed on an ongoing basis."[107] An investment company's exposure to derivatives is limited to 100% of its NAV, and global exposure is calculated using the commitment approach as the default method. Under the commitment approach, which is similar to the commitment approach in CESR's Global Exposure Guidelines, global exposure is calculated by converting the investment company's derivatives positions into equivalent positions in the underlying assets and then is quantified as the sum of the absolute values of the individual positions.[108] The investment company's exposure to the counterparty of an OTC derivative is limited to 10% of its NAV and is measured on a maximum potential loss basis that may be incurred by the investment company if the counterparty defaults.[109] Cash or money

106 *Id.* On April 14, 2011, ESMA published a final report on the guidelines on risk measurement and the calculation of the global exposure for certain types of structured UCITS. *See Guidelines to Competent Authorities and UCITS Management Companies on Risk Measurement and the Calculation of Global Exposure for Certain Types of Structured UCITS* (final report) (Apr. 14, 2011) (ref.: ESMA/2011/112), *available at* http://www.esma.europa.eu/popup2.php?id=7542 (these guidelines, which will need to be adopted and implemented by Member States, propose for certain types of structured UCITS, an optional regime for the calculation of the global exposure).

107 The Monetary Authority of Singapore, *Code on Collective Investment Schemes*, Chapter 3, section 3.1(f) (April 2011) at 7, *available at* http://www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/110408%20Revised%20Code_8%20April_final.pdf.

108 MAS allows for the use of a VaR approach, with prior approval and submission of specific information on the investment company manager's risk management process. *Id.* at Appendix 1, section 3.2(b).

109 *Id.* at Appendix 1, sections 5.2 and 5.4.

market instruments and bonds issued by a government with a rating of AAA may be tendered as collateral to reduce counterparty exposure.[110]

Other jurisdictions have adopted approaches to investment companies' use of derivatives that limit aggregate exposure and/or require maintaining liquid assets equal to the notional or "exercise" value of derivatives contracts. For example, the Central Bank of Ireland, in addressing non-UCITS investment companies offered to the public generally, has issued guidelines that provide standards analogous to a 'notional amount' or commitment approach and generally limits the maximum potential exposure to 25% of the investment company's NAV.[111] Separately, the Central Bank of Ireland permits the use of techniques and instruments by investment companies for the purposes of "efficient portfolio management," subject to certain conditions. These include a requirement that an investment company selling a futures contract must own the security that is the subject of the contract. Alternatively, the investment company's assets, or a proportion of its assets at least equal to the exercise value of the futures contracts sold, must reasonably be expected to behave in terms of price movement in the same manner as the futures contract.[112]

A similar approach is followed by the Canadian Securities Administrators, which permits investment companies sold to the general public to use derivatives for hedging and non-hedging purposes but limits the derivatives exposure and requires certain "cash cover" intended to limit

110 *Id.* at Appendix 1, sections 5.7 and 5.8.

111 Central Bank of Ireland, NU SERIES OF NOTICES: *Conditions Imposed in Relation to Collective Investment Schemes Other than UCITS* (July 2011) at 13.12, *available at* *http://www.centralbank.ie/regulation/industry-sectors/funds/non-ucits/Documents/Non%20UCITS%20Notices.pdf*

112 *Id.* at 16.10. In addition, certain requirements are imposed on the use of OTC derivatives. *Id.* at 16.10.

leverage.[113] For example, an investment company may enter into a swap if, among other things, the investment company holds cash cover in an amount that, together with margin on account for the swap and the market value of the swap, is not less than the underlying market exposure of the swap.[114]

The Hong Kong Securities and Futures Commission (the "SFC") applies a differentiated approach, limiting investment companies generally to the use of derivatives for non-hedging positions that are capped at 15% of NAV for options and warrants and 20% for futures.[115] For investment companies that may acquire financial derivative instruments extensively for investment purposes, the investment companies' global exposure relating to the financial derivative instruments should not exceed 100% of the total net asset value of the investment companies. For purposes of calculating global exposure, investment companies must use the commitment approach. This approach requires that derivative positions be converted into the equivalent position in the underlying assets of the derivative, taking into account the prevailing value of the underlying assets, counterparty risk, futures market movements, and the time available to liquidate the positions. There are also requirements for: (a) the over-the-counter

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113 National Instrument 81-102 *Mutual Funds* (Jan. 2011) at sections 2.7 and 2.8, *available at* http://www.bcsc.bc.ca/uploadedFiles/securitieslaw/policy8/81-102%20Mutual%20Funds%20%5BNI%5D%20Jan-1-11.pdf. In addition, for periods when the investment company would be required to make payments under the swap, the investment company is required to hold an equivalent quantity of the reference asset of the swap, a right or obligation to acquire an equivalent quantity of the reference asset of the swap and cash cover that, together with the margin on account for the swap, have a value at least equal to the aggregate amount of the obligations of the investment company under the swap, or a combination of the positions, without recourse to other assets of the investment company, to enable it to satisfy its obligations under the swap. *Id.* at sections 2.7 and 2.8.

114 *Id.* at section 2.8.

115 Hong Kong Securities and Futures Commission, *Code on Unit Trusts and Mutual Funds* (June 2010), Chapter 7, *available at* http://www.sfc.hk/sfc/doc/EN/intermediaries/products/handBooks/Eng_UT.pdf. *See also* Hong Kong Securities and Futures Commission *Handbook for Unit Trusts and Mutual Funds*, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products.

derivative counterparties (or their guarantors, if applicable) of these investment companies to be substantial financial institutions (as defined in the Code on Unit Trusts and Mutual Funds); (b) the net exposure for these investment companies to a single over-the-counter derivative counterparty to be no greater than 10% of NAV; and (c) the acceptability criteria of collateral as provided by the over-the-counter derivative counterparties.[116]

C. Request for Comment

The Commission requests comment concerning the current approach to the application of the senior securities limitations of section 18 of the Act to funds' use of derivatives. The Commission seeks views concerning the appropriateness and effectiveness of the asset segregation approach as a basis for section 18 compliance, and ways in which the approach might be improved to better serve the statutory purposes and protect investors. The Commission also seeks views concerning potential alternative approaches under which funds could capture

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116 Hong Kong Securities and Futures Commission, *Code on Unit Trusts and Mutual Funds* (June 2010), Chapter 8, *available at* http://www.sfc.hk/sfc/doc/EN/intermediaries/products/handBooks/Eng_UT.pdf. Other requirements include a restriction on premium paid to acquire identical options exceeding 5% of the NAV of the investment company, open positions in any futures contract month or option series may not be held if the combined margin requirement represents 5% or more of the NAV of the investment company, and the investment company may not hold open positions in futures or options contracts concerning a single commodity or a single underlying financial instrument for which the combined margin requirement represents 20% or more of the NAV of the investment company. *Id.*

Futures and options investments companies are subject to still different requirements, including that at least 30% of the investment company's NAV be held on deposit in short-term debt instruments and may not be used for margin requirements and no more than 70% of the NAV of the investment company may be committed as margin for futures or option contracts and/or premium paid for options purchased. Other requirements applicable to futures and options investment companies include a restriction on premium paid to acquire options outstanding with identical characteristics exceeding 5% of the NAV of the investment company, open positions in any futures contract month or option series may not be held if the combined margin requirement represents 5% or more of the net asset value of the investment company, and the investment company may not hold open positions in futures or options contracts concerning a single commodity or a single underlying financial instrument for which the combined margin requirement represents 20% or more of the net asset value of the investment company. *Id.*

the benefits of using derivatives that would meet these same important goals. Commenters are requested to consider these broad questions as well as the specific questions that follow:

1. Issues Concerning the Current Asset Segregation Approach

- Is the definition of leverage articulated by the Commission in Release 10666 – that is, the right to a return on a capital base that exceeds a fund's investment in the instrument producing the return – sufficiently precise, and appropriate to limit the risks addressed by the senior security prohibition of section 18? Are other measures of leverage equally pertinent to, and sufficiently objective, precise, and transparent to achieve the investor protection purposes of section 18? Do funds make use of any leverage measurements as part of their own portfolio oversight procedures? Are leveraged transactions involving derivatives subject to any special approval or review procedures?

- Does the segregated account approach adequately address the investor protection purposes and concerns underlying section 18 of the Act? What are the benefits and the shortcomings of the segregated account approach? What benefits may be lost under an approach that is more restrictive than the current segregated account approach?

- Derivatives can raise risk management issues for funds, such as leverage, illiquidity (particularly with respect to complex OTC derivatives), and counterparty risk, among others.[117] The segregated account approach addresses leverage, but may not address liquidity and counterparty

[117] *See* 2008 IDC Report, *supra* note 3, at 12-13. *See also* 2008 JPMorgan Article, *supra* note 6, at page 25.

concerns. Should funds that use derivatives be required to consider and address these concerns? For example, should funds be required to undertake an ongoing credit analysis of their derivatives counterparties, and an ongoing analysis of the liquidity of the derivatives, and to take action should the creditworthiness of the derivatives counterparties and the liquidity of the derivatives themselves decline below a certain point? Should diversification among counterparties be a requirement? Are there other risk considerations that funds engaged in derivatives investments should be required to take into account?

- What is the optimal amount of assets that should be segregated for purposes of complying with the leverage limitations of section 18? In general, should a fund segregate assets in an amount equal to the notional amount of a derivative contract? In what situations, if any, would a lesser amount satisfy the purposes and concerns underlying section 18's leverage limitations and why? Since futures, swaps, and similar derivatives generally have zero market value at inception and subsequent mark-to-market amounts may fluctuate widely, how effectively does segregating an amount equal to the daily, mark-to-market amount serve the Act's objective of limiting leverage and assuring the availability of adequate assets to cover a fund's ultimate obligations? To what extent do funds rely upon the mark-to-market standard to determine the amount of assets to be segregated? Are CDS, or some subset thereof, generally covered based on their notional amount, their mark-to-market value, or some other measure? Does it depend on whether the CDS cash-settles or involves physical delivery of the underlier?

- To what extent does the asset segregation approach cause funds to refrain from derivatives investments or strategies that could benefit investors? Please describe specific scenarios in which a fund might be deterred from engaging in derivatives activities for this reason. Does the asset segregation approach create particular impediments for certain types of funds or strategies? Please also provide any information relevant to assessing the impact upon the funds of asset segregation as contemplated by Release 10666.
- In Release 10666, the Commission stated that it believed that only liquid assets should be placed in the segregated accounts. The Commission listed cash, U.S. Government securities, or other appropriate high-grade debt obligations as examples of liquid assets that could be placed in a segregated account.[118] Subsequently, in the Merrill Lynch no-action letter, the staff took the position that "cash or liquid securities (regardless of type)" may be segregated for section 18 purposes. Should the Commission permit funds to segregate any liquid asset? Or should the Commission further limit the types of assets that may be placed in a segregated account? The 2010 ABA Derivatives Report has observed that the practical effect of segregating "any liquid asset" rather than segregating only the assets specifically noted as examples in Release

[118] *See* Release 10666, *supra* note 10, at discussion of "Segregated Account."

10666 "greatly increase[s] the degree to which funds [may] . . . use derivatives."[119] Is segregation of "any liquid asset" for purposes of section 18 consistent with the purposes and concerns underlying section 18's limitations on leverage? Should any restrictions be placed on the types of liquid assets that may be used for asset cover, *e.g.*, excluding assets that replicate the fund's exposure under the covered obligation?

- What types of liquid assets are currently used by funds for asset segregation purposes? Do funds commonly include equities among the liquid assets that they segregate? If so, what types of equities?
- Is owning, or having the right to obtain, the cash or other assets that a fund obligates itself to deliver in connection with senior securities an adequate substitute for segregation of liquid assets? To what extent do funds rely on this cover approach rather than asset segregation? Are cover methods that do not involve asset segregation as effective as asset segregation in terms of limiting a fund's ability to engage in leverage, limiting a fund's risk of loss, and making sure that a fund has set aside sufficient assets to cover its obligations under derivatives and other senior securities?
- Should the Commission revise its position in Release 10666 to provide expressly for cover methods in addition to asset segregation? If so, should the Commission take the position that a fund may only enter into such non-asset segregation cover methods with the same counterparty to the

119 2010 ABA Derivatives Report, *supra* note 8, at 14.

senior security being covered? If so, what conditions, if any, should be imposed on such cover methods?

- The Commission also requests comment on the different treatment afforded conventional bank borrowings under section 18, which generally require 300% asset coverage, and other transactions, such as reverse repurchase agreements, that may be functionally equivalent to borrowings but, under Release 10666, may be covered by segregation of assets equal to 100% of the fund's obligations. Why, if at all, should other senior securities be treated differently from bank borrowings for purposes of the amount of cover required? Should the Commission revise its position in Release 10666 so that all borrowings and their functional equivalents are subject to the same asset segregation requirements?

2. Alternatives to the Current Asset Segregation Approach

- What alternatives to the segregated account approach, if any, should the Commission consider to fulfill the investor protection purposes of section 18 of the Act? Please identify any alternative measures that would assure adequate coverage of the fund's ongoing exposures under a derivative investment, and provide a cushion to cover future exposure.
- What benefits would be lost, and/or what costs would increase, if an alternative approach to the segregated account were to limit funds' use of derivatives?
- As discussed above, the 2010 ABA Derivatives Report recommends a more flexible approach to section 18 compliance, under which funds

would specify a Risk Adjusted Segregated Amount ("RASA") for each derivative investment used by the fund.[120] Under this recommended approach, the amount of assets to be segregated would be determined by each fund, based on the risk profiles of the derivative instruments (including issuer- and transaction-specific risk) and its assessment of risk based upon consideration of relevant risk measures, such as VaR, potentially subject to Commission guidance of a general nature.[121] What benefits would accrue to funds and investors from the ABA's RASA approach? What would be the costs of this approach? In what respects would fund-determined asset segregation policies be expected to deviate from the current segregated account approach? Would such policies be likely to incorporate VaR or other risk methodologies? Do boards, as currently constituted, have sufficient expertise to oversee an alternative approach to leverage and derivatives management such as RASA and/or VaR? If funds were permitted to determine the cover amount for their derivatives investments, should the Commission give guidance concerning minimum requirements for cover amounts or methodologies for determining cover amounts? If funds were permitted to determine the cover amount for their derivatives investments, would the result be that different funds would likely reach different determinations, resulting in different cover amounts, for the same derivatives?

120 2010 ABA Derivatives Report, *supra* note 8, at 1, 17-18.

121 *Id.* at 17.

- Should the Commission consider a bifurcated approach to funds' use of derivatives, similar to that set out in CESR's Global Exposure Guidelines (which provides two methodologies, the commitment approach or an advanced risk measurement method such as VaR)? If the Commission were to pursue a bifurcated approach, should funds be permitted to elect to use notional amount (or similar reference) or a quantitative risk assessment such as VaR, or should funds with different levels of derivatives activities be required to choose one or the other measure based upon their level of derivatives activities or other factors?
- If funds are permitted to choose which quantitative risk assessment approach to use, under what circumstances, if any, should they be allowed to switch to a different assessment? Should a fund's proposed change in assessment require consideration and approval of its board of directors? Should shareholder approval of a fund's proposed change in assessment be required? For what reason(s) should a fund be permitted to change assessments, if any?
- We note that bank capital standards incorporate methodologies by which the current exposure and potential future exposure created by derivative investments are calculated. The potential future exposure calculation is based upon application of a specified multiplier, varying with the type and maturity of the derivative, to the notional amount of the investment.[122] Would a formula combining the current mark-to-market value of a fund's

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122 *See* 12 C.F.R. § 3 at Appendix C to Part 3 (2011) (Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches).

derivative investments with a measure of potential future exposure based upon a percentage of the notional amount of its derivative contracts provide a more robust measure of risk than the notional amount or mark-to-market value of the derivative? If so, are bank capital standards a relevant reference point for our consideration of the potential future exposure and asset segregation amount? If not, are there other preferable standards for measuring the potential future exposure of a derivative investment? How, if at all, would such an approach address the leverage concerns underlying section 18 of the Act? What would be the costs and benefits of employing an asset segregation calculation that reflects both current mark-to-market values and a potential future exposure approximation calculated by reference to notional amount? Given the purposes of section 18, should an additional cushion amount be considered in addition to current mark-to-market value and potential future exposure?

- The Commission also requests comment concerning the desirability of incorporating a VaR approach or other comparable risk measurement methodology in the segregated account approach to section 18. To what extent do funds currently employ VaR or a comparable risk measure as part of their routine portfolio oversight procedures? Would a VaR measure, potentially supplemented by stress testing and a leverage measure, provide an adequate methodology for addressing leverage risks in fund portfolios? What procedures would be required so that any VaR methodology chosen by a fund would be implemented in a way that adequately captures any additional risks associated with the use of leverage and derivatives by a fund? What other quantitative criteria might be employed in lieu of, or as a supplement to, VaR? Would adoption of VaR or a comparable risk standard require review by the Commission or Commission staff of particular risk measurement methodologies in order to establish an appropriate level of investor protection? What would be the costs and benefits of adopting a VaR standard in lieu of an asset segregation approach in addressing the treatment of derivatives under section 18?

- UCITS using VaR approaches to measure global exposure limits are required to disclose in their prospectus their expected level of leverage and the possibility of higher leverage.[123] In the event that the Commission were to accept a VaR approach in connection with funds' use of derivatives, should funds be required to disclose their expected and/or actual leverage levels?
- UCITS using VaR approaches to comply with global exposure limits are also required to maintain "a rigorous, comprehensive and risk-adequate stress testing program."[124] Should a stress testing requirement be imposed upon funds that use derivatives, at least where a risk-based methodology is used to determine the required asset segregation value? What standards, if

123 *See* CESR's Global Exposure Guidelines, *supra* note 87, at 35.

124 *Id.* at 31.

any, should the Commission establish for stress testing if such a requirement were to be imposed?

- Are there any alternative measures that would provide adequate coverage of a fund's future obligations throughout the life of a derivative instrument as well as the availability of resources to cover unanticipated price movements?
- During the recent credit crisis, did funds that used derivatives and leverage demonstrate the ability to foresee and manage the risks that manifested themselves in connection with derivatives and leverage? Are there examples during the credit crisis where funds incurred losses or experienced gains specifically attributable to their derivatives usage?
- Is it the case that most futures contracts are highly liquid, and that this facilitates rapid liquidation of a losing position, enabling funds to minimize losses? Are there futures contracts that are not highly liquid? Have there been instances where futures contracts, that may typically be considered liquid, have become less liquid, or illiquid? If so, please describe. Could there be instances in the future where derivatives that have historically been considered to be liquid become less liquid, or illiquid? If so, please describe.

3. Related Matters

- Do derivatives that create economic leverage, but that do not impose future payment obligations on funds, such as purchased options or commodity-linked notes, raise the same or similar concerns as derivatives that create indebtedness leverage? Do such derivatives present any other material concerns to funds or their investors, or raise other concerns under the Investment Company Act? If so, how should the Commission address them?

- Please comment on these, or any other, alternative approaches to the regulation of leverage under the Act. The Commission requests comment on whether any other regulatory frameworks provide relevant and useful approaches that the Commission should consider.
- Are there special considerations that need to be taken into account for smaller funds? How might taking such considerations into account impact investor protection?

III. DERIVATIVES UNDER THE INVESTMENT COMPANY ACT'S DIVERSIFICATION REQUIREMENTS

In this section of the release, the Commission discusses the diversification requirements of the Investment Company Act. The Commission also explores, and requests comment on, issues that arise in the course of applying those requirements to funds' use of derivatives.

A. The Diversification Requirements

Funds are required to disclose in their registration statements whether they are classified as diversified or non-diversified.[125] A fund that discloses in its registration statement that it is classified as diversified is prohibited from changing its classification to non-diversified without first obtaining shareholder approval.[126] A diversified fund is a fund that, with respect to 75% of

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125 Section 8(b)(1)(A) of the Act; Form N-1A, Items 16, 4(a) and 4(b)(1); Form N-2, Item 17.

126 Section 13(a)(1) of the Act.

the value of its total assets (the "75% bucket"),[127] has (among other things) no more than 5% of the value of its total assets invested in the securities of any one issuer.[128] A non-diversified fund is any fund that does not meet these requirements.[129]

The purpose of the diversification requirements is to prevent a fund that holds itself out as diversified from being too closely tied to the success of one or a few issuers or controlling portfolio companies.[130] As one commentator has noted, the requirements are designed to ensure that investors receive a clear statement of the character of the portfolio of the fund in which they have invested,[131] and are intended to prevent any diversified fund from becoming non-diversified without the prior approval of its shareholders.[132]

For purposes of determining whether a fund is diversified or non-diversified, the value of the fund's "total assets" is generally determined as of the end of the fund's last preceding fiscal

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127 Rule 5b-1 under the Investment Company Act generally defines "total assets," when used in computing values for purposes of sections 5 and 12 of the Act, as "the gross assets of the company with respect to which the computation is made, taken as of the end of the fiscal quarter of the company last preceding the date of computation."

128 Section 5(b)(1) of the Act. The term "issuer" is defined in sections 2(a) and 2(a)(22) of the Act as "unless the context otherwise requires, ...every person who issues or proposes to issue any security, or has outstanding any security which it has issued." In addition, a diversified fund, with respect to the 75% bucket, may not own more than 10% of the outstanding voting securities of any one issuer. *See* Section 5(b)(1) of the Act. A fund seeking to qualify as a "regulated investment company" must comply with the diversification requirements of section 851 of the IRC, even if the fund is not diversified under the Investment Company Act. The diversification requirements under the IRC are similar, but not identical, to the diversification requirements of the Investment Company Act. *See* 26 U.S.C. § 851(b)(3)(2010).

129 Section 5(b)(2) of the Act.

130 Senate Hearings, *supra* note 49, at 188 (Statement of David Schenker, Chief Counsel, Investment Trust Study, SEC, commenting on a version of section 5(b)(1) that was similar, but not identical, to the current version) ("a diversified company must have at least several different securities in its portfolio, and cannot make investments which will put them in a controlling position . . . .").

131 *See, e.g.*, Alfred Jaretzki, Jr., *The Investment Company Act of 1940*, 26 Wash. U. L. Q. 303, 314 n. 34 (Apr. 1941) ("Jaretzki") (the "distinction between diversified and non-diversified companies is due in large part, it is believed, to a desire to inform stockholders of the character of the portfolio of the company in which they have invested.")

132 *Id.* at 316-17.

quarter and includes the value of derivatives held by the fund. Under the Investment Company Act's definition of "value,"[133] the appropriate valuation methodology to be used by a fund generally depends upon: (a) whether market quotations for the fund's portfolio securities[134] are readily available; and (b) whether the fund owned the particular portfolio securities or other assets at the end of its last preceding fiscal quarter. Specifically, the Act states that, "unless the context otherwise requires," the value of a fund's assets for purposes of the diversification requirements is as follows:

- for each portfolio security owned at the end of the fund's last preceding fiscal quarter for which market quotations are readily available, the value of the security is the market value of the security at the end of such quarter;
- for any other portfolio security or asset owned at the end of the fund's last preceding fiscal quarter, the value of the security or asset is the fair value of the security or asset at the end of such quarter, as determined in good faith by the fund's board of directors; and
- for any security or asset acquired by the fund after the last preceding fiscal quarter, the cost thereof.[135]

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133 "Value" is defined in section 2(a)(41) of the Act.

134 Sections 2(a) and 2(a)(36) of the Act provide that, "unless the context otherwise requires," the term "security" includes, among other things, any "note" or "evidence of indebtedness." As discussed *supra* note 57, the definition of the term "security" in the Act is broader than the definitions of that term in the other federal securities laws and the Commission has interpreted the term "security" in light of the policies and purposes underlying the Act. As a general matter, most derivatives appear to be notes or evidences of indebtedness and thus securities for purposes of the diversification requirements. Treating derivatives as securities for diversification classification purposes appears to be consistent with the policies and purposes underlying the diversification requirements, including the concern that funds that classify themselves as diversified indeed have diverse portfolios of investments, the performance of which is not tied too closely to the success of one or a few issuers.

135 Sections 2(a)(41)(A)(i), (ii), and (iii) of the Act. Market value and fair value are discussed *infra*

B. Application of the Diversification Requirements to a Fund's Use of Derivatives

A diversified fund that contemplates investing in derivatives must consider how to value these instruments for purposes of calculating the 75% bucket based upon its "total assets" and for purposes of calculating whether the fund has invested 5% of the value of its total assets in the securities of any one "issuer." In addition, the fund must determine the identity of the issuer of each such derivative.

1. Valuation of Derivatives for Purposes of Determining a Fund's Classification as Diversified or Non-Diversified

When determining the value of a fund's total assets for purposes of determining the fund's classification as diversified or non-diversified, the fund must calculate the value of any derivative held by the fund. Under the Act, "unless the context otherwise requires," derivatives (and all other assets) held by a fund must be valued for diversification purposes using market values and fair values, at the end of the fund's last preceding fiscal quarter, or, if subsequently acquired, their cost.[136]

For purposes of calculating NAV under the Act's valuation provisions, derivatives are generally valued using a "market value" measure for exchange-traded derivatives and a "fair value" measure for OTC derivatives; under either measure, the value of a derivative would appear to be the value at which the derivative could be sold or otherwise transferred at the relevant time.[137] Compliance with the valuation provisions of the Act helps to ensure, among

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at Section VI. (Valuation of Derivatives). *See also Adoption of Rules Relating to the Classification of Management Investment Companies as either Diversified or Non-Diversified*, Investment Company Act Release No. 178 (Aug. 6, 1941) [6 FR 3966 (Aug. 8, 1941)].

136 *See* section 2(a)(41)(A) of the Act.

137 For additional discussion of valuation requirements and guidance, *see infra* Section VI. (Valuation of Derivatives).

other things, that the prices at which fund shares are purchased and redeemed are fair and do not result in dilution of shareholder interests or other harm to shareholders.[138]

The diversification requirements are designed to prevent a fund that holds itself out as diversified from having heightened exposure to one or a few issuers and help to accurately inform investors about the nature of the fund. Given that derivatives generally are designed to convey a leveraged return based on a reference asset over a period of time, their mark-to-market values at a given point do not reflect the asset base on which future gains and losses will be based or otherwise represent the potential future exposure of the fund under the derivatives investment. Use of a mark-to-market value for derivatives held by a fund could thus permit a fund to maintain an ongoing exposure to a single issuer or group of issuers in excess of 5% of the fund's assets on a notional basis, while continuing to classify itself as diversified.[139]

Should the Commission consider whether application of the diversification requirements to derivatives is a "context [that] otherwise requires" a different measure of value than the statutory definition of "value?" The value at which the derivative can be sold or otherwise transferred will reflect the gains or losses on that investment at a point in time. Would the use of the notional amount of the derivative, rather than its liquidation value, better achieve the purposes of the diversification provisions of the Act? The Commission requests comment on these issues and related questions set forth below.

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138 *Compliance Programs of Investment Companies and Investment Advisers*, Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] *available at* http://www.sec.gov/rules/final/ia-2204.pdf.

139 For example, a fund that holds itself out as diversified may have invested four percent of its assets in securities of an issuer to which it has additional exposure through a total return swap that creates exposure equal to another four percent of its assets on a notional basis, yielding a combined exposure to the issuer of eight percent of the fund's total assets. The current mark-to-market value of the total return swap would likely be sufficiently low to enable the fund to calculate its investments in the issuer at less than five percent of its total assets, but, its total exposure to that issuer is over five percent of its total assets.

2. Identification of the Issuer of a Derivative for Purposes of Determining a Fund's Classification as Diversified or Non-Diversified

The diversification requirements restrict a fund that is classified as diversified from investing, with respect to its 75% bucket, more than 5% of the value of its total assets in the securities of any one issuer. The Act defines the term "issuer" as "every person who issues or proposes to issue any security, or has outstanding any security which it has issued,"[140] unless the context otherwise requires.[141] In general, the "issuer" of an OTC derivative entered into by a fund would appear to be the fund's counterparty, and the "issuer" of an exchange-traded derivative would appear to be the clearinghouse due to the novation.[142] However, a derivative may have a reference asset that also has an issuer, *e.g.*, a total return swap on the common stock of a corporate issuer. In such a case, the potential exposure of the fund created by the derivative is to both the counterparty to the contract and the issuer of the reference security.

C. Request for Comment

The Commission requests comment concerning the application of the Act's diversification requirements to derivatives held in fund portfolios, including the following specific issues:

- <u>Valuation of Derivatives for Purposes of the Diversification Requirements</u>. As discussed above, the diversification requirements are designed to preclude a fund that has classified itself as "diversified" from concentrating its portfolio

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140 Section 2(a)(22) of the Act.

141 Section 2(a) of the Act.

142 *See Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies*, Securities Act Release No. 9222 (June 9, 2011) [76 FR 34920 (June 15, 2011)] at n. 18 and accompanying text, *available at* http://www.sec.gov/rules/proposed/2011/33-9222.pdf (also describing "novation" as a process through which the original obligation between a buyer and seller is discharged through the substitution of the central counterparty as seller to buyer and buyer to seller, creating two new contracts).

investments in the securities of any single issuer. In light of this purpose, how should a derivative be valued for purposes of applying the diversification tests? Could investors be misled by a fund's disclosure that it is diversified when it has ongoing exposure to a single issuer or group of issuers in excess of 5% of the fund's assets on a notional basis? In what circumstances, if any, would mark-to-market value provide an adequate measure of a fund's exposure to an issuer such that the purposes of the diversification requirements would be fulfilled? If a current market value measure is appropriate for this purpose, should any additional safeguards be adopted to address circumstances in which a derivative's potential future exposure may materially exceed its current market value? For example, should the "diversification" classification be qualified or supplemented to reflect the impact on the fund's diversification of the notional exposures created by derivatives? The Commission also requests comment concerning the potential for derivatives exposures to be understated. Further, if derivatives exposures are potentially understated, how should the issue be addressed? For example, should funds be required to provide additional information to investors? Also, if mark-to-market values are ascribed to derivatives for purposes of the diversification requirements, how should negative values for derivatives be treated?

- <u>Alternative Diversification Standards</u>. Should different or additional diversification standards be developed that would better address the types of exposures attainable through derivatives?

- Treatment of Counterparty Issues under the Diversification Requirements. In light of the statutory purpose of preventing a fund from holding itself out as diversified even though it is dependent upon the performance of a small number of issuers, should counterparties to derivatives investments with funds be considered issuers of securities for purposes of the diversification requirements? If counterparty obligations under a derivative investment are considered securities of an issuer for purposes of the diversification requirements, how should such obligations be measured for this purpose? The 2010 ABA Derivatives Report recommends that, for purposes of determining a fund's classification as diversified or non-diversified, a fund should be able to disregard its exposures to its derivative investment counterparties and that counterparty exposures should be addressed separately under section 12(d)(3) of the Act, in part to assure that counterparty exposures would be addressed for non-diversified as well as diversified funds.[143] Would it be preferable to address counterparty exposures under section 12(d)(3)?[144] If so, should diversification issues relating to counterparties that are not securities-related issuers continue to be addressed under the Act's diversification provisions?
- Relevance of Reference Assets Under Derivatives to Diversification Requirements. Under the 2010 ABA Derivatives Report's suggested approach, a derivative's reference asset would be considered a security issued by an issuer for

143 2010 ABA Derivatives Report, *supra* note 8, at 27-28.

144 Under section 12(d)(3) of the Investment Company Act, funds generally may not purchase or otherwise acquire any security issued by, or any other interest in, the business of a broker, dealer, underwriter, or investment adviser ("securities-related issuer"). *See infra* discussion in Section IV. (Exposure to Securities-Related Issuers Through Derivatives).

purposes of the diversification requirements, an approach that the 2010 ABA Derivatives Report indicates is already followed by many funds when calculating "long exposures" to the fund.[145] Should the issuer of reference assets underlying a derivative entered into by a fund be considered to be the issuer of a security for purposes of the diversification requirements in lieu of, or in addition to, the counterparty? If not, how, if at all, should exposure to the issuer of a reference asset be disclosed to investors and the potential inconsistency of such exposure with diversification categorization be addressed?

- Are there special considerations that need to be taken into account for smaller funds? How might taking such considerations into account impact investor protection?

IV. EXPOSURE TO SECURITIES-RELATED ISSUERS THROUGH DERIVATIVES

Funds engaging in derivatives investments may also confront issues under the Act's restrictions upon acquisition of interests in securities-related issuers. In this section of the release, the Commission discusses the application of section 12(d)(3) and rule 12d3-1, which address a fund's exposure to securities-related issuers, to funds' use of derivatives. The Commission seeks comment on the manner in which the Act's prohibition on such acquisitions and the Commission's exemptive rule granting limited relief from that prohibition should apply in the context of derivatives.

A. Investment Company Act Limitations on Investing in Securities-Related Issuers

Under section 12(d)(3) of the Investment Company Act, funds generally may not purchase or otherwise acquire any security issued by, or any other interest in, the business of a

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145 2010 ABA Derivatives Report, *supra* note 8, at 26.

broker, dealer, underwriter, or investment adviser ("securities-related issuer").[146] There are two reasons for this prohibition. First, it limits a fund's exposure to the entrepreneurial risks of securities-related issuers, including the fund's potential inability to extricate itself from an illiquid investment in a securities-related issuer.[147] Second, it is one of several Investment Company Act provisions which, taken together, prohibit fund sponsors, which include broker-dealers, underwriters, and investment advisers, from taking advantage of the funds that they sponsor.[148] Specifically, the prohibition has the effect of limiting the possibility of abusive reciprocal practices[149] between funds and securities-related issuers.

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146 Section 12(d)(3) of the Act. *See also Statement of the Commission Advising All Registered Investment Companies to Divest Themselves of Interest and Securities Acquired in Contravention of the Provisions of Section 12(d)(3) of the Investment Company Act of 1940 within a Reasonable Period of Time*, Investment Company Act Release No. 3542 (Sept. 21, 1962) [27 FR 9652 (Sept. 29, 1962)] ("1962 Statement") (stating that "prohibited purchases or acquisitions occur not only when a security or interest is originally purchased or acquired, but also when investment companies . . . hold an interest in a portfolio company which thereafter by merger, consolidation, reorganization . . . or otherwise, acquires an interest in a dealer, broker, underwriter or investment adviser"); *Exemption for Acquisition by Registered Investment Companies of Securities Issued by Persons Engaged Directly or Indirectly in Securities Related Businesses*, Investment Company Act Release No. 13725 (Jan. 17, 1984) [49 FR 2912 (Jan. 24, 1984)] ("1984 Proposing Release") at n.2 and accompanying text (discussing the 1962 Statement).

147 *See* 1984 Proposing Release, *supra* note 146, at n. 7 and accompanying text (discussing that "[i]n 1940, securities related businesses, for the most part, were organized as private partnerships. By investing in such businesses, investment companies would expose their shareholders to potential losses which were not present in other types of investments; if the business failed, the investment company as a general partner would be held accountable for the partnership's liabilities; if the business floundered, the investment company would be locked into its investment."). Rule 12d3-1 under the Act has, since 1984, provided a limited exemption from section 12(d)(3) for acquisitions of certain securities and, until 1993, addressed the liquidity concern underlying section 12(d)(3) by limiting the equity securities of a securities-related issuer that a fund may acquire to "margin securities," as defined in Regulation T of the Board of Governors of the Federal Reserve System, and generally limiting the permissible debt securities to "investment grade securities," as determined by at least one nationally recognized statistical rating organization. *See, e.g.*, 1984 Proposing Release, *supra* note 146, at nn. 24-25 and accompanying text. The rule has never permitted a fund to acquire a general partnership interest in a securities-related business.

148 *See id.* at n. 8 and accompanying text.

149 *See, e.g., id.* at n. 9 and accompanying text ("Such reciprocal practices include the possibility that an investment company might purchase securities or other interests in a broker-dealer to reward

Rule 12d3-1 under the Act provides funds with a limited exception from this prohibition. Under the rule, a fund may acquire securities of any person that (a) derives 15 percent or less of its gross revenues from "securities related activities,"[150] as long as the fund does not control such person after the acquisition, or (b) derives more than 15 percent of its gross revenues from "securities related activities," subject to limits on the percentage of the issuer's securities that may be acquired by a fund.[151] The rule does not permit a fund to acquire a general partnership interest in a securities-related issuer.[152]

B. Counterparty to a Derivatives Investment

When a fund invests in an OTC derivative, the fund receives the obligation of its counterparty to perform under the contract. If the counterparty is a securities-related issuer, a fund's acquisition of that obligation may constitute an acquisition of a security or another interest

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that broker-dealer for selling fund shares, rather than solely on investment merit. Similarly, the staff has expressed concern that an investment company might direct brokerage to a broker-dealer in which the company has invested to enhance the broker-dealer's profitability or to assist it during financial difficulty, even though that broker-dealer may not offer the best price and execution.")

150 The rule defines "securities related activities" as "activities as a broker, a dealer, an underwriter, an investment adviser registered under the Investment Advisers Act of 1940, as amended, or as an investment adviser to a registered investment company."

151 Under these limits, a fund may not acquire more than 5% of that class of the issuer's outstanding equity securities or more than 10% of the outstanding principal amount of the issuer's debt securities, and may not have more than 5% of the value of the fund's total assets invested in the securities of the issuer. Rule 12d3-1 defines "equity security" in accordance with rule 3a11-1 under the Exchange Act, which in turn includes "any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so." Rule 12d3-1 under the Act defines "debt security" as "all securities other than equity securities."

152 Rule 12d3-1 also does not permit the acquisition of a security issued by the fund's promoter, principal underwriter, or investment adviser, or an affiliated person of the promoter, principal underwriter, or investment adviser, subject to an exception for certain subadvisory relationships.

in a securities-related issuer within the scope of section 12(d)(3) of the Investment Company Act.[153] As noted above, in the case of exchange-traded derivatives that are cleared, the issuer of the derivative typically is the clearinghouse. In a no-action letter, the staff did not object to the assertion that, in acquiring an exchange-traded option, a fund generally would not appear to be acquiring securities issued by, or an interest in, a securities-related issuer.[154] In the case of OTC derivatives, if a fund's counterparty is a securities-related issuer, the fund's transaction with the counterparty may represent the acquisition of a security issued by, or an interest in, that issuer.[155]

If an OTC derivative with a securities-related issuer as the counterparty is a security issued by that counterparty, then the fund may be able to rely on rule 12d3-1 to engage in the transaction.[156] If such a derivative is not a security issued by the counterparty, but the transaction

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153 If the counterparty is not a securities-related issuer, the fund may enter into the transaction without being limited by section 12(d)(3). The fund will need to monitor the status of its counterparty during the term of the transaction to ensure that the counterparty remains a non-securities-related issuer. *See* 1962 Statement, *supra* note 146.

154 *See, e.g.,* Institutional Equity Fund, SEC Staff No-Action Letter (Feb. 27, 1984).

155 The Commission has stated, for example, that in entering into a repurchase agreement, a fund may be acquiring an interest in the counterparty that is prohibited by section 12(d)(3). *See, e.g., Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities*, Investment Company Act Release No. 25058 (July 5, 2001) at n. 5 and accompanying text [66 FR 36156 at note 5 (July 11, 2001)].

156 A derivative is likely to be categorized as a debt security subject to the 10% limitation of rule 12d3-1. Rule 12d3-1 defines "debt security" as "all securities other than equity securities." The Commission also by order has exempted certain transactions from section 12(d)(3) that may have involved a fund's acquisition of a security from a securities-related issuer. *See, e.g.*, the following orders issued by the Commission involving principal-protected funds: AIG SunAmerica Asset Management Corp., et al., Investment Company Act Release Nos. 26725 (notice) (Jan. 21, 2005) [70 FR 3946 (Jan. 27, 2005)] and 26760 (Feb. 16, 2005) (order) (by virtue of entering into a protection arrangement with an AIG affiliate that is a broker, dealer, underwriter, investment adviser to a registered investment company, or an investment adviser registered under the Investment Advisers Act, a fund may be deemed to have acquired a security from the AGI affiliate); Merrill Lynch Principal Protected Trust, et al., Investment Company Act Release Nos. 26164 (Aug. 20, 2003) (notice) [68 FR 51602 (Aug. 27, 2003)] and 26180 (Sept. 16, 2003) (order) (by virtue of entering into a protection arrangement with a Merrill Lynch affiliate that is a broker, dealer, underwriter, investment adviser to a registered investment company, or an investment adviser registered under the Investment Advisers Act of 1940, a fund may be deemed to have acquired a security from the Merrill Lynch affiliate).

may be deemed to be the fund's acquisition of "an interest in" a securities-related issuer (the counterparty), then rule 12d3-1 would not be available because it exempts only acquisitions of securities, and the transaction would be prohibited under the Investment Company Act. There is no bright-line test distinguishing transactions that may or may not constitute a fund's acquisition of an "interest in" a securities-related issuer. However, a fund's acquisition of a general partnership interest in a securities-related issuer, whether or not the interest is a security, is not permitted by rule 12d3-1.[157]

C. Exposure to Other Securities-Related Issuers Through Derivatives

The issue of whether an OTC derivative transaction is prohibited under the Investment Company Act as an impermissible acquisition of a security issued by, or an interest in, a securities-related issuer, also may require analysis of a fund's exposure to a reference asset underlying the derivative. If the derivative transaction is based upon the price or value of securities issued by, or interests in, a securities-related issuer, the fund's relationship to the issuer of the reference asset may raise both of the concerns underlying section 12(d)(3) – the fund's exposure to the risks of that securities-related issuer and the potential for reciprocal practices. For example, if the issuer of the reference asset is a broker-dealer, and the fund's position in the derivative transaction benefits from increases in the market price of the reference asset, the fund might direct brokerage or other business to that broker-dealer to enhance the broker-dealer's profitability. Consequently, the fund could be considered to have assumed an exposure to a

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157 In addition, section 12(d)(3) of the Act prohibits a fund's acquisition of any security issued by "or any other interest in" a securities-related issuer. The Commission has noted that, in enacting section 12(d)(3), Congress was particularly concerned with funds investing as general partners in securities-related issuers. *See Exemption of Acquisitions of Securities Issued by Persons Engaged in Securities-Related Business*, Investment Company Act Release No. 19204 (Jan. 4, 1993) [58 FR 3243 (Jan. 8, 1993)] at n. 10 and accompanying text. Rule 12d3-1(c) provides that "this section does not exempt the acquisition of: (1) a general partnership interest[.]"

securities-related issuer that is in violation of section 12(d)(3). In that event, the fund would need to consider the availability and conditions of rule 12d3-1 with respect to that entity before determining whether the fund may, and if so, to what extent, enter into the derivative transaction.

Certain OTC derivative transactions involve credit support providers or entities performing similar roles. These entities also may be securities-related issuers. In that case, the fund would need to determine whether the provision of credit support or similar protection for the fund's benefit in the derivative transaction constitutes the fund's acquisition of a security issued by, or an interest in, the credit support provider that is a securities-related issuer.[158] If it does, then the fund would need to analyze the derivative transaction under section 12(d)(3) with respect to the credit support provider as well.

D. Valuation of Derivatives for Purposes of Rule 12d3-1 under the Investment Company Act

As noted above, if a derivative transaction involves an acquisition by the fund of a security issued by a securities-related issuer, the fund may be able to rely on rule 12d3-1 under the Investment Company Act, which provides a conditional exemption to the prohibition in section 12(d)(3). For purposes of the conditions of rule 12d3-1, if the securities-related issuer, in its most recent fiscal year, derived more than 15% of its gross revenues from securities-related activities, as defined in the rule, the fund would need to determine whether such derivative is an equity or debt security and apply the percentage limitations in the rule accordingly.[159] Among other things, the fund would need to determine whether, immediately after the acquisition of such derivative, the fund has invested not more than five percent of the value of its total assets in

158 *See* rule 12d3-1(d)(7)(v) under the Act, deeming an acquisition of demand features or guarantees as not being the acquisition of securities of a securities-related issuer provided certain conditions are met.

159 *See supra* discussion at note 151.

the securities of the issuer. For purposes of this calculation, the exposure of the fund to its counterparty or its exposure to the issuer of a reference security may be understated were the current market or fair value of the derivative the appropriate measure. The potential future exposure of the fund to the securities-related issuer is, in each case, likely to be unaccounted for by a current mark-to-market standard. Neither the Commission nor the staff has addressed this point. The Commission understands that many funds perform the calculation under rule 12d3-1 based upon the notional amounts of derivatives transactions, although this practice is not uniform.

E. Request for Comment

The Commission asks for comment on all aspects of the application of section 12(d)(3) and rule 12d3-1 to funds' derivative transactions.

- Do commenters believe that OTC derivative transactions between funds and securities-related issuers implicate the purposes of section 12(d)(3), *i.e.*, protection against the entrepreneurial risks of securities-related issuers and the potential for reciprocal practices that disadvantage fund investors? If so, in what respects? If not, on what basis should a fund's exposure to a securities-related issuer in a derivatives transaction be distinguished from other types of investments to which section 12(d)(3) applies?
- Do commenters believe that a fund's exposure to price movements or performance of a reference security issued by a securities-related issuer implicates the purposes of section 12(d)(3)? If not, on what basis would such exposure be distinguished from other types of investments subject to section 12(d)(3)?

- Should the extent to which the securities-related issuer's obligations are secured by collateral provided by the issuer affect this analysis? If so, what specific effect should collateral arrangements be accorded and by what criteria should qualifying collateral arrangements be defined?
- The 2010 ABA Derivatives Report suggests that section 12(d)(3) "provides an appropriate framework for dealing with fund counterparty exposures."[160] The 2010 ABA Derivatives Report states that the counterparties to fund derivative transactions generally fall within the categories of securities-related issuers addressed by section 12(d)(3) and that, unlike the diversification requirements discussed above, section 12(d)(3) applies to all registered investment companies, regardless of diversification status. The 2010 ABA Derivatives Report also suggests that the Commission or the staff issue guidance concerning the manner in which the various provisions of rule 12d3-1 under the Act should apply to derivatives.[161] Is rule 12d3-1 the appropriate framework for exempting certain derivatives transactions from section 12(d)(3)? Are the existing percentage limitations in rule 12d3-1 appropriate in the context of derivatives? Should there be additional limitations or conditions to an exemption from section 12(d)(3) for derivative transactions? If so, what types of conditions or limitations? The Commission also asks commenters to identify and discuss the interpretive issues that may arise when rule 12d3-1 is applied to funds' use of derivatives.

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160 2010 ABA Derivatives Report, *supra* note 8, at 33. The Report states that "counterparty exposure" presents "the concern that a counterparty cannot pay a fund the amount that the fund is due under the derivative instrument…." *Id.*

161 *Id.* at 34-35.

V. PORTFOLIO CONCENTRATION

In this section, the Commission discusses the Investment Company Act's provisions regarding portfolio "concentration" and the application of these provisions to a fund's use of derivatives.

A. Investment Company Act Provisions Regarding Portfolio Concentration

Funds are required to disclose in their registration statements their policy concerning "concentrating investments in a particular industry or group of industries."[162] This requirement reflects the view that such a policy is likely to be central to a fund's ability to achieve its investment objectives, and that a fund that concentrates its investments will be subject to greater risks than funds that do not follow the policy.[163] The concentration requirements also are intended to prevent funds from substantially changing the nature and character of their businesses without shareholder approval.[164] Funds are prohibited from deviating from their policy concerning "concentration of investments in any particular industry or groups of industries" as recited in their registration statements without obtaining shareholder approval.[165] The Investment Company Act does not include definitions of the terms "concentration" and "industry or groups of industries." The Commission has stated generally that a fund is

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162 *See* Section 8(b)(1)(E) of the Act; Form N-1A, Items 4, 9 (instruction 4) and 16(c)(1)(iv); and Form N-2, Items 8.2.b(2) and 17.2.e.

163 *Registration Form Used by Open-End Management Investment Companies*, Investment Company Act Release No. 23064 (Mar. 13, 1998) ("Release 23064") [63 FR 13916 (Mar. 23, 1998)] at nn. 98-99 and accompanying text.

164 *See* Jaretzki, *supra* note 131, at 317. The concentration requirements focus on all of the funds' investments, and not solely on their investments in securities.

165 Section 13(a)(3) of the Act. *See also* Securities and Exchange Commission's Brief Amicus Curiae dated March 25, 2010, *In re: Charles Schwab Corp. Securities Litigation*, Master File No. C-08-01510-WHA (N. D. Cal.)("SEC Schwab Amicus Brief") at 2-3; *In re: Charles Schwab Corp. Securities Litigation*, No. C 08-01510 WHA, 2010 U.S. Dist. LEXIS 32113 (N. D. Cal. Mar. 30, 2010)("Schwab Opinion") at *3-*4.

concentrated in a particular industry or group of industries if the fund invests or proposes to invest more than 25% of the value of its net assets in a particular industry or group of industries.[166] The Commission also has stated that, in determining industry classifications, a fund may select its own industry classifications, but such classifications must be reasonable and should not be so broad that the primary economic characteristics of the companies in a single class are materially different.[167]

B. Issues Relating to the Application of the Act's Concentration Provisions to a Fund's Use of Derivatives

When a fund enters into a derivatives transaction, the fund may gain exposure to more than one industry or group of industries. For example, if a fund and a bank enter into a total return swap on stock issued by a corporation in the pharmaceuticals industry, the fund will have gained exposure to the banking industry (*i.e.*, the industry associated with the fund's counterparty) as well as exposure to the pharmaceuticals industry (*i.e.*, the industry associated with the issuer of the reference asset). As noted above, the Commission has stated that generally a fund is concentrated in a particular industry or group of industries if the fund invests or proposes to invest more than 25% of the value of its net assets in a particular industry or group of

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166 *See also* Form N-1A, Item 9, instruction 4 (defining industry concentration for Form N-1A disclosure purposes as "investing more than 25% of a Fund's net assets in a particular industry or group of industries"); *but compare* Form N-2, Item 8.2.b (instruction) (defining industry concentration for Form N-2 purposes as "25 percent or more of the value of Registrant's total assets invested or proposed to be invested in a particular industry or group of industries"). *See also, e.g.,* Release No. 23064, *supra* note 163, ("The Commission's staff has taken the position for purposes of the concentration disclosure requirement that a fund investing more than 25% of its assets in an industry is concentrating in that industry.").

167 *See* SEC Schwab Amicus Brief, *supra* note 165, at 8 and 9. *See also* Schwab Opinion, *supra* note 165, at *20 ("This order agrees . . . that a promoter is free to define an industry in any reasonable way when it establishes a fund and assumes for sake of argument that the promoter may unilaterally, even after the fund is up and running, clarify in a reasonable way a definitional line that may otherwise be vague. But once the promoter has drawn a clear line and thereafter gathers in the savings of investors, the promoter must adhere to the stated limitation unless and until changed by a stockholder vote.")

industries. This standard does not, by its terms, address derivative transactions by which a fund obtains exposure to a particular industry or group of industries, whether through exposure to the counterparty to the transaction or through its contractual exposure to a reference asset.

Another issue relevant to determining industry concentration is whether a fund values its derivatives using notional amount or market value. The 2010 ABA Derivatives Report states that "using the notional value, rather than the market value, of a derivative instrument may inflate an industry position relative to the fund's current economic exposure."[168] The 2010 ABA Derivatives Report further states that "funds typically comply with their concentration policies by looking to the reference asset and not any counterparty to the derivative instrument. Funds typically use market values for these calculations . . . ."[169]

C. Request for Comment

The Commission requests comment on the application of concentration requirements to funds' investments in derivatives, including the following questions.

- How do funds apply the concentration requirements to their investments in derivatives? Do they consider current market value or the notional amount of a derivative (or some other measure) for purposes of determining whether they have invested 25% or more of the value of their net assets in a particular industry or group of industries? Do funds focus solely upon the exposures to the industries with which their derivatives counterparties are associated, or do they also take into account their exposures to the industry or industries (if any) of the reference assets underlying those derivatives?

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168 2010 ABA Derivatives Report, *supra* note 8, at n. 57.

169 *Id.* at 29.

- Is it consistent with the policies and purposes underlying the concentration requirements for funds to focus on the industry of the issuer of the reference asset and disregard the exposure to the industry or industries with which the derivatives counterparty is associated? Should this depend on the level of collateral (if any) posted by the counterparty?
- Should the Commission provide guidance to funds on how they should comply with the concentration requirements when they use derivatives? If so, what should that guidance entail?
- Are there special considerations that need to be taken into consideration for smaller funds? How might taking such considerations into account impact investor protection?

VI. VALUATION OF DERIVATIVES

In this section, the Commission discusses, and requests comment on, the valuation of derivatives used by funds for purposes of applying the various provisions of the Investment Company Act.

A. Investment Company Act Valuation Requirements

When calculating their NAVs, funds must determine the value of their assets, including the value of the derivatives that they hold. The Investment Company Act specifies how funds must determine the value of their assets. Under the Act, all funds (other than money market funds),[170] whether open-end or closed-end, must calculate their NAVs by using the market values

[170] Money market funds that comply with the provisions of rule 2a-7 under the Act [17 CFR 270.2a-7], however, may value their portfolio securities on the basis of amortized cost. In addition, under certain circumstances, open-end funds may value certain of their portfolio securities on the basis of amortized cost. *See Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies*, Investment Company Act Release No. 9786 (May 31, 1977) [42 FR 28999 (June 7, 1977)], *available at* http://www.sec.gov/rules/interp/1977/ic-

of their portfolio securities when market quotations for those securities are "readily available."[171] When market quotations for a fund's portfolio securities or other assets are not readily available, the fund must calculate its NAV by using the fair value of those securities or assets, as determined in good faith by the fund's board of directors.[172]

There is no single methodology for determining the fair value of a security or other asset because fair value depends upon the facts and circumstances of each situation.[173] As a general principle, however, the fair value of a security or other asset held by a fund would be the amount that the fund might reasonably expect to receive for the security or other asset upon its current sale.[174] When determining the fair value of a security or other asset held by a fund, all indications of value that are available must be taken into account.[175]

B. Application of the Valuation Requirements to a Fund's Use of Derivatives

For many derivatives that are securities, such as exchange-traded options, market quotations typically are readily available. As a result, a fund generally must use market values to value such derivatives. For many other derivatives, however, market quotations are not readily available, and a fund that holds such derivatives is required to value those derivatives at their fair values as determined by the fund's board of directors.

9786.pdf.

171 Section 2(a)(41)(B) of the Act. *See also* ASR 118 and ASR 113, *supra* note 14. "Readily available" refers to public market quotations that are current, *i.e.*, "[r]eadily available market quotations refers to reports of current public quotations for securities similar in all respects to the securities in question." ASR 113, *supra* note 14, at 2.

172 ASR 113, *supra* note 14.

173 ASR 118, *supra* note 14.

174 ASR 113 and ASR 118, *supra* note 14.

175 ASR 118, *supra* note 14.

Valuation of some derivatives may present special challenges for funds. Some derivatives may have customized terms, including contractual restrictions on their transferability. Some derivatives also may restrict a fund's ability to close out the contract or to enter into an offsetting transaction. For some derivatives, there may be no quotations available from independent sources, and for some derivatives the fund's counterparty may be the only available source of pricing information.

C. Request for Comment

The Commission requests comment on funds' valuation of derivatives, including the following questions:

- How do funds determine the fair values of derivatives that they hold? To what extent do valuation determinations depend upon the type of derivative, reference asset, trading venue, and other factors?
- How do funds, when fair valuing derivatives, assess the accuracy and reliability of pricing information that is obtained from their counterparties or from other sources?
- How do funds take into account, when valuing derivatives, contractual restrictions on transferability, and restrictions on their ability to close out the transactions or to enter into offsetting transactions?
- Some derivatives held by funds may have negative values due to, among other things, changes in the value of the reference assets underlying the derivatives. Do funds calculate the values of such derivatives in the same manner as they value derivatives that have positive values? If not, why not?

- Should the Commission issue guidance on the fair valuation of derivatives under the Investment Company Act? If so, what issues should be addressed by that guidance?
- Are there special considerations that need to be taken into consideration for smaller funds? How might taking such considerations into account impact investor protection?

VII. GENERAL REQUEST FOR COMMENT

In addition to the specific issues highlighted for comment, the Commission invites members of the public to address any other matters that they believe are relevant to the use of derivatives by funds.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: August 31, 2011