SECURITIES AND EXCHANGE COMMISSION

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Mary L. Schapiro served as SEC Chairman
January 27, 2009 until December 14, 2012

Elisse B. Walter served as SEC Commissioner
July 9, 2008 until December 14, 2012

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

DANIEL L. GALLAGHER, COMMISSIONER

(54 Documents)

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

April 1, 2011

IN THE MATTER OF CHINA CHANGJIANG MINING & NEW ENERGY CO., LTD. File No. 500-1	:	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of China Changjiang Mining & New Energy Co., Ltd. ("CHJI"), a Nevada corporation previously known as North American Gaming and Entertainment Corporation. CHJI has headquarters and operations in the People's Republic of China and trades in the over-the-counter market under the symbol "CHJI."

Questions have arisen regarding the accuracy and completeness of information contained in CHJI's public filings with the Commission concerning, among other things, the company's financial statements for 2009 and 2010. CHJI has failed to disclose that (a) the company filed its last periodic report on Form 10-Q for the quarter ended September 30, 2010 without the required review of the interim financial statements by an independent public accountant; and (b) the company's independent auditor has resigned, withdrawn its audit opinion issued April 16, 2010 relating to the audit of the company's consolidated financial statements as of December 31, 2009, and informed the company that the financial statements for the quarters ended March 31, June 30, and September 30, 2010 could no longer be relied upon.

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 April 1, 2011 through 11:59 p.m. EDT, on April 14, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68341; File No.10-207)

In the Matter of the Application of Miami International Securities Exchange, LLC for Registration as a National Securities Exchange

Findings, Opinion, and Order of the Commission

December 3, 2012

I. Introduction

On April 26, 2012, Miami International Securities Exchange, LLC ("MIAX Exchange" or "MIAX") submitted to the Securities and Exchange Commission ("Commission") an Application for Registration as a National Securities Exchange ("Form 1 Application") under Section 6 of the Securities Exchange Act of 1934 ("Act").[1] Notice of MIAX's Form 1 Application was published for comment in the Federal Register on August 20, 2012.[2] The Commission received two comment letters concerning MIAX's Form 1 Application.[3] MIAX

1 15 U.S.C. 78f.

2 See Securities Exchange Act Release No. 67660 (August 15, 2012), 77 FR 50814 ("Notice").

3 See Letter from Michael J. Simon, Secretary, International Securities Exchange, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated October 4, 2012 ("ISE Letter"); and Letter from Jeffrey S. Davis, Vice President and Deputy General Counsel, NASDAQ OMX Group, Inc., to Elizabeth M. Murphy, Secretary, Commission, dated October 4, 2012 ("NASDAQ Letter"). In its letter, the International Securities Exchange ("ISE"), requested that MIAX clarify what it considered to be potential "unique aspects" of the proposed MIAX rules and asked the Commission to discuss how such provisions are consistent with the Act. Similarly, the letter from NASDAQ OMX ("NASDAQ") requested that MIAX clarify certain of its proposed rules and provide greater explanation or detail as to how they would work. In Section IV, below, the Commission considers the issues raised by the comment letters, along with MIAX's response thereto, and considers whether MIAX sufficiently addressed those concerns. In summary, the Commission believes that MIAX has sufficiently addressed each of the commenters' concerns and has proposed reasonable changes to its rules to address those concerns. The changes also clarify the potential sources of ambiguity that commenters identified. The changes proposed in Amendment No. 1 are either not material, consistent with the existing rules of other registered national securities exchanges, or responsive to the concerns of the Commission and do not raise any new or novel regulatory issues.

submitted a detailed response to comments on November 30, 2012.[4] On November 30, 2012, MIAX submitted Amendment No. 1 to its Form 1 Application.[5]

II. Statutory Standards

Under Sections 6(b) and 19(a) of the Act,[6] the Commission shall by order grant an application for registration as a national securities exchange if the Commission finds, among other things, that the proposed exchange is so organized and has the capacity to carry out the purposes of the Act and can comply, and can enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.

As discussed in greater detail below, the Commission finds that MIAX's application for exchange registration meets the requirements of the Act and the rules and regulations thereunder. Further, the Commission finds that the proposed rules of MIAX are consistent with Section 6 of the Act in that, among other things, they are designed to: (1) assure fair representation of the exchange's members in the selection of its directors and administration of its affairs and provide that, among other things, one or more directors shall be representative of investors and not be associated with the exchange, or with a broker or dealer;[7] (2) prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation

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4 See Letter from Barbara Comly, Executive Vice President, General Counsel & Corporate Secretary, MIAX, to Elizabeth M. Murphy, Secretary, Commission, dated November 30, 2012 ("MIAX Response Letter").

5 In Amendment No. 1, MIAX proposed changes to the Limited Liability Company Agreement and the By-Laws of Miami International Securities Exchange, LLC concerning the election of an interim board of directors, which is discussed below in Section IV. See Amendment No. 1. MIAX also proposed changes to its proposed rules in response to concerns raised by the two comment letters. See Amendment No. 1. The rule text changes are discussed below in Section III.

6 15 U.S.C. 78f(b) and 15 U.S.C. 78s(a), respectively.

7 See 15 U.S.C. 78f(b)(3).

and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and remove impediments to and perfect the mechanisms of a free and open market and a national market system;[8] (3) not permit unfair discrimination between customers, issuers, or dealers;[9] and (4) protect investors and the public interest.[10] Finally, the Commission finds that MIAX's proposed rules do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.[11]

III. Discussion

A. Governance of MIAX Exchange

1. MIAX Exchange Board of Directors

The board of directors of MIAX Exchange ("Exchange Board") will be its governing body and will possess all of the powers necessary for the management of its business and affairs, including governance of MIAX Exchange as a self-regulatory organization ("SRO").[12]

Under the By-Laws of MIAX Exchange ("MIAX Exchange By-Laws"):[13]

- The Exchange Board will be composed of not less than ten directors;[14]
- One director will be the Chief Executive Officer of MIAX Exchange;[15]

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8 See 15 U.S.C. 78f(b)(5).

9 See id.

10 See id.

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

12 See MIAX Exchange By-Laws Section 2.1. See also MIAX Exchange LLC Agreement Sections 7 and 8.

13 The MIAX Exchange By-Laws are included in the Second Amended and Restated Limited Liability Company Agreement of MIAX Exchange ("MIAX Exchange LLC Agreement").

14 See MIAX Exchange By-Laws Article II, Section 2.2(a).

15 See MIAX Exchange By-Laws Article II, Section 2.2(b).

- The number of Non-Industry Directors,[16] including at least one Independent Director,[17] will equal or exceed the sum of the number of Industry Directors[18] and Member Representative Directors;[19] and

- At least twenty percent of the directors on the Exchange Board will be Member Representative Directors.[20]

For the interim board (discussed below), and subsequently at the first annual meeting and each annual meeting thereafter, Miami Holdings, as the sole LLC Member of MIAX Exchange,

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16 "Non-Industry Director" means a Director who is an Independent Director or any other individual who would not be an Industry Director. See MIAX Exchange By-Laws Article I(y).

17 "Independent Director" means a "Director who has no material relationship with the [MIAX Exchange] or any affiliate of the [MIAX Exchange], or any [MIAX member] or any affiliate of any such [MIAX member]; provided, however, that an individual who otherwise qualifies as an Independent Director shall not be disqualified from serving in such capacity solely because such Director is a Director of the [MIAX Exchange] or [Miami International Holdings, Inc.]." See MIAX Exchange By-Laws Article I(n).

18 An "Industry Director" is, among other things, a Director that is or has served within the prior three years as an officer, director, employee, or owner of a broker or dealer, as well as any Director who has, or has had, a consulting or employment relationship with MIAX Exchange or any affiliate of MIAX Exchange within the prior three years. See MIAX Exchange By-Laws Article I(p). This definition is consistent with what the Commission has approved for other exchanges. See Securities Exchange Act Release No. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) ("BATS Order"). See also Securities Exchange Act Release Nos. 66871 (April 27, 2012), 77 FR 26323 (May 3, 2012) ("BOX Order"); and 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) ("DirectEdge Exchanges Order").

19 See MIAX Exchange By-Laws Article II, Section 2.2 (b)(i). "Member Representative Director" means a Director who has been appointed by Miami International Holdings, Inc. as an initial Director pursuant to Section 2.5 of the MIAX Exchange By-Laws to serve until the first annual meeting or who "has been elected by the LLC Member after having been nominated by the Member Nominating Committee or by an Exchange Member pursuant to [the] By-Laws and confirmed as the nominee of Exchange Members after majority vote of Exchange Members, if applicable. A Member Representative Director may, but is not required to be, an officer, director, employee, or agent of an Exchange Member." See MIAX Exchange By-Laws Article I(v). See also MIAX Exchange By-Laws Article II, Section 2.5.

20 See MIAX Exchange By-Laws Article II, Section 2.2 (b)(ii).

will elect the MIAX Exchange Board pursuant to the MIAX By-Laws.[21] In addition, Miami Holdings will appoint the initial Nominating Committee[22] and Member Nominating Committee,[23] consistent with each committee's compositional requirements,[24] to nominate candidates for election to the Exchange Board. Each of the Nominating Committee and Member Nominating Committee, after completion of its respective duties for nominating directors for election to the Board for that year, shall nominate candidates to serve on the succeeding year's Nominating Committee or Member Nominating Committee, as applicable. Additional candidates for the Member Nominating Committee may be nominated and elected by MIAX Exchange members pursuant to a petition process.[25]

The Nominating Committee will nominate candidates for each director position, and Miami Holdings, as the sole LLC Member, will elect those directors. For Member Representative Director positions, the Nominating Committee will nominate those candidates

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21 See MIAX Exchange By-Laws Article II, Section 2.4. See also MIAX Exchange LLC Agreement Section 9(a).

22 The Nominating Committee will be comprised of at least three directors, and the number of Non-Industry members on the Nominating Committee must equal or exceed the number of Industry members. See MIAX Exchange By-Laws Article V, Section 5.2. See also MIAX Exchange By-Laws Article IV, Section 4.2(a).

23 The Member Nominating Committee will be comprised of at least three directors, and each member of the Member Nominating Committee shall be a Member Representative member. See MIAX Exchange By-Laws Article V, Section 5.3. See also MIAX Exchange By-Laws Article IV, Section 4.2(a). Pursuant to MIAX Exchange By-Laws Article I(w), a "Member Representative member" is a member of any committee or hearing panel appointed by the Exchange Board who has been elected or appointed after having been nominated by the Member Nominating Committee pursuant to the by-laws and who is an officer, director, employee, or agent of an Exchange Member.

24 See MIAX Exchange By-Laws Article V, Section 5.1.

25 See id.

submitted to it, and approved, by the Member Nominating Committee.[26] Additional candidates, however, may be nominated for the Member Representative Director positions by MIAX Exchange members pursuant to a petition process.[27] If no candidates are nominated pursuant to a petition process, then the initial nominees submitted by the Member Nominating Committee will be nominated as Member Representative Directors by the Nominating Committee. If a petition process produces additional candidates, then the candidates nominated pursuant to the petition process, together with those nominated by the Member Nominating Committee, will be presented to MIAX Exchange members for a run-off election to determine the final slate of candidates for the vacant Member Representative Director positions.[28] In the event of a contested run-off election, the candidates who receive the most votes will be nominated as the final slate of Member Representative Director candidates by the Nominating Committee.[29] Miami Holdings, as the sole LLC Member, is obligated to elect the final slate of the Member Representative Director candidates that are nominated by the Nominating Committee.[30]

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26 The Member Nominating Committee will solicit comments from MIAX Exchange members for the purpose of approving and submitting names of candidates for election to the position of Member Representative Director. See MIAX Exchange By-Laws Article II, Section 2.4(b).

27 See MIAX Exchange By-Laws Article II, Section 2.4(c). The petition must be signed by executive representatives of 10% or more of the MIAX Exchange members. No MIAX Exchange member, together with its affiliates, may account for more than 50% of the signatures endorsing a particular candidate. See id.

28 See MIAX Exchange By-Laws Article II, Section 2.4(e) and (f). Each MIAX Exchange Member shall have the right to cast one vote for each available Member Representative Director nomination, provided that any such vote must be cast for a person on the List of Candidates and that no MIAX Exchange member, together with its affiliates, may account for more than 20% of the votes cast for a candidate. See MIAX Exchange By-Laws Article II, Section 2.4(f).

29 See MIAX Exchange By-Laws Article II, Section 2.4(f).

30 See id.

The Commission believes that the requirement in the MIAX Exchange By-Laws that 20% of the directors be Member Representative Directors and the means by which they will be chosen by MIAX Exchange members provide for the fair representation of members in the selection of directors and the administration of MIAX Exchange and therefore is consistent with Section 6(b)(3) of the Act.[31] As the Commission has previously noted, this requirement helps to ensure that members have a voice in the use of self-regulatory authority, and that an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.[32]

In addition, with respect to the requirement that the number of Non-Industry Directors, including at least one Independent Director, will equal or exceed the sum of the number of Industry Directors and Member Representative Directors, the Commission believes that the proposed composition of the MIAX Exchange Board satisfies the requirements in Section 6(b)(3) of the Act,[33] which requires in part that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, or with a broker or dealer. The Commission previously has stated that the inclusion of public, non-industry representatives on exchange oversight bodies is an important mechanism to support an exchange's ability to protect the public interest.[34] Further, the presence of public, non-industry representatives can help to

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31 15 U.S.C. 78f(b)(3).

32 See, e.g., Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (granting the exchange registration of Nasdaq Stock Market, Inc.) ("Nasdaq Order"); and BATS Order, supra note 18. See also Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) ("NYSE/Archipelago Merger Approval Order").

33 15 U.S.C. 78f(b)(3).

34 See, e.g., Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) ("Regulation ATS Release").

ensure that no single group of market participants has the ability to systematically disadvantage other market participants through the exchange governance process. The Commission believes that public, non-industry directors can provide unique, unbiased perspectives, which are designed to enhance the ability of the MIAX Exchange Board to address issues in a non-discriminatory fashion and foster the integrity of MIAX Exchange.[35]

Interim Exchange Board. Prior to commencing operations, Miami Holdings will appoint an interim Exchange board of directors ("Interim Exchange Board"), which will include interim Member Representative Directors. With respect to the selection of the interim Member Representative Directors for the Interim Exchange Board, prior to the commencement of operations as an exchange, MIAX will submit the names of its nominees for the interim Member Representative Directors positions to persons that have begun the process of becoming members in the new MIAX Exchange.[36] MIAX represents that the persons and firms that have applied to become the initial members of MIAX Exchange have already begun the process of completing the necessary applications, obtaining electronic connectivity, and testing their systems with MIAX.[37] MIAX additionally represents that the initial members of MIAX will consist substantially of the current group of persons and firms that have begun the membership application process with MIAX.[38]

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35 See Nasdaq Order and NYSE/Archipelago Merger Approval Order, supra note 32, and BATS Order, supra note 18.

36 See Amendment No. 1; see also MIAX Exchange By-Laws Section 2.5(b). Specifically, MIAX will submit the names of its nominees for the interim Member Representative Director positions to persons who have submitted initial documents for membership in the Exchange who would meet the qualifications for membership. See MIAX Exchange By-Laws Section 2.5(b).

37 See Amendment No. 1.

38 See Amendment No. 1.

Such persons will be allowed 14 days to submit the name of an alternative candidate and 5 days to vote for the final slate of candidates.[39] All other interim directors, except for the interim Member Representative Directors, will be appointed and elected by Miami Holdings, and must meet the MIAX Exchange board composition requirements as set forth in the MIAX Exchange By-Laws. Once these interim Member Representative Directors are seated on the Interim Exchange Board, then the Interim Exchange Board will meet the board composition requirements set forth in the governing documents of MIAX Exchange.

The Interim Exchange Board will serve until the first initial Exchange Board is elected pursuant to the full nomination, petition, and voting process set forth in the MIAX By-Laws.[40] MIAX Exchange will complete such process within 90 days after its application for registration as a national securities exchange is granted by the Commission.[41]

The Commission believes that the process for electing the Interim Exchange Board, as proposed, is consistent with the requirements of the Act, including that the rules of the exchange assure fair representation of the exchange's members in the selection of its directors and administration of its affairs.[42] As noted above, MIAX represents that the initial members of MIAX will consist substantially of the current group of persons and firms that have begun the membership application process with MIAX. MIAX will engage these persons and firms in the

39 See MIAX Exchange By-Laws Sections 2.5(b) and (d).

40 See Amendment No. 1; and MIAX Exchange By-Laws Sections 2.2(e) and 2.5(a).

41 See Amendment No. 1. The 90-day period is consistent with what the Commission recently approved for the BOX Exchange. See Securities Exchange Act Release No. 66871 (April 27, 2012), 77 FR 26323 (May 3, 2012) (allowing BOX Exchange to appoint an initial interim board to enable it to commence operations as a registered exchange). See also Securities Exchange Act Release No. 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) ("C2 Order") (allowing CBOE to appoint the initial board members and to issue a circular to trading permit holders identifying a slate of representative directors within 45 days from the date on which trading commenced on C2).

42 See 15 U.S.C. 78f(b)(3).

interim board election process by, prior to the commencement of operations as an exchange, providing each of them with the opportunity to participate in the selection of interim Member Representative Directors consistent with the MIAX Exchange By-Laws. Further, MIAX Exchange represents that it will complete the full nomination, petition, and voting process as set forth in the MIAX Exchange By-Laws, which will provide persons that are approved as members after the effective date of this Order with the opportunity to participate in the selection of the Member Representative Directors, within 90 days of when MIAX Exchange's application for registration as a national securities exchange is granted.[43] The Commission therefore believes that MIAX Exchange's initial interim board process is consistent with the Act, including Section 6(b)(3), in that it is designed to provide representation among the persons and firms likely to become members when MIAX commences operations and is sufficient to allow MIAX to commence operations for an interim period prior to going through the process to elect a new Exchange Board pursuant to the full nomination, petition, and voting process set forth in the MIAX Exchange By-Laws.

2. Exchange Committees

In the MIAX Exchange By-Laws, MIAX Exchange has proposed to establish several standing committees, which will be divided into two categories: Committees of the Board (composed of MIAX Exchange directors) and Committees of the MIAX Exchange (composed of a mixture of MIAX Exchange directors and persons that are not MIAX Exchange directors).[44] The standing Committees of the Board will be the Audit, Compensation, Appeals, and

43 MIAX's proposed timeline for the interim board process follows a process identical to what the Commission recently approved for the BOX Exchange.

44 See MIAX Exchange By-Laws Section 4.1.

Regulatory Oversight Committees.[45] In addition, the MIAX Chairman, with approval of the Exchange Board, may appoint an Executive Committee and a Finance Committee, which also would be Committees of the Board.[46]

The Audit Committee will consist of three or more directors, a majority of which will be Non-Industry Directors.[47] Each of the Compensation and Regulatory Oversight Committees will consist of three or more directors, all of which will be required to be Non-Industry Directors.[48] The Appeals Committee will consist of one Independent Director, one Industry Director, and one Member Representative Director.[49] If established, the Finance Committee will consist of at least three persons (who may, but are not required to, be directors) a majority of whom will be Non-Industry Directors.[50] The Executive Committee, if established, will consist of at least three directors. Because the Executive Committee will have the powers and authority of the Exchange Board in the management of the business and affairs of the MIAX Exchange between meetings of the Exchange Board, its composition must reflect that of the Exchange Board. Accordingly, the number of Non-Industry Directors on the Executive Committee must equal or exceed the number of Industry Directors and the percentages of Independent Directors and Member

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45 See MIAX Exchange By-Laws Section 4.1(a).

46 See MIAX Exchange By-Laws Section 4.5(e) and (f), respectively.

47 See MIAX Exchange By-Laws Section 4.5(b). A Non-Industry Director shall serve as Chairman of the Committee. See id. See also MIAX Exchange By-Laws Section 4.2(a) (requiring that each committee be comprised of at least three people).

48 See MIAX Exchange By-Laws Section 4.5(a) and 4.5(c).

49 See MIAX Exchange By-Laws Section 4.5(d).

50 See MIAX Exchange By-Laws Section 4.5(f). See also MIAX Exchange By-Laws Section 4.2(a) (providing that except as otherwise provided in the MIAX Exchange By-Laws, committees may include persons who are not members of the Board).

Representative Directors must be at least as great as the corresponding percentages on the Exchange Board as a whole.[51]

With respect to Committees of MIAX Exchange, MIAX Exchange has proposed to establish a Nominating Committee[52] and a Member Nominating Committee.[53] As discussed above, these committees will have responsibility for, among other things, nominating candidates for election to the Exchange Board. On an annual basis, the members of these committees will nominate candidates for the succeeding year's respective committees to be elected by Miami Holdings, as the sole LLC Member.[54] In addition, MIAX also has proposed to establish a Quality of Markets Committee,[55] which will provide advice and guidance to the Exchange Board on issues related to the fairness, integrity, efficiency and competiveness of the information, order handling and execution mechanisms of the exchange from the perspective of individual and institutional investors, retail and market making firms, exchange listed companies, and other market participants. The Quality of Markets Committee will include a broad representation of participants in MIAX Exchange. Additionally, at least 20% of the members of the committee will be Member Representative members, and the number of Non-Industry members must equal or exceed the total number of Industry and Member Representative members. MIAX also has proposed to establish a Business Conduct Committee as discussed further below.[56]

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51 See MIAX Exchange By-Laws Section 4.5(e).

52 See MIAX Exchange By-Laws Article V, Section 5.2, and supra note 22.

53 See MIAX Exchange By-Laws Article V, Section 5.3, and supra note 23.

54 See MIAX Exchange By-Laws Article V, Section 5.1, and supra note 25. Additional candidates for the Member Nominating Committee may be nominated and elected by MIAX Exchange members pursuant to a petition process. See supra note 27 and accompanying text.

55 See MIAX Exchange By-Laws Article IV, Section 4.6.

56 See infra note 381 and accompanying text.

The Commission believes that MIAX Exchange's proposed committees, which are similar to the committees maintained by other exchanges,[57] are designed to help enable MIAX Exchange to carry out its responsibilities under the Act and are consistent with the Act, including Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.[58]

B. Regulation of MIAX Exchange

When MIAX Exchange commences operations as a national securities exchange, MIAX Exchange will have all the attendant regulatory obligations under the Act. In particular, MIAX Exchange will be responsible for the operation and regulation of its trading system and the regulation of its members. Certain provisions in the MIAX Exchange and Miami Holdings governance documents are designed to facilitate the ability of MIAX Exchange and the Commission to fulfill their regulatory obligations. The discussion below summarizes some of these key provisions.

1. Ownership Structure; Ownership and Voting Limitations

MIAX Exchange will be structured as a Delaware limited liability company ("LLC"), which will be wholly-owned by the sole member of the LLC, Miami International Holdings, Inc. ("Miami Holdings"). The Miami Holdings' proposed Amended and Restated Certificate of Incorporation ("Miami Holdings Certificate") includes restrictions on the ability to own and vote shares of capital stock of Miami Holdings.[59] These limitations are designed to prevent any

57 See, e.g., BATS Order, supra note 18, and Nasdaq Order, supra note 32.

58 15 U.S.C. 78f(b)(1).

59 These provisions are consistent with ownership and voting limits approved by the Commission for other SROs. See e.g., Securities Exchange Act Release Nos. 62158 (May 24, 2010), 75 FR 30082 (May 28, 2010) (CBOE-2008-88) (CBOE Demutualization Approval Order); 58375 (August 18, 2008) 73 FR 49498 (August 21, 2008) (File No. 10-182) ("BATS Exchange Registration Order"); 53963 (June 8, 2006), 71 FR 34660 (June

Miami Holdings shareholder from exercising undue control over the operation of MIAX Exchange and to assure that the MIAX Exchange and the Commission are able to carry out their regulatory obligations under the Act.

In particular, for so long as Miami Holdings (directly or indirectly) controls MIAX Exchange, no person, either alone or together with its related persons,[60] may beneficially own more than 40% of any class of capital stock of Miami Holdings.[61] MIAX proposed a more conservative restriction for MIAX Exchange members, wherein MIAX Exchange members, either alone or together with their related persons, are prohibited from beneficially owning more than 20% of shares of any class of capital stock of Miami Holdings.[62] If any stockholder violates these ownership limits, Miami Holdings would redeem the shares in excess of the applicable ownership limit at their par value.[63] In addition, no person, alone or together with its related persons, may vote or cause the voting of more than 20% of the voting power of the then issued and outstanding capital stock of Miami Holdings.[64] If any stockholder purports to vote,

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15, 2006) (SR-NSX-2006-03) ("NSX Demutualization Order"); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26) ("CHX Demutualization Order"); and 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73) ("Phlx Demutualization Order").

60 See Miami Holdings Certificate NINTH (a)(ii) (defining "related persons").

61 See Miami Holdings Certificate NINTH (b)(i)(A).

62 See Miami Holdings Certificate NINTH (b)(i)(B).

63 See Miami Holdings Certificate NINTH (e). Any shares which have been called for redemption shall not be deemed outstanding shares for the purpose of voting or determining the total number of shares entitled to vote. Once redeemed by Miami Holdings, such shares shall become treasury shares and shall no longer be deemed to be outstanding. See id. Furthermore, if any redemption results in another stockholder owning shares in violation of the ownership limits described above, Miami Holdings shall redeem such shares. See id.

64 See Miami Holdings Certificate NINTH (b)(i)(C).

or cause the voting of, shares that would violate this voting limit, Miami Holdings would not honor such vote in excess of the voting limit.[65]

Any person that proposes to own shares of capital stock in excess of the 40% ownership limitation, or vote or grant proxies or consents with respect to shares of capital stock in excess of the 20% voting limitation, must deliver written notice to the Miami Holdings board to notify the Board of its intention.[66] The notice must be delivered to the Board not less than 45 days before the proposed ownership of such shares or proposed exercise of such voting rights or the granting of such proxies or consents.[67] The Miami Holdings board may waive the 40% ownership limitation and the 20% voting limitation, pursuant to a resolution duly adopted by the Board of Directors, if it makes certain findings,[68] except that the Miami Holdings board cannot waive the voting and ownership limits above 20% for MIAX Exchange members and their

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65 See Miami Holdings Certificate NINTH (d). The Miami Holdings Certificate also prohibits the payment of any stock dividends and conversions that would violate the ownership and voting limitations. See Miami Holdings Certificates FOURTH A.(b) and (e), and D.7.

66 See Miami Holdings Certificate NINTH (b)(iv).

67 See id.

68 See Miami Holdings Certificate NINTH (b)(ii)(B). The required determinations are that (A) such waiver will not impair the ability of MIAX Exchange to carry out its functions and responsibilities under the Act and the rules and regulations promulgated thereunder, (B) such waiver is otherwise in the best interests of MIAX Exchange and Miami Holdings, (C) such waiver will not impair the ability of the Commission to enforce the Act and (D) the transferee in such transfer and its related persons are not subject to any applicable "statutory disqualification" (within the meaning of Section 3(a)(39) of the Act). See Miami Holdings Certificate NINTH (b)(ii)(B) and (b)(iii). The Commission has previously approved the rules of other exchanges that provide for the ability of the exchange to waive the ownership and voting limitations discussed above for non-members of the exchange. See, e.g., DirectEdge Exchanges Order, supra note 18.

related persons.[69] Any such waiver would not be effective unless and until approved by the Commission pursuant to Section 19 of the Act.[70]

The Miami Holdings Certificate also contains provisions that are designed to further safeguard the ownership and voting limitation described above, or are otherwise related to direct and indirect changes in control. Specifically, any person that, either alone or together with its related persons owns, directly or indirectly, of record or beneficially, 5% or more of the capital stock of Miami Holdings will be required to immediately notify Miami Holdings in writing upon acquiring knowledge of such ownership.[71] Thereafter, such persons will be required to update Miami Holdings of any increase or decrease of 1% or more in their previously reported ownership percentage.[72]

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69 See id. These provisions are generally consistent with waiver of ownership and voting limits approved by the Commission for other SROs. See e.g., BATS Exchange Registration Order; NSX Demutualization Order, supra note 59; CHX Demutualization Order, supra note 59; and Securities Exchange Act Release No. 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08).

70 See Miami Holdings Certificate NINTH (b)(ii)(B).

71 See Miami Holdings Certificate NINTH(c)(i). The notice will require the person's full legal name; the person's title or status; the person's approximate ownership interest in Miami Holdings; and whether the person has power, directly or indirectly, to direct the management or policies of Miami Holdings. See id.

72 See Miami Holdings Certificate NINTH(c)(ii). Changes of less than 1% must also be reported to Miami Holdings if they result in such person crossing a 20% or 40% ownership threshold. See id. In addition, MIAX rules also impose limits on affiliation between the MIAX Exchange and a member of the MIAX Exchange. See MIAX Rule 201(g) ("Without prior Commission approval, the Exchange or any entity with which it is affiliated shall not directly or indirectly through one or more intermediaries acquire or maintain an ownership interest in an Exchange Member. In addition, without prior Commission approval, no Member shall be or become affiliated with (1) the Exchange; or (2) any affiliate of the Exchange. Nothing herein shall prohibit a Member from acquiring or holding an equity interest in (i) Miami International Holdings, Inc. that is permitted by the Certificate of Incorporation of Miami International Holdings, Inc. or (ii) Miami International Securities Exchange, LLC that is permitted by the Amended and Restated Limited Liability Company Agreement of Miami International Securities Exchange, LLC.").

The MIAX LLC Agreement does not include change of control provisions that are similar to those in the Miami Holdings Certificate; however the MIAX Exchange LLC Agreement explicitly provides that Miami Holdings is the sole LLC Member of MIAX Exchange.[73] Thus, if Miami Holdings ever proposes to no longer be the sole LLC Member of MIAX Exchange (and therefore no longer its sole owner), MIAX Exchange would be required to amend the MIAX Exchange LLC Agreement. Any changes to the MIAX Exchange LLC Agreement (which includes the MIAX Exchange By-Laws), including any change in the provisions that identify Miami Holdings as the sole owner of MIAX Exchange, must be filed with, or filed with and approved by, the Commission pursuant to Section 19 of the Act, as the case may be.[74] Further, pursuant to the MIAX Exchange By-Laws, Miami Holdings may not transfer or assign, in whole or in part, its ownership interest in MIAX Exchange, unless such transfer is filed with and approved by the Commission pursuant to Section 19 of the Act.[75]

Although Miami Holdings is not independently responsible for regulation, its activities with respect to the operation of MIAX Exchange must be consistent with, and must not interfere with, the self-regulatory obligations of MIAX Exchange. As described above, the provisions applicable to direct and indirect changes in control of Miami Holdings and MIAX Exchange, as well as the voting limitation imposed on owners of Miami Holdings who also are MIAX Exchange members, are designed to help prevent any owner of Miami Holdings from exercising undue influence or control over the operation of MIAX Exchange and to help assure that MIAX Exchange retains a sufficient degree of independence to effectively carry out its regulatory

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73 See MIAX Exchange LLC Agreement and MIAX Exchange By-Laws Article I(t) A (both of which define "LLC Member" to mean Miami Holdings, as the sole member of MIAX).

74 See 15 U.S.C. 78s. See also MIAX Exchange LLC Agreement, Section 28(b).

75 See MIAX Exchange By-Laws Article III, Section 3.4.

obligations under the Act. In addition, these limitations are designed to address the conflicts of interests that might result from a member of a national securities exchange owning interests in the exchange. Members that trade on an exchange traditionally have had ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange, including an entity that controls an exchange, could become so large as to cast doubts on whether the exchange may fairly and objectively exercise its self-regulatory responsibilities with respect to such member.[76] A member that is a controlling shareholder of an exchange could seek to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and conduct surveillance of the member's conduct or diligently enforce the exchange's rules and the federal securities laws with respect to conduct by the member that violates such provisions. As such, the Commission believes that these requirements are designed to minimize the potential that a person or entity can improperly interfere with or restrict the ability of MIAX Exchange to effectively carry out its regulatory oversight responsibilities under the Act.

The Commission believes that MIAX's and Miami Holding's proposed governance provisions are consistent with the Act, including Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.[77] In particular, these requirements are designed to minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or MIAX Exchange to effectively carry out their regulatory oversight responsibilities under the Act.

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76 See, e.g., DirectEdge Exchanges Order and BATS Order, supra note 18.

77 15 U.S.C. 78f(b)(1).

2. Regulatory Independence and Oversight

Although Miami Holdings will not itself carry out regulatory functions, its activities with respect to the operation of MIAX Exchange must be consistent with, and must not interfere with, MIAX Exchange's self-regulatory obligations. In this regard, MIAX Exchange and Miami Holdings propose to adopt certain provisions in their respective governing documents that are designed to help maintain the independence of the regulatory functions of MIAX Exchange. These proposed provisions are substantially similar to those included in the governing documents of other exchanges that recently have been granted registration.[78] Specifically:

- The directors, officers, employees, and agents of Miami Holdings must give due regard to the preservation of the independence of the self-regulatory function of MIAX Exchange and must not take actions that would interfere with the effectuation of decisions by the MIAX Exchange Board relating to its regulatory functions or that would interfere with MIAX Exchange's ability to carry out its responsibilities under the Act.[79]

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78 See e.g., DirectEdge Exchanges Order and BATS Order, supra note 18, and C2 Order, supra note 41.

79 See Amended and Restated By-Laws of Miami Holdings ("Miami Holdings By-Laws"), Article VII, Section 1.

Similarly, Article II, Section 2.1(d) of the MIAX Exchange By-Laws requires the MIAX Exchange Board to, when managing the business and affairs of MIAX Exchange and evaluating any proposal, consider the requirements of Section 6(b) of the Act. Section 2.1(e) also requires the MIAX Exchange Board, when evaluating any proposal to take into account (among other things and to the extent relevant), the potential impact on the integrity, continuity and stability of the national securities exchange operated by MIAX Exchange and the other operations of MIAX Exchange on the ability to prevent fraudulent and manipulative acts and practices and on investors and the public, and whether such would promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities or assist in the removal of impediments to or perfection of the mechanisms for a free and open market

- Miami Holdings must comply with federal securities laws and the rules and regulations promulgated thereunder, and agrees to cooperate with the Commission and MIAX Exchange pursuant to, and to the extent of, their respective regulatory authority. In addition, Miami Holdings' officers, directors, employees, and agents must comply with federal securities laws and the rules and regulations promulgated thereunder and agree to cooperate with the Commission and MIAX Exchange in respect of the Commission's oversight responsibilities regarding MIAX Exchange and the self-regulatory functions and responsibilities of MIAX Exchange.[80]
- Miami Holdings, and its officers, directors, employees, and agents submit to the jurisdiction of the U.S. federal courts, the Commission, and MIAX Exchange, for purposes of any action, suit, or proceeding pursuant to U.S. federal securities laws, and the rules and regulations thereunder, arising out of, or relating to, MIAX Exchange activities.[81]
- All books and records of MIAX Exchange reflecting confidential information pertaining to the self-regulatory function of MIAX Exchange (including but not limited to disciplinary matters, trading data, trading practices, and audit information) shall be retained in confidence by MIAX Exchange and its personnel and will not be used by MIAX Exchange for any non-regulatory purpose and shall not be made available to persons (including, without limitation, any MIAX Exchange member) other than to personnel of the Commission, and those personnel of MIAX Exchange,

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and a national market system. See, e.g., Amended and Restated By-Laws of BATS, Article III, Section 1.

80 See Miami Holdings By-Laws, Article VII, Section 4.

81 See Miami Holdings By-Laws, Article VII, Section 5.

members of committees of MIAX Exchange, members of the MIAX Exchange Board, or hearing officers and other agents of MIAX, to the extent necessary or appropriate to properly discharge the self-regulatory function of MIAX Exchange.[82]

- The books and records of MIAX Exchange and Miami Holdings must be maintained in the United States[83] and, to the extent they are related to the operation or administration of MIAX Exchange, Miami Holdings books and records will be subject at all times to inspection and copying by the Commission.[84]
- Furthermore, to the extent they relate to the activities of MIAX Exchange, the books, records, premises, officers, directors, employees, and agents of Miami Holdings will be deemed to be the books, records, premises, officers, directors, employees, and agents of MIAX Exchange, for purposes of, and subject to oversight pursuant to, the Act.[85]
- Miami Holdings will take necessary steps to cause its officers, directors, employees, and agents, prior to accepting a position as an officer, director, employee or agent (as applicable) to consent in writing to the applicability of provisions regarding books

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[82] See MIAX Exchange By-Laws Article X, Section 10.4. The Commission notes that the Miami Holdings LLC Agreement also provides that all books and records of MIAX Exchange reflecting confidential information pertaining to the self-regulatory function of MIAX Exchange will be subject to confidentiality restrictions. See Miami Holdings By-Laws Article VII, Section 2. The requirement to keep such information confidential shall not limit the Commission's ability to access and examine such information or limit the ability of officers, directors, employees, or agent of Miami Holdings to disclose such information to the Commission. See id.

[83] See MIAX Exchange By-Laws Article X, Section 10.4; and Miami Holdings By-Laws Article VII, Section 3.

[84] See Miami Holdings By-Laws Article VII, Section 3.

[85] See Miami Holdings By-Laws Article VII, Section 3.

and records, confidentiality, jurisdiction, and regulatory obligations, with respect to their activities related to MIAX Exchange.[86]

- Miami Holdings Certificate and By-Laws require that, so long as Miami Holdings controls MIAX Exchange, any changes to those documents be submitted to the MIAX Exchange Board, and, if such change is required to be filed with the Commission pursuant to Section 19(b) of the Act and the rules and regulations thereunder, such change shall not be effective until filed with, or filed with and approved by, the Commission.[87]

The Commission believes that the provisions discussed in this section, which are designed to help maintain the independence of MIAX Exchange's regulatory function and help facilitate the ability of MIAX Exchange to carry out its responsibility and operate in a manner consistent with the Act, are appropriate and consistent with the requirements of the Act, particularly with Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.[88] Whether MIAX Exchange operates in compliance with the Act, however, depends on how it and Miami Holdings in practice implement the governance and other provisions that are the subject of this Order.[89]

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86 See Miami Holdings By-Laws Article VII, Section 6.

87 See Miami Holdings Certificate Article VII; and Miami Holdings By-Laws, Article XII, Section 1.

88 15 U.S.C. 78f(b)(1).

89 The Commission notes that it is reviewing the various standards and processes it uses to facilitate the registration of national securities exchanges and other entities required to register with the Commission and plans to issue a concept release designed to collect information and evaluate different aspects of these registration standards and processes, including the policy objectives of registration, how best to achieve those policy objectives through registration and other means, and the relative benefits and costs of the various means available. See Securities Exchange Act Release No. 65543 (October 12, 2011), 76 FR 65784, 65786 fn. 13 (October 24, 2011).

Further, Section 19(h)(1) of the Act[90] provides the Commission with the authority "to suspend for a period not exceeding twelve months or revoke the registration of [an SRO], or to censure or impose limitations upon the activities, functions, and operations of [an SRO], if [the Commission] finds, on the record after notice and opportunity for hearing, that [the SRO] has violated or is unable to comply with any provision of the Act, the rules or regulations thereunder, or its own rules or without reasonable justification or excuse has failed to enforce compliance" with any such provision by its members (including associated persons thereof).[91] If Commission staff were to find, or become aware of, through staff review and inspection or otherwise, facts indicating any violations of the Act, including without limitation Sections 6(b)(1) and 19(g)(1), these matters could provide the basis for a disciplinary proceeding under Section 19(h)(1) of the Act.

The Commission also notes that, even in the absence of the governance provisions described above, under Section 20(a) of the Act any person with a controlling interest in MIAX Exchange would be jointly and severally liable with and to the same extent that MIAX Exchange is liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.[92] In addition, Section 20(e) of the Act creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Act or rule thereunder.[93] Further, Section 21C of the Act authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision

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90 See 15 U.S.C. 78s(h)(1).

91 See id.

92 15 U.S.C. 78t(a).

93 15 U.S.C. 78t(e).

of the Act through an act or omission that the person knew or should have known would contribute to the violation.[94] These provisions are applicable to all entities' dealings with MIAX Exchange, including Miami Holdings.

3. Regulation of MIAX

As a prerequisite for the Commission's granting of an exchange's application for registration, an exchange must be organized and have the capacity to carry out the purposes of the Act.[95] Specifically, an exchange must be able to enforce compliance by its members, and persons associated with its members, with the federal securities laws and the rules of the exchange.[96] The discussion below summarizes how MIAX Exchange proposes to conduct and structure its regulatory operations.

a. Regulatory Oversight Committee

The regulatory operations of MIAX Exchange will be monitored by the Regulatory Oversight Committee of the MIAX Exchange Board. The Regulatory Oversight Committee will consist of at least three directors, all of whom will be Non-Industry Directors. The Regulatory Oversight Committee will be responsible for overseeing the adequacy and effectiveness of MIAX Exchange's regulatory and SRO responsibilities, assessing MIAX Exchange's regulatory performance, and assisting the MIAX Exchange Board (and committees of the MIAX Exchange Board) in reviewing MIAX Exchange's regulatory plan and the overall effectiveness of MIAX Exchange's regulatory functions.[97]

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94 15 U.S.C. 78u-3.

95 See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

96 See id. See also Section 19(g) of the Act, 15 U.S.C. 78s(g).

97 See MIAX Exchange By-Laws Article IV Section 4.5(c). The Regulatory Oversight Committee is responsible for reviewing MIAX Exchange's regulatory budget, and also will meet regularly with the Chief Regulatory Officer. See id.

Further, a Chief Regulatory Officer ("CRO") of MIAX Exchange will have general day-to-day supervision over MIAX Exchange's regulatory operations.[98] The Regulatory Oversight Committee also will be responsible for recommending compensation and personnel actions involving the CRO and senior regulatory personnel to the Compensation Committee of the MIAX Exchange for action.[99] The CRO will report to the Regulatory Oversight Committee.[100]

b. Regulatory Funding

To help assure the Commission that it has and will continue to have adequate funding to be able to meet its responsibilities under the Act, MIAX Exchange represented that, prior to commencing operations as a national securities exchange, Miami Holdings will provide sufficient funding to MIAX Exchange for the exchange to carry out its responsibilities under the Act.[101] Specifically, MIAX Exchange represents that prior to launching operations, Miami Holdings will allocate sufficient operational assets and make a capital contribution of not less than $2,000,000 into MIAX Exchange's capital account, in addition to either directly making payments of, or contributing adequate funds from Miami Holdings to MIAX Exchange for payments by MIAX Exchange of: (i) personnel costs (including regulatory department personnel), (ii) technology support for regulatory oversight, (iii) infrastructure costs, and (iv) industry and regulatory memberships.[102]

98 See MIAX Exchange By-Laws Article VI, Section 6.10.

99 See MIAX Exchange By-Laws Article IV, Section 4.5(c).

100 See MIAX Exchange By-Law Article VI, Section 6.10.

101 See MIAX Form 1 Application, Exhibit I.

102 See id.

MIAX Exchange also represents that such direct funding by Miami Holdings, as well as allocations and contributions by Miami Holdings to MIAX Exchange, will be adequate to operate MIAX Exchange, including the ongoing regulation of the exchange, and that Miami Holdings and MIAX Exchange have entered into a funding agreement that requires Miami Holdings to provide adequate funding for the exchange's initial and ongoing operations, including the regulation of MIAX Exchange.[103]

Further, any revenues received by MIAX Exchange from fees derived from its regulatory function or regulatory penalties will not be used for non-regulatory purposes.[104] Any excess funds, as determined by MIAX Exchange, may be remitted to Miami Holdings, however "Regulatory Funds" will not be remitted to Miami Holdings.[105]

c. Rule 17d-2 Agreements; Regulatory Contract with CBOE

Section 19(g)(1) of the Act,[106] among other things, requires every SRO registered as either a national securities exchange or national securities association to examine for, and enforce compliance by, its members and persons associated with its members with the Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this

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103 See id.

104 See MIAX Exchange By-Laws Article IX, Section 9.4.

105 See MIAX Form 1 Application, Exhibit I. See also MIAX Exchange LLC Agreement Section 16; and MIAX Exchange By-Laws Article IX, Section 9.4. MIAX Exchange By-Laws Article 1(ee) defines "Regulatory Funds" as "fees, fines, or penalties derived from the regulatory operations of the [MIAX Exchange]", but such term does not include "revenues derived from listing fees, market data revenues, transaction revenues, or any other aspect of the commercial operations of the [MIAX Exchange], even if such revenues are used to pay costs associated with the regulatory operations of the [MIAX Exchange]." This definition is consistent with the rules of other SROs. See e.g., By-Laws of NASDAQ OMX PHLX LLC, Article I(ii); and By-Laws of NASDAQ OMX BX, Inc., Article I(ii).

106 15 U.S.C. 78s(g)(1).

responsibility pursuant to Section 17(d) or Section 19(g)(2) of the Act.[107] Rule 17d-2 of the Act[108] permits SROs to propose joint plans to allocate regulatory responsibilities amongst themselves for their common rules with respect to their common members .[109] These agreements, which must be filed with and declared effective by the Commission, generally cover areas where each SRO's rules substantively overlap, including such regulatory functions as personnel registration and sales practices. Without this relief, the statutory obligation of each individual SRO could result in a pattern of multiple examinations of broker-dealers that maintain memberships in more than one SRO. Such regulatory duplication would add unnecessary expenses for common members and their SROs.

A 17d-2 plan that is declared effective by the Commission relieves the specified SRO of those regulatory responsibilities allocated by the plan to another SRO.[110] Many SROs have entered into Rule 17d-2 agreements.[111] MIAX Exchange has represented to the Commission that

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107 15 U.S.C. 78q(d) and 15 U.S.C. 78s(g)(2), respectively.

108 See Section 17(d)(1) of the Act and Rule 17d-2 thereunder, 15 U.S.C. 78q(d)(1) and 17 CFR 240.17d-2. Section 17(d)(1) of the Act allows the Commission to relieve an SRO of certain responsibilities with respect to members of the SRO who are also members of another SRO. Specifically, Section 17(d)(1) allows the Commission to relieve an SRO of its responsibilities to: (i) receive regulatory reports from such members; (ii) examine such members for compliance with the Act and the rules and regulations thereunder, and the rules of the SRO; or (iii) carry out other specified regulatory responsibilities with respect to such members.

109 17 CFR 240.17d-2. Section 19(g)(1) of the Act requires every SRO to examine its members and persons associated with its members and to enforce compliance with the federal securities laws and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d) of the Act. Section 17(d) was intended, in part, to eliminate unnecessary multiple examinations and regulatory duplication with respect to Common Members. See Securities Exchange Act Release No. 12935 (October 28, 1976), 41 FR 49091 (November 8, 1976) ("Rule 17d-2 Adopting Release").

110 See id.

111 See, e.g., Securities Exchange Act Release Nos. 59218 (January 8, 2009), 74 FR 2143 (January 14, 2009) (File No. 4-575) (FINRA/Boston Stock Exchange, Inc.); 58818 (October 20, 2008), 73 FR 63752 (October 27, 2008) (File No. 4-569) (FINRA/BATS

it intends to become a party to the existing multiparty options Rule 17d-2 plans concerning sales practice regulation and market surveillance.[112] Under these agreements, the examining SROs will examine firms that are common members of MIAX Exchange and the particular examining SRO for compliance with certain provisions of the Act, certain rules and regulations adopted thereunder, and certain MIAX Exchange Rules.

In addition, MIAX Exchange has entered into a Regulatory Services Agreement ("RSA") with the Chicago Board Options Exchange, Incorporated ("CBOE"), under which CBOE will perform certain regulatory functions on behalf of MIAX Exchange.[113] Pursuant to the RSA, CBOE, in its capacity as service provider to MIAX Exchange, will perform various services on MIAX's behalf, including conducting certain market surveillances; assisting MIAX Exchange in conducting investigations of potential violations of MIAX Exchange rules and/or federal securities laws related to activity on the Exchange; conducting examinations related to Exchange members' conduct on MIAX Exchange; assisting MIAX Exchange with disciplinary proceedings pursuant to MIAX Exchange rules, including issuing charges and conducting hearings; and providing dispute resolution services to Exchange members on behalf of MIAX Exchange,

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Exchange, Inc.); 55755 (May 14, 2007), 72 FR 28057 (May 18, 2007) (File No. 4-536) (National Association of Securities Dealers, Inc. ("NASD") (n/k/a FINRA) and CBOE concerning the CBOE Stock Exchange); 55367 (February 27, 2007), 72 FR 9983 (March 6, 2007) (File No. 4-529) (NASD/ISE); and 54136 (July 12, 2006), 71 FR 40759 (July 18, 2006) (File No. 4-517) (NASD/Nasdaq).

112 See MIAX Form 1 Application, Exhibit L. See also Securities Exchange Act Release Nos. 66974 (May 11, 2012), 77 FR 29705 (May 18, 2012) (File No. S7-966) (notice of filing and order approving and declaring effective an amendment to the multiparty 17d-2 plan concerning options-related sales practice matters); and 66975 (May 11, 2012), 77 FR 29712 (May 18, 2012) (File No. 4-551) (notice of filing and order approving and declaring effective an amendment to the multiparty 17d-2 plan concerning options-related market surveillance).

113 See MIAX Form 1 Application, Exhibit L.

including operation of the MIAX Exchange's arbitration program.[114] Notwithstanding the RSA, MIAX Exchange will retain ultimate legal responsibility for the regulation of its members and its market.

The Commission believes that it is consistent with the Act for MIAX Exchange to contract with another SRO to perform certain examination, enforcement, and disciplinary functions.[115] These functions are fundamental elements of a regulatory program, and constitute core self-regulatory functions. The Commission believes that CBOE, as an SRO that operates two options exchanges, should have the capacity to perform these functions for MIAX Exchange.[116] However, MIAX Exchange, unless relieved by the Commission of its responsibility,[117] bears the ultimate responsibility for self-regulatory responsibilities and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on MIAX Exchange's behalf. In performing these regulatory functions, however, the SRO retained to perform regulatory functions may nonetheless bear liability for causing or aiding and abetting the failure of MIAX Exchange to perform its regulatory functions.[118] Accordingly, although

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114 See MIAX Form 1 Application, Exhibit L.

115 See, e.g., Regulation ATS Release, supra note 34. See also Securities Exchange Act Release Nos. 50122 (July 29, 2004), 69 FR 47962 (August 6, 2004) (SR-Amex-2004-32) (order approving rule that allowed Amex to contract with another SRO for regulatory services) ("Amex Regulatory Services Approval Order"); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004) ("NOM Approval Order"); Nasdaq Order, supra note 32; and BATS Order, supra note 18.

116 See, e.g., Amex Regulatory Services Approval Order, supra note 115; NOM Approval Order, supra note 115; and Nasdaq Order, supra note 32. The Commission notes that the RSA is not before the Commission and, therefore, the Commission is not acting on it.

117 See supra note 108.

118 For example, if failings by the SRO retained to perform regulatory functions have the effect of leaving an exchange in violation of any aspect of the exchange's self-regulatory obligations, the exchange will bear direct liability for the violation, while the SRO retained to perform regulatory functions may bear liability for causing or aiding and abetting the violation. See, e.g., Nasdaq Order, supra note 32; BATS Order, supra note

CBOE will not act on its own behalf under its SRO responsibilities in carrying out these regulatory services for MIAX Exchange, as the SRO retained to perform regulatory functions, CBOE may have secondary liability if, for example, the Commission finds that the contracted functions are being performed so inadequately as to cause a violation of the federal securities laws by MIAX Exchange.

C. Trading System

1. Access to MIAX

Access to MIAX will be granted to individuals or organizations who are approved to become members. Approved members will be issued Trading Permits that grant the member the ability to transact on MIAX Exchange through the exchange's electronic systems.[119] Trading Permits will not convey upon members any ownership interest in MIAX Exchange, and they will not be transferable except in cases where a member experiences a change in control or corporate reorganization.[120] Membership will be open to any broker-dealer that: (1) is registered under Section 15 of the Act;[121] and (2) has and maintains membership in another registered options exchange or the Financial Industry Regulatory Authority ("FINRA").[122] There will be no limit to the number of Trading Permits that MIAX Exchange can issue, although MIAX could determine in the future that a limit on or decrease to the number of Trading Permits issued is

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18; and Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (File No. 10-127) (approval of registration of ISE as a national securities exchange).

119 See MIAX Exchange Rule 200(a). MIAX intends to allow each member to determine the best method for accessing MIAX , whether by using customized front-end software or through third-party vendors who route orders to MIAX through front-end or service bureau configurations. See MIAX Form 1 Application, Exhibit E.

120 See MIAX Rule 200(d).

121 See MIAX Rule 200(b).

122 See MIAX Rule 200(c)(7).

necessary.[123] Members of MIAX may be one of three classes of market maker,[124] or they may be non-market makers.

Those seeking to become members of MIAX will need to submit an application in accordance with procedures that MIAX will announce by Regulatory Circular.[125] Entities that become members, and their associated persons, will be required to meet and maintain certain

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123 See MIAX Rule 200(a). MIAX would announce in advance any limitation or decrease it plans to impose pursuant to Rule 200(a). See id. In the event that MIAX imposes a limitation or decrease, MIAX, in doing so, may not eliminate the ability of an existing member to trade on MIAX Exchange unless MIAX Exchange is permitted to do so pursuant to a rule filing submitted to the Commission under Section 19(b) of the Act. See id. In addition, MIAX's exercise of authority under proposed Rule 200 would be subject to the provisions of Section 6(c)(4) of the Act. See id. See also 15 U.S.C. 78f(c)(4) (providing that an exchange may limit: (1) the number of members of the exchange and (2) the number of members and designated representatives of members permitted to effect transactions on the floor of the exchange without the services of another person acting as broker, provided, however, that no exchange shall have the authority to decrease the number of memberships in such exchange, or the number of members and designated representatives of members permitted to effect transactions on the floor of such exchange without the services of another person acting as broker, below such number in effect on May 1, 1975, or the date such exchange was registered with the Commission, whichever is later. In addition, the Commission, in accordance with the provisions of section 19(c) of the Act, may amend the rules of any exchange to increase (but not to decrease) or to remove any limitation on the number of memberships in such exchange or the number of members or designated representatives of members permitted to effect transactions on the floor of the exchange without the services of another person acting as broker, if the Commission finds that such limitation imposes a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.). See also CBOE Rule 3.1(a)(vi) (concerning limiting or reducing the number of types of trading permits). In addition, MIAX's exercise of authority under proposed Rule 200 would be subject to the provisions of Section 6(b)(2) of the Act, which requires the rules of an exchange to provide that any registered broker or dealer or any natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof. See 15 U.S.C. 78f(b)(2).

124 See MIAX Rule 600. Market Maker registration is discussed in greater detail below, infra Section III(C)(3)(a).

125 See MIAX Rule 200(c). Any proposed application fees contemplated by Rule 200(c) would need to be filed with the Commission pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder. See 15 U.S.C. 78s(b) and 17 CFR 240.19b-4, respectively.

qualification and registration criteria similar to what is required by other options exchanges.[126] In addition, MIAX proposes further requirements on members that seek to do business with the public.[127] Applicants who are denied membership may appeal MIAX Exchange's decision pursuant to MIAX's rules governing Hearings, Review, and Arbitration.[128] Every member will be subject to MIAX's regulatory jurisdiction, including MIAX's disciplinary jurisdiction.[129]

Further, MIAX Rule 608 requires market makers to have a letter of guarantee. In its comment letter, NASDAQ argues that MIAX should broaden this rule to require all members to provide a letter of guarantee, not just market makers.[130] In response, MIAX explains that MIAX Rule 209 already requires a letter of guarantee for all MIAX members.[131]

In addition, in its comment letter, NASDAQ notes that MIAX Rule 507 requires a member who changes clearing information to contact the clearing member on the other side of a trade.[132] NASDAQ argues this approach is potentially burdensome for MIAX members since some MIAX members might not maintain contact information for all other MIAX members.[133] NASDAQ believes that a better approach, given that the Options Clearing Corporation serves as

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126 See MIAX Rule 200 Series. Such criteria include, but are not limited to, capital maintenance requirements. See, e.g., C2 Rules 3.1 and 3.2 (containing similar criteria).

127 See MIAX Rule 1300 Series. These Rules also are similar to the rules of other exchanges. See, e.g., ISE Rules Chapter 6.

128 See MAX Rule 1100 Series.

129 See MIAX Rule 200(f). For MIAX's rules concerning discipline, see MIAX Rule 1000 Series.

130 See NASDAQ Letter, supra note 3, at 4.

131 See MIAX Response Letter, supra note 4, at 15-16. MIAX noted that MIAX Rule 608, which NASDAQ referenced, is a rule that relates specifically to market makers, and as such, it simply reiterates that Rule 209's general requirement concerning letters of guarantee applies specifically to market makers. See id.

132 See NASDAQ Letter, supra note 3, at 4.

133 See id.

the central clearing party for listed options trades, would be for the member to notify MIAX.[134] In response, MIAX revised Rule 507 to accommodate this suggestion, which MIAX believes should be less burdensome for members.[135]

The Commission finds that MIAX's proposed membership rules are consistent with the Act, including Section 6(b)(2) of the Act, which requires the rules of an exchange to provide that any registered broker or dealer or natural person associated with a broker or dealer may become a member of such exchange or associated with a member thereof.[136] MIAX's proposed rules with respect to exchange membership are substantively similar to the rules of other exchanges.

The Commission notes that pursuant to Section 6(c) of the Act,[137] an exchange must deny membership to any person, other than a natural person, that is not a registered broker or dealer, any natural person that is not, or is not associated with, a registered broker or dealer, and registered broker-dealers that do not satisfy certain standards, such as financial responsibility or operational capacity. As a registered exchange, MIAX must independently determine if an applicant satisfies the standards set forth in the Act, regardless of whether an applicant is a member of another SRO.[138]

In addition, members may enter into arrangements with other parties, including non-members and other members, to provide "Sponsored Access" to trading on MIAX.[139] Members who provide such Sponsored Access will be responsible for all trading conducted pursuant to the

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134 See id.

135 See MIAX Response Letter, supra note 4, at 13. MIAX notes that its revised rule is similar to the operation of ISE Rule 707. See id.

136 15 U.S.C. 78f(b)(2).

137 15 U.S.C. 78f(c).

138 See, e.g., BOX Order, supra note 18 at 26337; BATS Order, supra note 18, at 73 FR 49502; and Nasdaq Order, supra note 32, at 71 FR 3555.

139 See MIAX Rule 210.

access agreement, and to the same extent as if the member were trading directly.[140] Accordingly, members that provide Sponsored Access must maintain and implement policies and procedures to supervise and monitor sponsored trading activity.[141] Additionally, non-members who seek to trade on MIAX through Sponsored Access agreements will need to agree to comply with all applicable federal securities laws and rules and MIAX Exchange rules.[142] MIAX's rules governing Sponsored Access arrangements are similar to the rules of other exchanges[143] and are consistent with Rule 15c3-5 under the Act.[144]

2. Linkage

MIAX intends to become a participant in the Plan Relating to Options Order Protection and Locked/Crossed Markets or any successor plan ("Linkage Plan").[145] If admitted as a participant to the Plan, other plan participants would be able to send orders to MIAX in accordance with the terms of the plan as applied to MIAX Exchange.

MIAX Exchange rules include relevant definitions, establish the conditions pursuant to which members may enter orders in accordance with the Linkage Plan, impose obligations on MIAX Exchange regarding how it must process incoming orders, establish a general standard that members and MIAX Exchange should avoid trade-throughs, establish potential regulatory

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140 See MIAX Rule 210(a).

141 See id.

142 See MIAX Rule 210(d)(1)(i). See also, e.g., 17 CFR 240.15c3–5.

143 See, e.g., Nasdaq Rule 4611(d).

144 17 CFR 240.15c3–5.

145 See MIAX Form 1 Application, Exhibit E. See also Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (File No. 4-546) (order approving the national market system Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the Chicago Board Options Exchange, Incorporated, ISE, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.).

liability for members that engage in a pattern or practice of trading through other exchanges, and establish obligations with respect to locked and crossed markets.

The Commission believes that MIAX has proposed rules that are designed to comply with the requirements of the Linkage Plan.[146] Further, as provided below, before MIAX can commence operations as an exchange, it must become a participant in the Linkage Plan.

3. Market Makers

a. Registration and Appointment

Members of MIAX may apply to become one of three types of market maker: Primary Lead Market Maker, Lead Market Maker, or Registered Market Maker (collectively, "Market Makers"). Market Makers are entitled to receive certain benefits and privileges in exchange for fulfilling certain affirmative and negative market-making obligations.[147] Each class of Market Maker will receive a specific level of benefits and privileges in exchange for a specific level of obligation that such Market Maker assumes to the MIAX market.

To begin the process of registering as a Registered Market Maker or Lead Market Maker, a member will be required to file a written application with MIAX.[148] In reviewing a member's application for membership, MIAX will consider, among other things, the applicant's market making ability.[149] Only approved Lead Market Makers may apply to be considered for

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146 See MIAX Rule 1400 Series.

147 Market Makers' benefits and obligations are discussed in greater detail in the following section.

148 See MIAX Rule 600(b).

149 See id. The provision permitting MIAX to consider "such other factors as [it] deems appropriate" must be applied in a manner that is consistent with the Act, including provisions that prohibit an exchange from acting in an unfairly discriminatory manner. See 15 U.S.C. 78f(b)(5); see also C2 Order, supra note 41, at n. 80, 76 FR at 66704.

appointment as a Primary Lead Market Maker in one or more option classes traded on MIAX.[150] All members who are approved to become Market Makers will be designated as specialists on MIAX for all purposes under the Act and rules thereunder.[151]

Once approved, a Market Maker would seek appointment to make markets in options classes.[152] Either the Exchange Board or a committee thereof[153] would evaluate an application for Market Maker status based on: (1) the financial resources available to the Market Maker; (2) the Market Maker's experience and expertise in market making or options trading; (3) the preferences of the Market Maker to receive appointment(s) in specific option class(es); and (4) the maintenance and enhancement of competition among Market Makers in each option class.[154] MIAX will allow one Primary Lead Market Maker appointment per class, and will have a maximum class quoting limit of fifty Market Makers per class.[155] Once appointed, MIAX will surveil a Market Maker's activity for continued compliance with all applicable rules and requirements, which are discussed in more detail below.

The Commission finds that MIAX's rules for the registration and appointment of Market Makers are consistent with the Act. In particular, MIAX's rules provide an objective process by which a member could become a Market Maker on MIAX and provide for oversight by MIAX

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150 See id.

151 See MIAX Rule 600(a).

152 See MIAX Rule 602.

153 See MIAX Rule 602(a). MIAX Rule 1100 Series provides the process for hearings, review, and arbitration of claims by persons economically aggrieved by MIAX Exchange action, which would include denial of registration as a Market Maker.

154 See id.

155 See Amendment No. 1 (in which MIAX revised its Rule 602(c) to increase the proposed class quoting limit from 10 to 50). See also, e.g., C2 Rule 8.11(a) (imposing a class quoting limit of 50) and CBOE Rule 8.3A, Interpretations and Policies .01 (imposing a class quoting limit of 50).

Exchange to monitor for continued compliance by Market Makers with the terms of their application for such status. The Commission notes that MIAX's proposed Market Maker registration and appointment requirements are similar to those of other options exchanges.[156]

b. Market Maker Obligations

Pursuant to MIAX rules, all Market Makers will be subject to a number of general obligations. In particular, the transactions of a Market Maker must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market.[157] Among other things, a Market Maker must: (1) engage in dealings for its own account when there is a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between options contracts of the same class; (2) compete with other market makers; (3) make markets that will be honored for the number of contracts entered; (4) update quotations in response to changed market conditions; and (5) price option contracts fairly by, among other things, meeting the bid/ask differential requirements prescribed.[158] In addition, Market Makers must maintain minimum net capital in accordance with MIAX rules and the federal securities laws.[159] Market Makers also must maintain information barriers between market making activities and any other

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156 See, e.g., ISE Rules 800 and 801, and C2 Rule 8.1 (registration); ISE Rule 802 and C2 Rule 8.11 (appointment).

157 See MIAX Rule 603(a).

158 See MIAX Rule 603(b)(4). Specifically, as set forth in note 285, infra, following the opening rotation, Market Makers must create differences of no more than $5 between the bid and offer. Prior to the opening rotation, bid/ask differentials shall be no more than $.25 between the bid and offer for each option contract for which the bid is less than $2, no more than $.40 where the bid is at least $2 but does not exceed $5, no more than $.50 where the bid is more than $5 but does not exceed $10, no more than $.80 where the bid is more than $10 but does not exceed $20, and no more than $1 where the bid is more than $20, provided that the Exchange may establish differences other than the above for one or more option.

159 See MIAX Rule 609.

business activities that are reasonably designed to prevent the misuse of material, non-public information.[160]

MIAX's rules governing Market Maker quoting obligations are tailored to the specific class of Market Maker.[161] Specifically, a Primary Lead Market Maker will be subject to the highest standard applicable on MIAX, as they will be required to provide continuous two-sided Standard quotes and/or Day eQuotes[162] throughout the trading day 99% of the time in the lesser of 99% of the series, or 100% of the series minus one put-call pair, in each appointed class.[163] Primary Lead Market Makers also are required to participate in the opening rotation.[164] Lead Market Makers must provide continuous two-sided quotes (consisting of Standard quotes and/or Day eQuotes) throughout the trading day 90% of the time in 90% of the series in each of their appointed classes.[165] Lead Market Makers also must participate in the opening rotation.[166] Lastly, Registered Market Makers must provide continuous two-sided quotes (consisting of Standard quotes and/or Day eQuotes) 90% of the time in 60% of the series in each of its appointed classes.[167] Further, Registered Market Makers may be called upon by a MIAX

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160 See MIAX Rule 610.

161 See MIAX Rule 604.

162 See infra Section III(C)(5) (discussing the various types of quotes that may be submitted by Market Makers on MIAX).

163 See MIAX Rule 604(e)(1). See also Amendment No. 1 (revising MIAX Rule 604(e)(1) to provide that these obligations will be applied on a class-by-class basis).

164 See MIAX Rule 604(e)(1)(i).

165 See MIAX Rule 604(e)(1). See also Amendment No. 1 (revising MIAX Rule 604(e)(2) to provide that these obligations will be applied on a class-by-class basis).

166 See MIAX Rule 604(e)(2).

167 See MIAX Rule 604(e)(3). See also Amendment No. 1 (revising MIAX Rule 604(e)(3) to provide that these obligations will be applied on a class-by-class basis).

Exchange official to submit a single quote or maintain continuous quotes in one or more series of its appointed classes whenever, in the judgment of such official, it is necessary to do so in the interest of fair and orderly markets.[168] For purposes of meeting the continuous quoting obligations discussed herein, a Market Maker's quote must meet the bid/ask differential requirements of MIAX Rule 603(b)(4).[169]

In options classes other than to which they are appointed, a Market Maker is prohibited from engaging in transactions in an account in which it has an interest that are disproportionate to, or in derogation of, the performance of its market making obligations as set forth in the MIAX rules.[170] Further, the total number of contracts executed during a quarter by a Registered Market Maker in options classes to which it is not appointed may not exceed 25% of the total number of contracts traded by such Registered Market Maker in classes to which it is appointed.[171] Similarly, the total number of contracts executed during a quarter by a Lead Market Maker (including a Primary Lead Market Maker) in options classes to which it is not appointed may not exceed 10% of the total number of contracts traded by such Lead Market

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168 See MIAX Rule 604(e)(3)(iii).

169 See MIAX Rule 604(e)(1)-(3) (for Primary Lead Market Makers, Lead Market Makers, and Registered Market Makers, respectively).

170 See MIAX Rule 603(d). Among other things, a Market Maker should not effect purchases or sales except in an orderly manner. See id. See also ISE Rule 803(d) (containing an identical provision).

171 See MIAX Rule 605(b)(2). See also ISE Rule 805(b)(2) (limiting the total number of contracts a Competitive Market Maker registered on that Exchange may execute per quarter in classes to which it is not appointed to 25% or less of the total contracts traded by that Market Maker in classes to which it is appointed).

Maker in classes to which it is appointed.[172] Executions resulting from orders in a Registered Market Maker's and Lead Market Maker's appointed classes are included in these 25% and 10% limitations, respectively.[173]

If MIAX finds any failure by a Market Maker to meet minimum performance standards or properly perform as a Market Maker, such Market Maker may be subject to suspension, termination, or restriction of registration in one or more of the securities in which the Market Maker is registered.[174]

Market Makers will receive certain benefits in return for satisfying their responsibilities.[175] For example, a broker-dealer or other lender may extend "good faith" credit to a member of a national securities exchange or registered broker-dealer to finance its activities

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172 See MIAX Rule 605(b)(3); see also ISE Rule 805(b)(3) (limiting the total number of contracts a Primary Market Maker registered on that Exchange may execute per quarter in classes to which it is not appointed to 10% or less of the total contracts traded by that Market Maker in classes to which it is appointed.

173 See MIAX Rule 605(b)(2)-(3). MIAX's inclusion of executions resulting from orders is more restrictive than similar rules of other exchanges, which do not include orders executed in appointed classes towards Market Makers' 25% and 10% limitations, respectively. See, e.g., ISE Rule 805(b)(2)-(3).

See also Amendment No. 1 (where MIAX revised Rule 605 to remove consideration of non-priority quotes from the 25% and 10% limitations). MIAX's proposal not to count non-priority quotes in the 25% or 10% buckets does not raise any new or novel issue because even a non-priority quote still would be required to meet the maximum differential provision contained in MIAX Rule 603(b)(4). Accordingly, such a valid width quote, even if it may not comply with a potentially narrower "priority quote width standard" under MIAX Rule 517(b)(ii), would still represent a valid width quote that can be counted towards a Market Maker's quoting obligation, consistent with the practice on other exchanges.

174 See MIAX Rules 600 and 602(f).

175 See, e.g., NOM Approval Order, supra note 115, at 73 FR 14526 (discussing the benefits and obligations of market makers).

as a market maker or specialist.[176] In addition, market makers are excepted from the prohibition in Section 11(a) of the Act.[177] The Commission believes that a market maker must be subject to sufficient and commensurate affirmative obligations, including the obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis, to justify favorable treatment.[178] The Commission further believes that the rules of all U.S. options markets need not provide the same standards for market maker participation, so long as they impose affirmative obligations that are consistent with the Act.[179]

The Commission believes that MIAX's Market Maker participation requirements impose appropriate affirmative obligations on MIAX Exchange's Market Makers that are commensurate with the benefits afforded to such participants and, accordingly, are consistent with the Act.

Specifically, with regard to MIAX's proposed continuous quoting obligations, only those quotes that are liquidity providing – Standard quotes and Day eQuotes – will be counted towards a Market Maker's quoting obligations, rather than all types of eQuotes that a Market Maker will be permitted to utilize.[180] The Commission believes that this treatment is appropriate under the Act and consistent with a Market Maker's obligation to contribute to the maintenance of a fair and orderly market. Further, the Commission believes that the specific levels of benefits conferred on the different classes of Market Makers are appropriately balanced by the obligations imposed by MIAX's rules. For example, as discussed below, Primary Lead Market

176 See 12 CFR 221.5 and 12 CFR 220.7; see also 17 CFR 240.15c3-1(a)(6) (capital requirements for market makers).

177 15 U.S.C. 78k(a).

178 See NOM Approval Order, supra note 115, at 73 FR 14526.

179 See id.

180 See infra Section III(C)(5) (discussing the various quote types that Market Makers can utilize).

Makers and Lead Market Makers are entitled to certain participation entitlements,[181] and at the same time, are subject to heightened continuous quoting obligations to justify these special benefits.[182]

Finally, the Commission believes that the Act does not mandate a particular market model for exchanges, and while Market Makers may become an important source of liquidity on MIAX, they will likely not be the only source as MIAX is designed to match buying and selling interest of all MIAX participants.

4. Order Display, Execution, and Priority

MIAX will operate a fully automated electronic options marketplace. Liquidity will be derived from orders to buy and orders to sell, as well as market maker quotations, submitted to MIAX electronically by its members from remote locations. There will be no physical trading floor. Options traded on the Exchange will be subject to Minimum Price Variations that will begin at $0.05 for option contracts trading at less than $3.00 per option, and $.10 for option contracts trading at $3.00 per option or higher.[183] In addition, MIAX will participate in the penny pilot program pursuant to which it will permit certain options with premiums under $3 (as well as heavily traded options on certain indices) to be quoted and traded in increments as low as $.01.[184]

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181 See infra notes 225 - 240 and accompanying text (describing the Primary Lead Market Maker and Directed Lead Market Maker participation entitlements). See also infra Section III(C)(5) (discussing the benefit Market Makers receive from the MIAX priority quote rule).

182 See supra Section III(C)(3)(b) (describing Primary Lead Market Maker and Lead Market Maker quoting obligations).

183 See MIAX Rule 510(a).

184 NASDAQ points out that MIAX's rule concerning the "penny pilot" did not contain a date for the end of the penny pilot. See NASDAQ Letter, supra note 3, at 3. In response, MIAX amended its Rule 510 to insert the industry-wide date for the schedule expiration

All orders and quotes submitted to MIAX will be displayed unless: (i) the order is a contingent order (such as immediate or cancel orders); or (ii) the quote is a certain type of eQuote[185] (such as an Auction or Cancel eQuote). Displayed orders and quotes will be displayed on an anonymous basis (except for attributable orders,[186] which will allow voluntary disclosure of firm identification information) at a specified price. Non-displayed orders will not be displayed to any participant.

In certain cases, orders and quotes may be displayed at a price different from the price specified by the submitting member.[187] One such case is non-displayed penny orders. Specifically, MIAX proposes to allow a member to enter an order or quote (as applicable) priced in a penny increment for series that are subject to a minimum price variation other than a penny

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the penny pilot (i.e., December 31, 2012), and MIAX noted that at the time it filed its Form 1 application, the scheduled expiration of the penny pilot was June 30, 2012 (which the Commission notes preceded publication of the notice of MIAX's Form 1 application in the Federal Register). See MIAX Response Letter, supra note 4, at 13. MIAX notes that the December 31, 2012 expiration date conforms to other exchange rules, including CBOE Rule 6.42 and ISE Rule 710. See id.

185 See infra Section III(C)(5) (discussing eQuotes). The Commission notes that MIAX has not proposed orders with reserve size at this time.

186 An Attributable Order is a market or limit order which displays the user firm's ID for purposes of trading on MIAX. Use of Attributable Orders will be voluntary. This order type is consistent with similar order types on other exchanges. See, e.g., CBOE Rule 6.53(o) (attributable order type).

187 In its comment letter, ISE disagreed with the broad statement in Exhibit E of MIAX's Form 1 application that says that orders and quotes will be displayed at the price specified by the submitting member. ISE points out that there are two additional instances, beyond what MIAX described in its Exhibit E, where an order or quote will not be displayed at the submitted price: (1) customer interest (either Professional or Priority customers) that is marked Do Not Route that would lock or cross the NBBO; and (2) market maker quotes and orders that would trade through the ABBO. See ISE Letter, supra note 3, at 1-2. In each case, the orders will be displayed one minimum price variation away from the opposite side NBBO, but will remain available for execution on MIAX at the price that locks the NBBO. See ISE Letter, supra note 3, at 1-2. In response, MIAX revised Exhibit E to note all instances of when orders and quotes will not be displayed or will be displayed at one price and executable at a different price. See MIAX Response Letter, supra note 4, at 3-4.

(e.g., 5 cents or 10 cents). The order would be displayed at the applicable minimum increment (rounded as appropriate), not the narrower penny price, but would be available for execution at the non-displayed penny price (i.e., a "non-displayed penny order").[188] With respect to MIAX's proposed use of non-displayed penny orders, the ISE Letter appears to assert that MIAX has proposed to permit non-displayed prices to be entered in regular trading increments in all classes, which (if true) ISE would oppose to the extent it could decrease transparency and further internalization of order flow.[189] ISE believes that MIAX's proposal on this point could be much broader than what has been previously approved by the Commission.[190] In response, MIAX notes that, pursuant to MIAX Rule 516(b)(3), non-displayed penny orders will only be accepted in designated classes, which must have a minimum price variation larger than one penny.[191] MIAX notes that such orders, which are limit orders priced in a one-cent increment, are executable at their stated penny limit price, but are displayed at the closest minimum price variation that does not violate the limit price.[192] MIAX reiterated that it does not propose to handle orders and quotes in a manner that will permit non-displayed prices in the regular trading increments in all options classes, and that its proposed rule is not intended to be broader than what has previously been approved by the Commission.[193] To clarify this point, MIAX revised

188 See MIAX Rule 516(b)(4) (Non-displayed Penny Order). This functionality is based on similar rules of other exchanges. See, e.g., CBOE Rule 6.13B (Penny Price Improvement).

189 See ISE Letter, supra note 3, at 2.

190 See id.

191 See MIAX Response Letter, supra note 4, at 9.

192 See id.

193 See id.

Rule 516(b)(3) to state that non-displayed penny orders would only be accepted in designated classes and must have a minimum pricing variation larger than one penny.[194]

In its comment letter, NASDAQ notes that proposed MIAX Rule 516(b)(4) is silent on what would happen if a member attempted to submit a non-displayed penny order in an option that is not eligible for such orders.[195] In response, MIAX amended proposed MIAX Rule 516(b)(3) to state that such order would be rejected.[196]

Members may submit the following types of orders: Market; Limit (including Marketable Limit, Fill-or-Kill, Immediate-or-Cancel, Non-Displayed Penny,[197] and Auction or Cancel ("AOC")); WAIT;[198] Attributable; Intermarket Sweep ("ISO"); Do Not Route;[199]

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194 See id.

195 See NASDAQ Letter, supra note 3, at 3.

196 See MIAX Response Letter, supra note 4, at 9.

197 See supra note 188.

198 "WAIT" orders are orders that, upon entry into the MIAX system, are held for one second without processing for potential display and/or execution. After one second, the order is processed for potential display and/or execution in accordance with all order entry instructions as determined by the entering party. See MIAX Rule 516(c). See also NYSE Arca Rule 6.62(w) (containing an identical type of WAIT Order).

199 In its comment letter, ISE notes that MIAX Rule 520 does not address how hidden prices that may result from the display of Do Not Route orders are treated for the requirement to expose orders before attempting to trade against them. See ISE Letter, supra note 3, at n. 6. MIAX clarified this point by revising Rule 520 (Limitation on Orders) to add new Interpretation .04 stating that Market Maker orders and quotes displayed at a price other than their limit price or quote price as described in Rule 515(d), and orders subject to the managed interest process – which includes all Do Not Route orders that could not be executed in full and are not cancelled – are not deemed to be "exposed" for purposes of Rule 520. See MIAX Response Letter, supra note 4, at 8 - 9.

In addition, NASDAQ requests clarification on MIAX Rule 516(f) regarding Do Not Route orders and how they operate when the NBBO locks contemporaneously. See NASDAQ Letter, supra note 3, at 4. In response, MIAX revised MIAX Rule 516(g) (previously 516(f)) to clarify that a Do Not Route order may execute at a price equal to or better than, but not inferior to, the best away market price, and if, after exhausting interest on MIAX, the best away market remains and the Do Not Route order has not been fully executed, the order will be handled in accordance with MIAX's managed interest

Opening; Customer Cross; Qualified Contingent Cross; Day Limit; and Good 'Til Cancelled.[200] With the exception of the AOC Order, which is unique to MIAX, all of these order types are based on similar order types available on other options exchanges.[201] MIAX's AOC Order is a limit order which is used to provide liquidity during a specific MIAX Exchange mechanism (e.g., the opening imbalance mechanism in MIAX Rule 503) with a time in force that corresponds to the duration of that event.[202] In other words, such an order would automatically expire at the end of the auction or event. AOC Orders are not displayed to any market

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process. See MIAX Response Letter, supra note 4, at 7-8. MIAX further notes that in case of contemporaneous locks, Do Not Route orders will be handled as set forth in MIAX Rules 515 and 516. See MIAX Response Letter, supra note 4, at 8. Further, ISE requests a technical clarification about the use of the term "away best bid/offer" in MIAX Rule 516(f), and whether it is intended to be different from the term "ABBO." See ISE Letter, supra note 3, at n. 3. In response, MIAX eliminated this term in Rule 516 and instead notes that the specifics for handling a Do Not Route Order are set forth in Rule 515(c)(2), which explains such orders' handling without using the term "away best bid/offer." See MIAX Response Letter, supra note 4, at 7.

200 See MIAX Rule 516 for a description of each of the order types. MIAX notes that not all of these order types will be available upon initiation of operations. Rather, MIAX Exchange will update members through Regulatory Circulars as to the order types that will be available initially. See also infra Section III(C)(5) (discussing various quote types that market makers may submit). NASDAQ argues that MIAX should be compelled to define which order types will be available and file changes when new order types are introduced. See NASDAQ Letter, supra note 3, at 3. In response, MIAX represents that it plans to use each of the order types listed in Rule 516 in the foreseeable future and states that it believes that its rule provides adequate detail about each order type. See MIAX Response Letter, supra note 4, at 14. In addition, MIAX represents that it will file a proposed rule change whenever it seeks to introduce a new order type. See MIAX Response Letter, supra note 4, at 14 - 15. The Commission agrees that MIAX has appropriately set forth in its rules the order types that it plans to introduce, has represented that it intends to utilize all of the proposed order types contained in its current proposed rules, and has acknowledged that it will need to file a proposed rule change if it ever seeks to introduce additional new order types.

201 See, e.g., NOM Chapter VI, Section 1(g)(5) (WAIT Order); ISE rule 715(h) (Attributable Order); NOM Chapter VI, Section 1(e)(8) (Intermarket Sweep Order); Phlx Rule 1080(m)(iv)(A) (Do Not Route Order); ISE Rule 714(i) (Customer Cross Order); ISE Rule 715(j) (Qualified Contingent Cross Order); NYSE MKT Rule 131 (Day Order and Good 'Til Cancelled Order).

202 See MIAX Rule 517(a)(2)(ii).

participant, are not included in the MIAX best bid or offer, are not eligible for trading outside of the event, and may not be routed. The Commission believes that this order type, while not specifically based on an order type on another exchange, is substantially similar to order types approved by the Commission on other exchanges for use in various auction mechanisms, which are similarly not displayed to any participant and have a limited time in force related to the auction, and thus raises no new regulatory issues.[203]

Trades will execute on MIAX when orders or quotes on the MIAX order book match one another.[204] The MIAX system will continuously and automatically match orders pursuant to either price/time priority or pro-rata priority, as determined by MIAX on a class-by-class basis.[205]

MIAX also will offer additional priority overlays at its discretion on a class-by-class basis, which include "Priority Customer" and "Market Turner" overlays. Priority overlays would only be applicable for pro rata priority.[206] Under the "Priority Customer" overlay, the highest bid and lowest offer will have priority except that Priority Customer orders[207] will have priority

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203 See, e.g., CBOE Rule 6.13A, Simple Auction Liaison ("SAL"). See also Securities Exchange Act Release No. 54229 (July 27, 2006), 71 FR 44058 (August 3, 2006) (CBOE-2005-90) (order approving a proposal to adopt a Simple Auction Liaison system to auction qualifying inbound orders for potential price improvement).

204 NASDAQ points out that MIAX Rules 511 (Acceptance of Quotes and Orders) and 512 (Contract Made on Acceptance of Bid or Offer) appear to be duplicative. See NASDAQ Letter, supra note 3, at 4. In response, MIAX has deleted MIAX Rule 512 as duplicative. See MIAX Response Letter, supra note 4, at 13.

205 See MIAX Rule 514.

206 See Amendment No. 1. See also infra notes 218 to 224 and accompanying text (describing more completely the revisions MIAX made to the priority rules in response to comments).

207 MIAX rules define "priority customer" as a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial accounts(s). See MIAX Rule

over "professional interest"[208] and all Market Maker interest at the same price.[209] If there were two or more Priority Customer orders for the same options series at the same price, priority would be afforded based on the sequence in which such orders were received. This priority overlay is the same as public customer priority overlays that have been approved by the Commission on other exchanges.[210]

Under the "Market Turner" priority overlay, the "Market Turner" refers to the participant that was the first to enter an order or quote at a better price than the previous best disseminated MIAX price, where such order or quote is continuously in the market until the order or quote trades. When this priority overlay is in effect, the Market Turner would have priority at the highest bid or lowest offer that he or she established.[211] The Commission notes that an identical Market Turner priority overlay has been approved for use on another exchange.[212]

In its comment letter, ISE asks for clarification on the proposed execution priority provisions, including priority overlays. Specifically, ISE believes that it is difficult to understand how the different combinations or allocation methodologies, priority overlays, and entitlements will work.[213] ISE noted that the Form 1, by design, does not require a level of detail and discussion, as well as statutory analysis, which is required in SRO proposed rule changes filed on

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100. See also ISE Rule 100(a)(37A) (containing an identical definition of "priority customer").

208 Pursuant to MIAX Rule 100, "professional interest" includes: (i) an order that is for the account of a person or entity that is not a Priority Customer, and (ii) an order or non-priority quote for the account of a Market Maker. See also infra notes 284 - 290 for a discussion of "priority" and "non-priority" quotes.

209 See MIAX Rule 514(d)(1).

210 See, e.g., CBOE Rule 6.45A(a)(ii)(1).

211 See MIAX Rule 514(d)(2).

212 See CBOE Rule 6.45A(a)(iii)(2).

213 See ISE Letter, supra note 3, at 3.

Form 19b-4.[214] For example, ISE presents an example of an allocation methodology that consists of pro rata with a Priority Customer and Market Turner overlays and asks how the overlays would interact with each other on MIAX.[215] NASDAQ also asks whether the priority provisions contained in MIAX Rule 514, when read in conjunction with the execution processes in MIAX Rule 515, might result in the ability for directing or internalizing orders in a new way.[216] In particular, NASDAQ asks about the interplay between the market turner overlay, non-displayed penny orders, and the liquidity refresh pause.[217]

In response, MIAX amended proposed MIAX Rules 514 and 515 to clarify the operation of two different trade allocation methodologies (i.e., price-time and pro rata) with the possible priority overlays, which includes clarification of the different priority overlays that are applicable to a pro rata allocation methodology.[218] Specifically, MIAX revised proposed Rule 514 to clarify that the Market Turner overlay will never be in effect in conjunction with any other priority overlays, and that the priority overlays are only applicable to the pro rata allocation methodology (i.e., the priority overlays cannot be used in conjunction with the price time methodology).[219] MIAX also clarified in Rule 514(d) that market maker priority quotes have precedence over other professional interest under the pro rata methodology only (i.e., priority quotes would not have precedence under the price time methodology).[220]

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214 See id.

215 See id.

216 See NASDAQ Letter, supra note 3, at 2.

217 See id.

218 See MIAX Response Letter, supra note 4, at 10-11.

219 See id.

220 See id. See also infra Section III(C)(5) for a more detailed discussion of priority quotes.

In addition, MIAX expanded the discussion in Exhibit E to its Form 1 application to provide a detailed description of how the different trade allocation and priority overlays would operate.[221] MIAX also provided a series of examples to illustrate the proposed operation of its execution rule.[222] MIAX states that the clarifications to the rule text make clear that it has no intention to allow for the ability for directing or internalizing orders in a way not previously approved by the Commission.[223] Further, in response to NASDAQ, MIAX stated that it does not believe that there is any unique aspect to the operation of the market turner priority overlay, the liquidity refresh pause, or the rules related to non-displayed penny orders on MIAX or the overall functionality of these features when used in combination on the Exchange.[224]

In addition, proposed MIAX rules provide that it may grant Primary Lead Market Makers and Lead Market Makers certain participation entitlements. For example, Primary Lead Market Makers[225] may be entitled to a participation entitlement with respect to each incoming order if they have a priority quote[226] at the National Best Bid and Offer ("NBBO").[227] The Primary Lead Market Maker participation entitlements will only be in effect if the Priority Customer overlay also is in effect and will apply only to any remaining balance after any Priority Customer orders

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221 See MIAX Response Letter, supra note 4, at 10.

222 See Amendment No. 1.

223 See MIAX Response Letter, supra note 4, at 2.

224 See id.

225 See supra Section III(C)(3) (discussing the various categories of Market Makers, including Primary Lead Market Makers).

226 See infra Section III(C)(5) (discussing priority quotes).

227 See MIAX Rule 514(g). Specifically, the Primary Lead Market Maker's participation entitlement will be equal to the greater of: (i) the proportion of the total size at the best price represented by the size of its quote, or (ii) 60% of the contracts to be allocated if there is only one other Market Maker quotation at the NBBO or 40% if there are two or more other Market Maker quotes at the NBBO. See MIAX Rule 514(g)(1).

have first been satisfied.[228] Further, neither a Primary Lead Market Maker nor a Lead Market Maker could be allocated a total quantity greater than the quantity they are quoting at the execution price, and they will not receive any further allocation of an order if they receive a participation entitlement.[229]

Another such entitlement provides that small size orders (i.e., five or fewer contracts) will be allocated in full to the Primary Lead Market Maker if it has a priority quote at the NBBO.[230] In its comment letter, NASDAQ commented that MIAX Rule 514(g)(2), which provides this small order preference to Primary Lead Market Makers, states that small size is "initially" defined as 5 or fewer contracts.[231] NASDAQ argues that MIAX should not be allowed to have the discretion to change that number without filing a proposed rule change, and worries that MIAX might seek to unilaterally define such orders as "10 or 50 contracts" without first submitting a rule filing.[232] In response, MIAX amended Rule 514(g)(2) to avoid any doubt by stating that "small size orders are defined as five (5) or fewer contracts."[233] MIAX further represents that any changes to the small size order rule would be made pursuant a subsequent proposed rule change filing with the Commission.[234]

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228 See MIAX Rule 514(g).

229 See MIAX Rule 514(i)(4).

230 See MIAX Rule 514(g)(2). The rule provides that MIAX Exchange will review the functioning of this provision quarterly to make sure that small size orders do not account for more than 40% of the volume executed on MIAX.

231 See NASDAQ Letter, supra note 3, at 3.

232 See id.

233 See MIAX Response Letter, supra note 4, at 13.

234 See id.

MIAX also permits Electronic Exchange Members[235] to utilize Directed Orders.[236] A "Directed Order" refers to an order that an Electronic Exchange Member enters into the MIAX system and directs to a particular Lead Market Maker, including a Primary Lead Market Maker[237] ("Directed Lead Market Maker"). The Lead Market Maker must have an appointment in the relevant options class to receive a Directed Order in that class. A Directed Lead Market Maker may be granted a participation entitlement if he or she has a priority quote at the NBBO.[238] The Directed Lead Market Maker participation entitlement will only be in effect if the Priority Customer overlay also is in effect and will apply only to any remaining balance after Priority Customer orders have first been satisfied. The Commission believes that these participation entitlements for Primary Lead Market Makers and Directed Lead Market Makers are consistent with those that the Commission has approved for other exchanges.[239] Further, the Commission believes that these entitlements are appropriately balanced by the obligations imposed on these classes of market makers, as discussed in detail above.[240] In particular, the Commission notes that Primary Lead Market Makers and Lead Market Makers are subject to higher quoting obligations than other Registered Market Makers who are not eligible to receive

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235 An Electronic Exchange Member is the holder of a trading permit who is not a Market Maker. See MIAX Rule 100.

236 See MIAX Rule 514(h).

237 See supra Section III(C)(3) (discussing the various categories of market makers, including Lead Market Makers).

238 See MIAX Rule 514(h). Specifically, the Directed Lead Market Maker's participation entitlement will be equal to the greater of: (i) the proportion of the total size at the best price represented by the size of its quote; or (ii) 60% of the contracts to be allocated if there is only one other Market Maker quotation at the NBBO or 40% if there are two or more other Market Maker quotes at the NBBO.

239 See, e.g., ISE Rule 713, Supp. 01 and .03.

240 See supra Section III(C)(3)(b) (discussing market maker obligations).

the aforementioned participation entitlements.[241] Therefore, the Commission believes that the proposed rules regarding participation entitlements are consistent with the Act.

In its comment letter, ISE identifies several proposed MIAX rules that ISE believes would benefit from increased detail or description. For example, ISE opines that certain aspects of Rule 514 (regarding quote priority) and Rule 515 (regarding processing of orders and quotes) may be novel.[242] In response, MIAX states that it does not believe that any aspects of MIAX Rules 514 or 515 raise new issues not previously addressed by the Commission; nevertheless MIAX made revisions to those rules to clarify their operation.[243]

In its comment letter, NASDAQ expresses concern over a few MIAX rules that used terms such as "from time to time" or "may."[244] For example, NASDAQ notes MIAX Rule 514(j) that says MIAX may, from time to time, make available to members the quantity of Priority Customer contracts included in its best bid and offer.[245] NASDAQ questions when MIAX might do this and asks whether this would be a market data feed.[246] NASDAQ asks for a more detailed description of this provision, and recommends that it not be adopted at this time if

241 As discussed above, supra Section III(C)(3)(b), Primary Lead Market Makers must provide continuous two-sided quotes 99% of the time in: (i) the lesser of 99% of the series, or 100% of the series minus one put-call pair, in each appointed class that is traded on at least one other exchange; and (ii) 100% of the series in each appointed class that is singly listed on MIAX. See MIAX Rule 604(e)(1). Lead Market Makers must provide continuous two-sided quotes 90% of the time in 90% of the series in each of its appointed classes. See MIAX Rule 604(e)(2).

242 See ISE Letter, supra note 3, at 1.

243 See MIAX Response Letter, supra note 4, at 2.

244 See NASDAQ Letter, supra note 3, at 2.

245 See id.

246 See id.

MIAX is not prepared to roll it out at its commencement of operations.[247] In response, MIAX revised several of its proposed rules to add further detail including changing the terms "from time to time" or "may" to a more definitive "will" or a more specific time frame.[248] For example, MIAX revised MIAX Rule 503(b) concerning openings to clarify that the procedure described in that rule "will" be used to reopen a class after a trading halt.[249] In addition, MIAX amended MIAX Rule 514(h) to provide that eligible order types for Directed Lead Market Makers will only be set forth in the MIAX Rules and not by regulatory circular.[250] Further, MIAX deleted MIAX Rule 514(j) and instead has included text in MIAX Rule 506 to clarify that it "will" make available to subscribers of its data feeds and to all market participants through the public data feed an indication when there is Public Customer interest included in the MBBO.[251]

In addition, NASDAQ recommends that MIAX Rule 503(h) and (i), which use the term "may," should be clarified to specify how a closing procedure would be employed after the close of the market.[252] In response, as noted above, MIAX revised MIAX Rule 503 to replace the word "may" with the word "will" to clarify that the procedure described in that rule "will" be used to reopen a class after a trading halt.[253] Further, MIAX deleted MIAX Rule 503(i) concerning rotations in the event of a trading halt in a proprietary product because MIAX does

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247 See id.

248 See MIAX Response Letter, supra note 4, at 12-13.

249 See id.

250 See id. at 13.

251 See id. at 12.

252 See NASDAQ Letter, supra note 3, at 2.

253 See MIAX Response Letter, supra note 4, at 13.

not have any proprietary products at the time and that provision would be inapplicable currently.[254]

NASDAQ also requests clarification on MIAX Rule 503(e)(1) concerning the opening process, and in particular, whether MIAX would consider off-exchange trades or trades on markets other than the primary market when it decides whether to open an option class for trading.[255] In response, MIAX revised MIAX Rule 503(e)(1) to clarify that the opening process will begin following the dissemination of a quote or trade in the "market for the underlying security," which MIAX previously defined in MIAX Rule 503(d) as either the primary listing market, the primary volume market, or the first market to open the underlying security, as determined on a class-by-class basis and announced to members in advance.[256]

Further, NASDAQ recommends that MIAX Rule 503(g) be clarified to be more specific about when the Help Desk may deviate from the standard manner of the opening procedure.[257] In response, MIAX revised Rule 503 to note that the Help Desk may delay (rather than "deviate") the opening procedure when necessary in the interests of maintaining a fair and orderly market.[258] MIAX notes that Phlx Rule 1047(c) similarly allows an exchange official to delay the opening procedure, and that the Phlx rule provides the same level of detail as the revised MIAX rule.[259]

NASDAQ believes that MIAX's proposed rule text provides MIAX with too much discretion concerning the order types that initially will be available for use on MIAX, and argues

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254 See id. at 12.

255 See NASDAQ Letter, supra note 3, at 2.

256 See MIAX Response Letter, supra note 4, at 13.

257 See NASDAQ Letter, supra note 3, at 2.

258 See MIAX Response Letter, supra note 4, at 12.

259 See id. at 14.

that MIAX should be compelled to define which order types will be available when and file new rule changes when new order types are introduced or when order types are processed differently.[260]

For example, NASDAQ notes MIAX Rule 516 states that "not all order types listed and described in this rule will be initially available for use on the Exchange."[261] NASDAQ argues that, if the functionality related to certain order and quote types is not available on MIAX, then MIAX should specify in its rules what is available and file proposed rule changes when it introduces additional order or quote types and related functionality.[262] In response, MIAX believes it is permissible and appropriate to list in its rules all order and quote types that it intends to use soon after it commences operations, provided that the applicable rules contain a sufficient level of detail about each order and quote type.[263] MIAX believes that MIAX Rules 516 and 517 provide adequate detail on each of the order and quote types listed therein.[264] MIAX further believes that it is appropriate to use a regulatory circular to specify which order and quote types have been activated from among those specified in its rules.[265] MIAX

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260 See NASDAQ Letter, supra note 3, at 2-3. NASDAQ notes that existing exchanges are required to file detailed rule changes that describe how a proposed rule would work. See id. NASDAQ notes that the details and specific functionality are important to users, who need to understand how their orders will be handled in various situations. See id. at 3.

261 See NASDAQ Letter, supra note 3, at 2.

262 See id. at 3. For example, NASDAQ notes that MIAX Rule 516(d) says that Attributable Orders may not be available for all MIAX systems and MIAX would issue a Regulatory Circular specifying which systems and class of securities will have Attributable Orders. See id. In response, MIAX has revised Rule 516(e) (previously Rule 516(d)) to clarify that Attributable Orders will be available in the MIAX system on initial launch. See MIAX Response Letter, supra note 4, at 8.

263 See MIAX Response Letter, supra note 4, at 14-15.

264 See id. MIAX notes that other exchanges have similar rules, for example C2 Options Exchange.

265 See id.

represents that it intends to activate in the foreseeable future each of the proposed order and quote types contained in its proposed rules.[266]

In addition, NASDAQ notes that MIAX Rule 514(g)(2) states that MIAX will advise membership through a Regulatory Circular when additional order types are eligible to be directed.[267] NASDAQ believes this flexibility may be problematic, and notes that directed orders can warrant additional regulatory scrutiny in light of the issues surrounding participation guarantees that usually accompany directed orders.[268] In response, MIAX amended MIAX Rule 514(h)(2) to remove its ability to specify this information in a regulatory circular and instead represents that it will submit a rule filing with the Commission when it proposes to extend directed order functionality to additional order types.[269] MIAX further represents that any order types eligible to be directed will be set forth in the MIAX rules.[270]

The Commission believes that MIAX Exchange's proposed display, execution, and priority rules discussed above in this section are consistent with the Act. In particular, the Commission finds that the proposed rules are consistent with Section 6(b)(5) of the Act,[271] which, among other things, requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and to not permit unfair discrimination between customers,

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266 See id. at 14.

267 See NASDAQ Letter, supra note 3, at 3.

268 See id.

269 See MIAX Response Letter, supra note 4, at 13.

270 See id.

271 15 U.S.C. 78f(b)(5).

issuers, or dealers. The Commission also finds that the proposed rules are consistent with Section 6(b)(8) of the Act,[272] which requires that the rules of an exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The trading rules of MIAX are substantially similar to the current trading rules of other exchanges, as noted above, which were filed with and approved by the Commission (or otherwise became effective) pursuant to Section 19(b) of the Act. Therefore, the Commission believes that these rules raise no new regulatory issues and are consistent with the Act. However, certain MIAX trading rules are, in fact, novel in some respect or unique to MIAX and may not be similarly based on the existing rules of other exchanges. The trading rules that are novel or unique to MIAX, including the use of eQuotes, priority quotes, and exposure mechanisms, are discussed separately in detail below.

5. eQuotes and Priority Quotes

The MIAX rules provide that Market Makers will be permitted to submit bids and offers to MIAX as orders, Standard quotes, or "eQuotes."[273] Standard quotes refer to the traditional type of quotes that exist on other markets, and submission of a Standard quote by a Market Maker will cancel and replace any previously submitted Standard quote by the Market Maker.[274] In contrast, eQuotes will be quotes with a specific time in force, and Market Makers will be permitted to submit multiple eQuotes to MIAX Exchange (in addition to their single Standard quote).[275] In other words, the submission of an eQuote will not replace an existing Standard

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272 15 U.S.C. 78f(b)(8).

273 See MIAX Rule 517.

274 See MIAX 517(a)(1).

275 While Market Makers would be permitted to layer the book with multiple types of quotes, MIAX Rule 517(a)(2)(i) provides that one type of eQuote, the Day eQuote, will have limitations as to the number of such quotes that a single Market Maker could place

quote or eQuote. Thus, while Market Makers could only have one Standard quote active at any one time, they will be permitted to have multiple types of eQuotes active in a single series. The types of eQuotes available on MIAX will include Day eQuotes, Auction or Cancel ("AOC") eQuotes, Opening Only ("OPG") eQuotes, Immediate or Cancel ("IOC") eQuotes, Fill or Kill eQuotes ("FOK"), and Intermarket Sweep eQuotes.[276] MIAX's proposed eQuote types are analogous to order types, often of the same name, that could be used by members and Market Makers on MIAX, as discussed above, except that the eQuotes would be submitted by Market Makers through their quote handling terminal and may receive priority over other orders and quotes, as discussed below.[277]

The Commission believes that the proposed eQuotes provisions are consistent with the Act. The Commission acknowledges that, while Market Maker "quotes" traditionally provide liquidity to the market, MIAX's proposed eQuotes will allow Market Makers to utilize various

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on the same side of an individual option. This limitation is no more than 10 Day eQuotes on the same side of an individual option (as that term is defined in MIAX Rule 100), and the specific limit within this range would be sent to members through a Regulatory Circular. The same limit will apply to all types of Market Makers. MIAX has stated in its Form 1 that it does not intend to allow to the use of Day eQuotes upon initiation of its operations. See Exhibit E of MIAX's Form 1 Application.

276 See MIAX Rule 517(a)(2) for a description of each of the e-Quote types. MIAX notes that not all of these order types will be available upon initiation of operations. Rather, MIAX will update members through Regulatory Circulars as to the order types that initially will be available and as additional order types become available.

277 NASDAQ pointed out an inconsistency between MIAX's proposed Rule 612(a) and MIAX's technical system specifications, as the technical specifications say that eQuotes are not considered for purposes of the MIAX Aggregate Risk Manager. See NASDAQ Letter, supra note 3, at 3. NASDAQ recommended that MIAX clarify this point in its rule text. See id. In response, MIAX states that it believes the rule and the technical specifications are both correct as written. See MIAX Response Letter, supra note 4, at 15. Specifically, MIAX notes that it does not plan to support Day eQuotes at its initial launch. See id. Accordingly, the technical specifications are accurate in that Day eQuotes would not be considered at this time for purposes of the Aggregate Risk Manager. See id. The subsequent introduction by MIAX of Day eQuotes would require corresponding amendments to the technical specifications. See id.

types of "quotes" that may instead remove liquidity from the market. However, under MIAX's proposed rules, only certain types of quotes that provide liquidity (i.e., only Standard quotes and Day eQuotes) will be permitted to count toward a Market Maker's continuous quoting obligations.[278] In other words, Market Makers on MIAX will still be required to post traditional, continuous two-sided quotes that provide liquidity to the market.

Further, as noted above, the proposed eQuote types are largely analogous to orders, and other markets allow Market Makers to submit similar types of orders that also are not permitted to count towards a Market Maker's quoting obligations.[279]

The Commission notes that all quote types that may be submitted by Market Makers, whether Standard quotes or eQuotes, must be firm in accordance with the Market Maker's obligations under the MIAX rules[280] and Rule 602 of Regulation NMS.[281] However, the MIAX rules provide that bids and offers in certain of the eQuote types will not be disseminated to quotation vendors, including AOC eQuotes, OPG eQuotes, IOC eQuotes, FOK eQuotes, and Immediate or Cancel Intermarket Sweep Quotes. The Commission believes that this is consistent with the Act and Rule 602 of Regulation NMS due to the limited time in force or other contingencies associated with these particular eQuote types. Rule 602 of Regulation NMS generally requires exchanges to make their best bids and offers in U.S.-listed securities available in the consolidated quotation data that is widely disseminated to the public.[282] Paragraph (a)(1)(i)(A) of Rule 602, however, excludes bids and offers communicated on an exchange that

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278 See MIAX Rule 604(e); see also supra Section III(C)(3)(b) (discussing Market Maker obligations).

279 See, e.g., ISE Rule 805.

280 See MIAX Rules 604(d) and 517.

281 17 CFR 242.602.

282 See id.

either are executed immediately after communication or cancelled or withdrawn if not executed immediately after communication. The Commission believes that IOC eQuotes, FOK eQuotes, and Immediate or Cancel Intermarket Sweep Quotes fall within this exclusion under paragraph (a)(1)(i)(A) of Rule 602 and thus are consistent with the Act. Further, paragraph (a)(1)(i)(B) of Rule 602 excludes any bid or offer communicated prior to the commencement of trading in a security. Accordingly, the Commission notes that OPG eQuotes, which are quotes that can be submitted by a Market Maker only during the opening and will expire at the end of the opening process, are excluded from the dissemination requirements of Rule 602. Finally, as noted above with respect to AOC orders, the Commission has previously approved similar order types as consistent with the Act that are used in various auction mechanisms on other exchanges that are not displayed to any market participants.[283] The Commission believes that AOC eQuotes are analogous to these types of orders, and as such, the Commission believes that MIAX's proposal to not disseminate AOC eQuotes is consistent with the Act.

On MIAX, all Market Maker quotes will be designated as either "priority quotes" or "non-priority quotes."[284] As clarified by MIAX in Amendment No. 1, to be considered a priority quote, the following standards must be met at the time of execution:

1. the Market Maker must have a two-sided quote pair that is valid width (i.e., it must meet the bid/ask differential requirements in MIAX Rule 603(b)(4)[285] (i.e., a "valid width quote"));

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283 See supra note 203 and accompanying text.

284 See MIAX Rule 517(b).

285 MIAX Rule 603(b)(4) provides that, following the opening rotation, Market Makers must create differences of no more than \$5 between the bid and offer. Prior to the opening rotation, bid/ask differentials shall be no more than \$.25 between the bid and offer for each option contract for which the bid is less than \$2, no more than \$.40 where the bid is at least \$2 but does not exceed \$5, no more than \$.50 where the bid is more than \$5 but

2. the initial size of both of the Market Maker's bid and offer must meet the minimum quote size requirements of MIAX Rule 604(b)(2);
3. the bid/ask differential of the Market Maker's two-sided quote pair must meet the priority width requirements specified by MIAX for each option;[286] and
4. either of the following are true: (i) at the time a locking or crossing quote or order enters the MIAX system, the Market Maker's two-sided quote pair is a valid width quote resting on the Book; or (ii) immediately prior to the time the Market Maker enters a new quote that locks or crosses the MBBO, the Market Maker must have had a valid width quote already existing (i.e., exclusive of the Market Maker's new marketable quote or update) among his two-sided quotes.[287]

When determining whether a Market Maker has a valid width quote, MIAX will consider only Standard quotes and Day eQuotes.[288] In the event that a Market Maker has a priority quote on MIAX Exchange, all of that Market Maker's quotes (including all Standard quotes and eQuotes) would be entitled to have precedence over all other "Professional Interest"[289] (i.e., non-Priority Customer orders, Market Maker orders, and non-priority quotes) at the same price in accordance with MIAX Rule 514(e).[290]

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does not exceed $10, no more than $.80 where the bid is more than $10 but does not exceed $20, and no more than $1 where the bid is more than $20, provided that MIAX may establish differences other than the above for one or more option.

286 MIAX added text to MIAX Rule 517(b)(1)(ii) to clarify that MIAX will establish priority quote widths through a proposed rule change filed with the Commission, and the width could be as narrow as one MVP or as wide as, but not wider than, the bid/ask differentials in MIAX Rule 603(b)(4). See Amendment No. 1.

287 See MIAX Rule 517(b)(1)(i).

288 See MIAX Rule 517(b)(2).

289 See MIAX Rule 100 and supra note 208

290 See MIAX Rules 517(b)(1) and 514(e).

In its comment letter, ISE asks about MIAX Rule 514(e) and whether a Market Maker priority quote has precedence over other professional interest under both pro rata priority and price time priority, as well as when executing against an Intermarket Sweep Order.[291] In response, MIAX revised MIAX Rule 514(e) to clarify that Market Maker priority quotes will have precedence over other professional interest under the pro rata allocation methodology but not under the price time methodology.[292]

Further, ISE commented on MIAX Rule 603 and the priority quote provision. ISE believes that quote width violations would not be "against the rules" on MIAX, and also questions whether the priority quote provision is an appropriate "heightened" quotation requirement for a Market Maker to obtain a "priority quote".[293] While stating that it would not object to this approach, ISE requests that the Commission, if it approves MIAX's registration, to set forth the statutory basis for allowing a Market Maker to obtain a priority over other professional interests via a priority quote.[294] In response, MIAX added text to MIAX Rule 517(b) to clarify that MIAX would establish the priority quote width requirement through a proposed rule change filed with the Commission, and the requirement can have bid/ask differentials as narrow as one minimum price variation or as wide as, but never wider than, the minimum bid/ask differentials contained in MIAX Rule 603.[295] MIAX represented that the

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291 See ISE Letter, supra note 3, at 4.

292 See Amendment No. 1 and MIAX Response Letter, supra note 4, at 10. MIAX also clarified that a Market Maker will have precedence over other professional interest when MIAX receives an Intermarket Sweep Order at a price inferior to the NBBO. See id.

293 See ISE Letter, supra note 3, at 4. MIAX responded that ISE's assumption was incorrect, and MIAX affirmed that market makers may be subject to disciplinary action if their quotation spread exceeds $5. See MIAX Response Letter, supra note 4, at 11.

294 See ISE Letter, supra note 3, at 5.

295 See Amendment No. 1 and MIAX Response Letter, supra note 4, at 11-12.

priority quote width standards "will be in addition to and generally more stringent than the regulatory requirements applied to Market Makers," and that "the categorization of Market Maker quotes as priority and non-priority allows the Exchange to provide incentives to its Market Makers to provide tighter markets."[296] Until MIAX establishes narrower priority quote width requirements, however, the priority quote width will be the standard bid/ask differentials contained in MIAX Rule 603.[297] In addition, MIAX clarified that the initial size of the bid and the offer for a priority quote must meet the minimum size requirement of MIAX Rule 604(b)(2).[298] Further, MIAX affirms that there is, despite ISE's assumption to the contrary, a maximum market quotation spread requirement during regular market hours.[299] Thus, a violation of the quote width requirements contained in MIAX Rule 603, which is a free-standing rule, would constitute a rule violation separate and apart from the priority quote provisions and would subject a market maker to disciplinary action.[300]

The Commission believes that it is appropriate and consistent with the Act for MIAX to provide its Market Makers that are meeting their priority quote width obligations with precedence over other Professional interest in the manner that MIAX has proposed. MIAX's proposed priority quote rule and the precedence afforded to Market Makers that maintain a priority quote provides Market Makers with a benefit in return for the obligations to the market that they have assumed (e.g., the obligation to supply a continuous quote), while Market Makers will have precedence at the same price over other Professional participants that either do not

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296 See MIAX Response Letter, supra note 4, at 11.

297 See Amendment 1 (revising MIAX Rule 517(b)(ii)).

298 See MIAX Response Letter, supra note 4, at 11.

299 See id.

300 See id.

have any obligations (i.e., non-Market Maker Professional interest) or participants that are not quoting valid width markets (i.e., other Market Makers).[301] As discussed in further detail above, the Commission previously has recognized that, due to the obligations imposed on market makers, it is appropriate and consistent with the Act to confer certain corresponding benefits on them.[302] In the event a professional participant wanted to receive the benefits of becoming a market maker, it could apply to register as a market maker, subject to the Exchange's registration requirements and the participant's willingness to undertake the applicable obligations.[303] Further, at least one other exchange affords market makers precedence over other professional interest in a manner similar to the MIAX rules.[304]

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301 See Phlx Rule 1000(b)(14)(defining a "professional" to mean any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s), and providing that, subject to limited exceptions, "[a] professional will be treated in the same manner as an off-floor broker-dealer for purposes of Rules 1014(g)…").

302 See infra Section III(C)(3)(b) (discussing Market Maker obligations and benefits).

303 In Amendment No. 1, MIAX revised the maximum number of Market Makers allowed to quote per class up to 50 from 10. See Amendment 1 (revising rule 602(c)(2) to increase the Class Quoting Limit to 50 from 10). MIAX notes that a class quoting limit of 50 Market Makers is consistent with the practice at other exchanges (see, e.g., CBOE Rule 8.3A and C2 Rule 8.11). See MIAX Response Letter, supra note 4, at 12. In addition, the higher limit will provide additional opportunity for interested participants to become Market Makers on MIAX and avail themselves of the benefits afforded to Market Makers on MIAX in return for undertaking the applicable obligations to the MIAX market. See id.

304 See Phlx Rule 1014(g)(vii). Unlike MIAX's proposed rule, the Phlx rule provides that, for automatically executed trades, all market makers have precedence over other market participants, irrespective of whether such market makers are meeting their bid-ask differential requirements. In addition, NASDAQ BX has filed a proposed rule change to provide similar precedence for its market makers. See Securities Exchange Act Release No. 68041 (October 11, 2012), 77 FR 63903 (October 17, 2012) (BX-2012-065).

In addition, MIAX's priority quote proposal establishes a framework that could readily take into account future efforts by MIAX, which would be submitted pursuant to a proposed rule change submitted in accordance with Section 19 of the Act, to reduce and further narrow the maximum permitted width from the standard maximum $5 width, which is the current standard among U.S. options exchanges. If it does so, MIAX's

6. Section 11(a) of the Act

Section 11(a)(1) of the Act[305] prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion (collectively, "covered accounts"), unless an exception applies.

Rule 11a2-2(T) under the Act,[306] known as the "effect versus execute" rule, provides exchange members with an exemption from the Section 11(a)(1) prohibition. Rule 11a2-2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with Rule 11a2-2(T)'s conditions, a member: (1) must transmit the order from off the exchange floor; (2) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;[307] (3) may not be affiliated with the executing member; and (4) with respect to an account over which the member has investment

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system would provide an additional incentive for Market Makers to provide these narrower valid width quotes at all times through affording them precedence in return for their increased obligations.

At the same time, the Commission acknowledges that MIAX's current proposed bid/ask differential requirement (i.e., $5 following the opening) is in line with the current industry standard among the options exchanges. Thus, MIAX will provide precedence to Market Makers based on a proposed quote width standard that is, at present, no more strict than other markets. However, as noted above, even if MIAX does not ultimately impose a narrower valid priority quote width, MIAX's proposal is consistent with the rules of two other exchanges, which provide such precedence to market makers without regard to whether they are meeting their bid-ask differential requirements.

305 15 U.S.C. 78k(a)(1).

306 17 CFR 240.11a2-2(T).

307 The member may, however, participate in clearing and settling the transaction. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (regarding the NYSE's Designated Order Turnaround System ("1978 Release")).

discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule.

In a letter to the Commission,[308] MIAX requested that the Commission concur with its conclusion that MIAX members that enter orders into the MIAX trading system satisfy the requirements of Rule 11a2-2(T). For the reasons set forth below, the Commission believes that MIAX members entering orders into the MIAX trading system will satisfy the conditions of Rule 11a2-2(T).

First, Rule 11a2-2(T) requires that orders for covered accounts be transmitted from off the exchange floor. MIAX will not have a physical trading floor, and the MIAX trading system will receive orders from members electronically through remote terminals or computer-to-computer interfaces. In the context of other automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.[309] Since the MIAX trading system receives all orders electronically through remote terminals or computer-to-computer interfaces, the Commission believes that the trading system satisfies the off-floor

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308 See Letter from Barbara J. Comly, General Counsel and Corporate Secretary, Miami Holdings, to Richard R. Holley, III, Assistant Director, Division of Trading and Markets, Commission, dated November 30, 2012 ("MIAX 11(a) Request Letter").

309 See, e.g., Securities Exchange Act Release Nos. 59154 (December 23, 2008) 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (order approving proposed rules of BX); 49068, (January 13, 2004), 69 FR 2775 (January 20, 2004) (establishing, among other things, BOX as an options trading facility of BSE); 44983, (October 25, 2001), 66 FR 55225 (November 1, 2001) (approving the PCX's use of the Archipelago Exchange as its equity trading facility); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (regarding NYSE's Off-Hours Trading Facility). See 1978 Release, supra note 307. See also Securities Exchange Act Release No. 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) (regarding the American Stock Exchange ("Amex") Post Execution Reporting System, the Amex Switching System, the Intermarket Trading System, the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange, the PCX Communications and Execution System, and the Philadelphia Stock Exchange ("Phlx") Automated Communications and Execution System) ("1979 Release").

transmission requirement.

Second, Rule 11a2-2(T) requires that the member not participate in the execution of its order once it has been transmitted to the member performing the execution. MIAX has represented that the MIAX trading system will at no time following the submission of an order allow a member or an associated person of such member to acquire control or influence over the result or timing of an order's execution.[310] According to MIAX, the execution of a member's order is determined solely by what orders, bids, or offers are present in the MIAX trading system at the time the member submits the order and the order priority based on MIAX rules.[311] Accordingly, the Commission believes that a MIAX member will not participate in the execution of its order submitted into the trading system.

Rule 11a2-2(T)'s third condition is that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that the requirement is satisfied when automated exchange facilities, such as the MIAX trading system, are used, as long as the design of these systems ensures that members do not possess any special or unique trading advantages over non-members in handling their orders after transmitting them to MIAX Exchange.[312] MIAX has represented that the design of its trading system ensures that

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310 See MIAX 11(a) Request Letter, supra note 308. Members may change or cancel an order or quote at any time before the order is executed on the Exchange. See MIAX Form 1 Application, Exhibit E. The Commission has stated that the non-participation requirement is satisfied under such circumstances, so long as such modifications or cancellations are also transmitted from off the floor. See 1978 Release, supra note 307 (stating that the "non-participation requirement does not prevent initiating members from canceling of modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor").

311 See MIAX11(a) Request Letter, supra note 308.

312 In considering the operation of automated execution systems operated by an exchange, the Commission noted that while there is no independent executing exchange member,

no member has any special or unique trading advantage over non-members in the handling of its orders after transmitting its orders to MIAX.[313] Based on MIAX's representation, the Commission believes that the MIAX trading system satisfies this requirement.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T).[314] MIAX members trading for covered accounts over which they exercise investment discretion must comply with this condition in order to rely on the rule's exemption.[315]

7. Exposure Mechanisms and Routing

MIAX's system is designed to automatically execute incoming orders or quotes against orders and quotes in its system, provided that such incoming orders and quotes will not be

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the execution of an order is automatic once it has been transmitted into each system. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See 1979 Release.

313 See MIAX 11(a) Request Letter, supra note 308.

314 17 CFR 240.11a2-2(T)(a)(2)(iv). In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated person thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d). See also 1978 Release, supra note 307 (stating "[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

315 See MIAX 11(a) Request Letter, supra note 308.

executed at prices inferior to the NBBO.[316] In the event that an incoming order could not be fully executed on MIAX because it would trade through the NBBO (see "Route Timer," below) or, in certain cases, because there is insufficient size on MIAX to execute an incoming order in full when that order exhausts a Market Maker quote (see "Liquidity Refresh Pause," below), its proposed execution rules provide for the use of exposure mechanisms in certain instances.

Liquidity Refresh Pause. First, MIAX proposes to implement a "Liquidity Refresh Pause" to allow additional orders or quotes to be received where an incoming order ("initiating order") exhausts a Market Maker's quote that was all or part of the MIAX BBO ("MBBO") and there are unexecuted contracts remaining from the initiating order.[317] Specifically, the Liquidity Refresh Pause would be utilized in instances where MIAX is the only market at the NBBO, and an incoming initiating order is a limit order that crosses the NBBO upon receipt or is a market order and, in either case, could only be partially executed on MIAX where it exhausted a Market Maker quote at the MBBO. In such cases, rather than immediately executing at the next available price, the MIAX system would pause the market for a period of time not to exceed one second to allow additional Marker Maker orders and quotes and other market participant orders to be submitted.

At the start of the Liquidity Refresh Pause, the MIAX system will broadcast a message to subscribers of MIAX's data feeds, providing a description of the option and the size and side of the order or quote.[318] During the pause, the system will display the remainder of the initiating

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316 See MIAX Rule 515.

317 See MIAX Rule 515(c)(1)(iii).

318 See MIAX Rule 515(c)(1)(iii)(A).

order at the original NBBO price and, on the opposite side of the market, it will display MIAX's next bid or offer as non-firm.[319]

All market participants may respond to the broadcast message during the Liquidity Refresh Pause.[320] During the Liquidity Refresh Pause, if MIAX receives a new order or quote on the opposite of the market from the initiating order's remaining contracts that locks or crosses the original NBBO, MIAX will immediately execute the remaining contracts at the original NBBO price, provided it would not trade through the current NBBO.[321] If MIAX receives a new order or quote on the same side of the market as the initiating order's remaining contracts that locks or crosses the original NBBO, MIAX will add the new order or quote to the MBBO size and disseminate the updated MBBO.[322] The initiating order and any new orders or quotes on the same side of the market received during the Liquidity Refresh Pause will be processed in the order in which they were received.[323]

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319 See id. See also Phlx Rule 1082a(ii)(B)(3) (dissemination of non-firm quotes on opposite side of initiating order during Quote Exhaust timer); Securities Exchange Act Release No. 66315 (February 3, 2012), 77 FR 6828 (February 9, 2012) (Phlx-2012-12) (immediately effective filing to display non-firm quotes in conjunction with Quote Exhaust process).

320 See MIAX Rule 515(c)(1)(iii)(A)(1)(a).

321 See MIAX Rule 515(c)(1)(iii)(A)(1)(b).

322 See MIAX Rule 515(c)(1)(iii)(A)(1)(c). If MIAX receives an IOC or a FOK order on the same side of the market as the initiating order's remaining contracts, the MIAX system will immediately cancel the IOC and FOK orders. If MIAX receives an AOC order on the same side of the market as the initiating order's remaining contracts, the MIAX system will immediately reject the AOC order. If MIAX receives an ISO on the same side of the market as the initiating order's remaining contracts, the Liquidity Refresh Pause will be terminated early and the initiating order and any new orders received during the pause will be processed in the order in which they were received. See MIAX Rule 515(c)(1)(iii)(A)(1)(e)-(g).

323 See MIAX Rule 515(c)(1)(iii)(A)(1)(c). If all of the remaining contracts in the initiating order and any new orders or quotes on the same side of the market received during the Liquidity Refresh Pause are traded or cancelled during the Liquidity Refresh Pause, the

At the end of the Liquidity Refresh Pause, if there are still unexecuted contracts remaining in the initiating order or any new interest on the same side of the market, the MIAX system will execute the remaining contracts in accordance with MIAX's "price protection" process, which ensures that the execution of remaining contracts is limited to only one minimum price variation ("MPV") inferior to the original NBBO price, provided it does not trade through the current NBBO.[324] Specifically, if the next MIAX bid or offer is only one MPV inferior to the original NBBO, the initiating order's remaining contracts will be immediately executed at the next MIAX bid or offer up to the remaining contracts or the size of the MIAX bid or offer, whichever is less, provided the execution does not trade at a price inferior to the current NBBO.[325] If the next MIAX bid or offer is more than one MPV inferior to the original NBBO, then the initiating order will be handled depending on whether the limit price of the initiating order crosses the original NBBO by one or more MPVs. In particular, if the initiating order is a limit order whose limit price crosses the original NBBO by more than one MPV or if it is a market order, the remaining unexecuted portion of the initiating order will be cancelled.[326] If the initiating order is a limit order whose limit price crosses the original NBBO by one MPV, the MIAX system will display and book the initiating order at its limit price. If the limit price would

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Liquidity Refresh Pause will be terminated early and normal trading will resume. See MIAX Rule 515(c)(1)(iii)(A)(1)(d).

324 See MIAX Rule 515(c)(1)(iii)(A)(2) and MIAX Form 1 Application, Exhibit E.

325 If there are still contracts remaining from the initiating order, then the order will be handled pursuant to subparagraphs (1) or (2) of MIAX Rule 515(c)(1)(iii)(A)(2)(a), depending on whether the limit price of the initiating order crosses the original NBBO by one MPV or more.

326 See MIAX Rule 515(c)(1)(iii)(A)(2)(b)(2).

lock or cross the NBBO, then the MIAX system will handle the order in accordance with MIAX's "managed interest process."[327]

Under the "managed interest process," the initiating order will be displayed one MPV away from the current opposite-side NBBO if displaying the order at its limit price would lock or cross the NBBO.[328] Should the NBBO price change to an inferior price level, the initiating order's displayed price will continue to re-price so that it is displayed one MPV away from the new NBBO until the order reaches its original limit price, is fully executed, or is cancelled.[329] However, while displaying the initiating order one MPV away from the opposite-side NBBO, the initiating order will be placed on the MIAX book at a price that locks the current opposite-side NBBO.[330] If MIAX receives a new order or quote on the opposite side of the market from the initiating order that could be executed, the MIAX system will immediately execute the remaining contracts to the extent possible at the initiating order's current booked bid or offer price, provided that it does not trade through the current NBBO.[331]

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327 See MIAX Rule 515(c)(1)(iii)(A)(2)(b)(1). . The "managed interest process" is set forth in MIAX Rule 515(c)(2). In addition to its potential use at the end of the Liquidity Refresh Pause, the "managed interest process" would be used more broadly for orders, such as Do Not Route orders, that could not be executed or could not be executed in full and could not be displayed at their limit price because that limit price would lock or cross the NBBO. See MIAX Rule 515(c)(2) (noting specifically that the "managed interest process" could apply pursuant to Rule 515 subparagraphs (c)(1)(i)A), (c)(1)(ii)(A), (c)(1)(ii)(B)1.a, (c)(1)(ii)(B)2.a, c(1)(iii)(A)2.a.1), (c)(1)(iii)(A)2.b.1), (c)(1)(iii)(B)1.a., and (c)(1)(iii)(B)2.a.).

328 See MIAX Rule 515(c)(2).

329 See id. See also Phlx Rule 1080(m)(iv)(A) (providing a functionally similar process of handling Do Not Route orders, displaying the order one MPV away from the current NBBO, booking the order internally on the Phlx book at a price that would lock the current NBBO, and re-pricing the order until it reaches its limit price in the event the NBBO moves to an inferior level).

330 See id.

331 See Phlx Rule 1080(m)(iv)(A) (providing that Do Not Route orders that are re-priced to one MPV away from the current NBBO will interact with incoming contra-side orders at

In its comment letter, ISE requests that MIAX clarify the operation of MIAX Rule 515, with reference to the execution price of a resting order that has a non-displayed execution price, including confirmation that the order would not be executed at a price that would trade through the NBBO.[332] ISE further requests clarification as to how certain orders are re-priced, including pursuant to MIAX Rule 515(c)(2) and (d) and whether those rules contemplate that an order will be continuously re-priced, or only re-priced once.[333] NASDAQ asked a question similar to ISE concerning whether the managed interest process would result in a resting order being re-priced only once or dynamically as the away markets move.[334]

In response, MIAX revised several provisions in MIAX Rule 515 to clarify the execution price for a resting non-displayed order and to clarify the circumstances under which such orders are re-priced and the circumstances in which the booked price would differ from the NBBO.[335] For example, MIAX amended MIAX Rule 515(c)(2) to clarify that orders in the managed interest process are continuously re-priced.[336] MIAX also clarified in additional spots in MIAX

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the best away market price); see also, e.g. Phlx Rule 1082(a)(ii)(B)(3)(d) (providing that if Phlx receives an order or quote on the opposite side of the market from the initiating quote or order during the Quote Exhaust Timer that locks or crosses the reference price at any time during the Quote Exhaust Timer, it will execute immediately against the initiating quote or order at the reference price, which is price at which the initiating order was initially partially executed).

332 See ISE Letter, supra note 3, at n. 3. MIAX added the phrase "provided that the execution price does not violate the current NBBO" to the place in MIAX Rule 516(f) (which was renumbered to 516(g)) where ISE noted it was missing. See MIAX Response Letter, supra note 4, at 6.

333 See ISE Letter, supra note 3, at n. 3. ISE also asks for clarification as to whether Do Not Route orders will be continuously re-priced, or only re-priced once. See id. at n. 2.

334 See NASDAQ Letter, supra note 3, at 2.

335 See MIAX Response Letter, supra note 4, at 5-6.

336 See id.

Rules 515, 516, and 529 that such orders will not be executed at a price that would trade through the NBBO.[337]

In addition, NASDAQ notes that MIAX Rule 515 contains a number of situations where the rule provides that a posted order will immediately execute any remaining contracts when an inbound order comes into the MIAX system; however, MIAX's rule does not address what happens if the inbound order does not contain sufficient size to fully execute against the resting order.[338] In response, MIAX revised Rules 515(c) and 515(d) as well as 529(b)(2) to clarify what happens in such situations if an inbound order comes into the MIAX system where such inbound order contains less than the size of the posted order.[339] Specifically, MIAX will disseminate a revised MBBO that reflects the incoming order's remaining size and price.[340] For example, when MIAX is alone at the NBBO and utilizes the Liquidity Refresh Pause, if unexecuted contracts remain from an initiating order, MIAX would revise its MBBO to reflect the balance of the unexecuted order.[341]

Route Timer. MIAX also has proposed to subject Public Customer[342] orders to a "Route Timer" when it receives a route-eligible Public Customer order that cannot be filled on MIAX.[343] Specifically, if MIAX receives a Public Customer order ("initiating order") that is marketable

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337 See id.

338 See NASDAQ Letter, supra note 3, at 4.

339 See MIAX Response Letter, supra note 4, at 6-7.

340 See MIAX Rules 515(d), 515(c)(1)(iii)(A)(1)(b), and 529(b)(2)(i)..

341 See MIAX Rule 515(c)(1)(iii)(A)(1)(b).

342 See supra note 207.

343 Orders with certain contingencies, such as IOC orders, and orders marked with a "do not route" qualifier are not eligible for routing. See also infra notes 359 - 363and accompanying text (concerning ISE's comment regarding the proposed rule's limited applicability to Priority Customers) and Amendment No. 1 (in which MIAX revised the rule to apply to the broader category of Public Customers).

against the NBBO on an away market ("ABBO") and MIAX is not at the NBBO, or MIAX's disseminated market is equal to the ABBO but MIAX has insufficient size to satisfy the initiating order,[344] the order may be subject to a Route Timer not to exceed one second.[345] During the Route Timer, Market Makers and other market participants may interact with the initiating order before MIAX routes the order to an away market or otherwise handles the order in accordance with MIAX Rule 515 or 529, as discussed below.

Like the Liquidity Refresh Pause discussed above, when the Route Timer is activated, MIAX will broadcast a notification ("Route Notification") to subscribers of MIAX's data feeds, providing the size and side of the option.[346] During the timer, the MIAX system will display and book the initiating order at its limit price. However, if the limit price locks or crosses the current opposite side NBBO, the system will display the initiating order one MPV away from the current opposite side NBBO and book the initiating order at price that will internally lock the current opposite side NBBO.[347] The initiating order will remain available for execution up to its original

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344 The Route Timer will be utilized when MIAX is not at the NBBO, or is at the NBBO along with other markets but does not have sufficient size to execute a routable Public Customer initiating order in full. In contrast, the Liquidity Refresh Pause, discussed above, will be used when MIAX is the only market at the NBBO. See MIAX Rule 515(c)(1)(iii). The Route Timer is applicable only for Public Customer orders that are routable but do not meet the criteria for immediate routing discussed below. See MIAX Rule 529(b)(2)(i).

345 See MIAX Rule 529(b)(2). Orders that meet certain criteria may be eligible for immediate routing rather than the one second Route Timer, as discussed further below. See infra notes 356 - 357 and accompanying text.

346 See MIAX Rule 529(b)(2)(i). See also Amendment No. 1 (in which MIAX removed rule text from Rule 529(b)(2)(i) that also would have provided the NBBO price on the opposite side of the market from the order in the Route Notification).

347 The internally locked price will not be visible to any participant.

bid or down to its original offer.[348] MIAX will display its next bid or offer on the opposite side of the market from the initiating order as non-firm.[349]

During the Route Timer, if MIAX receives a new order or quote on the opposite side of the market from the initiating order that can be executed, the MIAX system will immediately execute the remaining contracts at the initiating order's current booked bid or offer price,[350] provided that the execution price does not trade through the current NBBO.[351]. If MIAX receives orders or quotes on the same side of the market as the initiating order, such new orders or quotes will join the initiating order in the Route Timer, and the MIAX system will disseminate an updated MBBO that includes the new order or quote's size.[352] If there is a change in the ABBO during the Route Timer that would allow the initiating order to trade on MIAX at the revised NBBO, the Route Timer will be cancelled and regular trading will resume.[353]

At the end of the Route Timer, if necessary, the MIAX system will route ISO orders to away markets disseminating the NBBO.[354] If, after routing to away markets, additional contracts

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348 See MIAX Rule 529(b)(2)(i).

349 See id. See also supra note 319.

350 See supra note 331.

351 See id.

352 See MIAX Rule 529(b)(2)(ii).

353 See MIAX Rule 529(b)(2)(ii). In addition, if, during the Route Timer, the initiating order and all interest on the same side of the market is traded in full or cancelled, the Route Timer will be terminated.

354 See MIAX Rule 529(b)(2)(iii). At the end of the Route Timer, same side orders or quotes will be handled in the order in which they were received by MIAX. See MIAX Rule 529(b)(2)(ii).

remain to be executed from the initiating order, the MIAX system will handle the remaining interest in accordance with MIAX Rule 515.[355]

Immediate Routing. In addition, in limited circumstances where a number of criteria are met, certain Public Customer orders that are eligible for routing could be routed immediately without being subject to the Route Timer ("Immediate Routing").[356] These criteria generally require that a Public Customer order be significantly greater in size than the size of the NBBO posted at away markets and must be received by MIAX at a time when MIAX has significant interest posted at one MPV inferior to the NBBO at away markets. Specifically, an incoming Public Customer order ("initiating order") will be eligible for Immediate Routing if: (i) the initiating order's limit price crosses the opposite side NBBO; (ii) the MBBO is inferior to the NBBO on the opposite side of the market by one MPV; (iii) the displayed NBBO is not crossed; (iv) the initiating order size is equal to or greater than three times the total size of the away markets represented in the opposite side ABBO; (v) the size of the quotes and orders at the MBBO combined with the total size of the ABBO on the opposite side of the market are equal to or greater than one half the size of the initiating order; (vi) MIAX's disseminated market includes a bid of greater than zero with a size of greater than zero if the order is a sell order; and (vii) the size of MIAX's disseminated market is equal to or greater than three times the total size

355 See MIAX Rule 529(b)(2)(iii). MIAX Rule 515 is the general rule governing execution of orders and quotes. It provides a number of different provisions describing how the MIAX system will handle orders that cannot be executed in part or in full. In accordance with Rule 515, depending on a variety of factors, orders may be cancelled, handled in accordance with the "managed interest process," or subject to the Liquidity Refresh Pause, among others. See generally MIAX Rule 515.

356 See MIAX Rule 529(b)(1). See also infra notes 359 - 363and accompanying text (concerning ISE's comment regarding the proposed rule's limited applicability to Priority Customers) and Amendment No. 1 (in which MIAX revised the rule to apply to the broader category of Public Customers).

of the away markets represented in the opposite side ABBO.[357] If a Public Customer order meets the aforementioned criteria, the MIAX system will immediately route ISO orders priced at the ABBO to the away markets disseminating prices better than the MBBO.[358]

In its comment letter, ISE discusses MIAX Rules 515(c) and 529 and notes that MIAX would only route Priority Customer Orders but not other types of public customer orders, like Professional orders.[359] ISE questions whether this distinction is consistent with the Intermarket Linkage Plan and the Act.[360] In addition, ISE requests clarification on the use of the terms "NBBO" and "ABBO" in MIAX Rules 515 and 529, respectively.[361] In response, MIAX revised its Route Timer provisions in MIAX Rules 529 (Order Routing to Other Exchanges) and 503 (Openings on the Exchange) to change all references from "Priority Customer Order" to "Public Customer Order."[362] The term "Public Customer" is defined in MIAX Rule 100 to mean a person that is not a broker or dealer in securities.[363] Accordingly, MIAX has addressed ISE's comment by broadening the types of interest that it will route, as ISE suggested, to include all Public Customer interest, which term includes Professional Customers, in a manner that is consistent with the Intermarket Linkage Plan and the Act.

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357 See MIAX Rule 529(b)(1).

358 See id. If there are still contracts remaining to be executed from the initiating order after routing, the remaining interest will be handled in accordance with MIAX Rule 515.

359 See ISE Letter, supra note 3, at 3.

360 See id.

361 See id. at n. 7. MIAX notes that the NBBO is the combined best bid and best offer from both the ABBO (all markets excluding MIAX) and the MBBO (MIAX's best bid and best offer). See MIAX Response Letter, supra note 4, at 8-9. MIAX believes that the terms are used correctly in MIAX Rules 515 and 529. See MIAX Response Letter, supra note 4, at 7.

362 See MIAX Response Letter, supra note 4, at n. 35.

363 See MIAX Rule 100.

The Commission believes that MIAX's proposed exposure and routing mechanisms, including the Liquidity Refresh Pause, Route Timer, and Immediate Routing criteria, are consistent with the Act. Several exchanges have adopted rules that provide for substantially similar exposure functionalities[364] that afford an opportunity for members to electronically "step up" and match a better-priced bid or offer available on another exchange, rather than immediately sending orders to other exchanges for execution.[365]

The Commission believes that MIAX's proposed Liquidity Refresh Pause is consistent with the Act. The rules governing MIAX's Liquidity Refresh Pause are substantially similar to those that the Commission approved for Phlx's "Quote Exhaust" process.[366] However, unlike MIAX, Phlx does not broadcast a message during its Quote Exhaust Timer. The Commission has, however, approved other similar broadcast messages for dissemination during order exposure or flash-type processes on other exchanges.[367] Further, MIAX's Liquidity Refresh Pause will limit the incoming order's execution price to one MPV inferior to the original NBBO price.[368] The Commission believes that this "price protection" functionality of MIAX's

364 See, e.g., ISE Rule 803, Supplementary Material .02 and Securities Exchange Act Release Nos. 57812 (May 12, 2008), 73 FR 28846 (May 19, 2008) (SR-ISE-2008-28) and 58038 (June 26, 2008), 73 FR 38261 (July 3, 2008) (SR-ISE-2008-50); and CBOE Rule 6.14A(b), HAL.

365 The Commission notes that it has proposed changes to Rule 602 of Regulation NMS that may affect these electronic "flash" mechanisms, if adopted. See Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632, 48633 (September 23, 2009) (File No. S7-21-09).

366 See Phlx Rule 1082(a)(ii)(B)(3). See also Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32) (approving Quote Exhaust process) and supra note 319.

367 See, e.g., CBOE Rule 6.14A, Hybrid Agency Liaison ("HAL"). CBOE sends out an "exposure message" for orders received by its HAL system to electronically expose the order at the NBBO price.

368 Phlx's rule does not include a similar provision. Phlx Rule 1082(a)(ii)(B)(3)(f) provides that the system will conduct an "Acceptable Price Range" test to determine whether there

Liquidity Refresh Pause can benefit investors by ensuring that, should the NBBO price move to an inferior price during the one second (or less) pause, a limit will be imposed on how far away from the original NBBO price the initiating order may be executed; specifically, it may only be executed one MPV from the original NBBO price. In addition, an incoming order will not receive an execution pursuant to the Liquidity Refresh Pause process if such order would trade through the then-current NBBO. Further, market participants may utilize an IOC or FOK order to avoid having MIAX potentially subject their order to the Liquidity Refresh Pause process.[369]

Pursuant to MIAX's Immediate Routing process, orders will have to meet a number of criteria to be eligible for immediate routing, as described above. As such, many, if not most, orders likely will be subject to the one second Route Timer, rather than immediately routing to an away exchange displaying the NBBO. MIAX, however, is not required to route orders to away exchanges. Further, market participants may avoid the Route Timer by utilizing an IOC or FOK Order.

In addition, broker-dealers have a duty of best execution.[370] A broker-dealer must carry out a regular and rigorous review of the quality of the options markets to evaluate its best

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is a valid next available price at which the system may execute the remaining unexecuted contracts. See Phlx Rule 1082(a)(ii)(B)(3)(f).

369 See MIAX Rules 515(c)(1), 515(e), and 515(f).

370 A broker-dealer has a legal duty to seek to obtain best execution of customer orders. See, e.g., Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 269-70, 274 (3d Cir.), cert. denied, 525 U.S. 811 (1998); Certain Market Making Activities on Nasdaq, Securities Exchange Act Release No. 40900 (Jan. 11, 1999) (settled case) (citing Sinclair v. SEC, 444 F.2d 399 (2d Cir. 1971); Arleen Hughes, 27 SEC 629, 636 (1948), aff'd sub nom. Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949)). See also Order Execution Obligations, Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290 (Sept. 12, 1996) ("Order Handling Rules Release"). A broker-dealer's duty of best execution derives from common law agency principles and fiduciary obligations, and is incorporated in SRO rules and, through judicial and Commission decisions, the antifraud provisions of the federal securities laws. See Order Handling Rules Release, 61 FR at 48322. See also Newton, 135 F.3d at 270. The duty of best execution requires

execution policies, including the determination as to which options market it routes customer order flow.[371] The protection against trade-throughs supports the broker-dealer's duty of best execution by helping ensure that customer orders are not executed at prices inferior to the best quotations, but it does not supplant or diminish the broker-dealer's responsibility for achieving best execution, including its duty to evaluate the execution quality of markets to which it routes customer orders.[372] Thus, to meet their best execution obligations, broker-dealers will need to consider and evaluate the functioning of the MIAX routing mechanisms and the quality of any resulting executions in making their determination of whether to route customer orders to MIAX.

D. Discipline and Oversight of Members

As noted above, one prerequisite for the Commission's grant of an exchange's application for registration is that a proposed exchange must be so organized and have the capacity to be able to carry out the purposes of the Act.[373] Specifically, an exchange must be

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broker-dealers to execute customers' trades at the most favorable terms reasonably available under the circumstances, i.e., at the best reasonably available price. Newton, 135 F.3d at 270. Newton also noted certain factors relevant to best execution - order size, trading characteristics of the security, speed of execution, clearing costs, and the cost and difficulty of executing an order in a particular market. See id. at 270 n.2 (citing Payment for Order Flow, Exchange Act Release No. 33026 (Oct. 6, 1993), 58 FR 52934, 52937-38 (Oct. 13, 1993) (Proposed Rules)). See In re E.F. Hutton & Co., Securities Exchange Act Release No. 25887 (July 6, 1988). See also Securities Exchange Act Release No. 34902 (October 27, 1994), 59 FR 55006, 55008-55009 (November 2, 1994) ("Approval of Payment for Order Flow Final Rules'). See also Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) ("NMS Adopting Release"), at 37537 (discussing the duty of best execution).

371 See NMS Adopting Release, supra note 370, at 37538. See also Securities Exchange Act Release No. 49175 (February 3, 2004), 69 FR 6124, 6128 (February 9, 2004) ("Options Concept Release").

372 See NMS Adopting Release, supra note 370, at 37538.

373 See 15 U.S.C. 78f(b)(1).

able to enforce compliance by its members and persons associated with its members with federal securities laws and the rules of the exchange.[374]

MIAX rules codify MIAX's disciplinary jurisdiction over its members, thereby facilitating its ability to enforce its members' compliance with its rules and the federal securities laws.[375] MIAX's rules permit it to sanction members for violations of its rules and violations of the federal securities laws by, among other things, expelling or suspending members; limiting members' activities, functions, or operations; fining or censuring members; suspending or barring a person from being associated with a member; or any other fitting sanction in accordance with MIAX rules.[376]

MIAX's disciplinary and oversight functions will be administered in accordance with Chapter X of the MIAX rules, which governs disciplinary actions. Unless delegated to another SRO pursuant to the terms of an effective 17d-2 plan,[377] MIAX regulatory staff (including regulatory staff of another SRO that may be acting on MIAX Exchange's behalf pursuant to a regulatory services agreement) will, among other things, investigate potential securities laws violations and initiate charges pursuant to MIAX rules.[378]

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374 See id.

375 See MIAX Rule 1000.

376 See id. See also CBOE Rule 17.1(a) and ISE Rule 1600(a) (containing identical provisions).

377 See supra note 112 (concerning the 17d-2 plans to which MIAX has committed to join).

378 See MIAX Rules 1002 and 1004. As noted above, MIAX has entered into a RSA with CBOE under which CBOE will perform certain regulatory functions on behalf of MIAX. MIAX may perform some or all of the functions specified in the Chapter X of the MIAX Rules. See also MIAX Rule 1015. CBOE will: assist MIAX in conducting market surveillance and investigations of potential violations of MIAX rules and/or federal securities laws related to activity on MIAX ; conduct examinations related to MIAX members' conduct on MIAX; assist MIAX with disciplinary proceedings pursuant to MIAX rules, including issuing charges and conducting hearings; and provide dispute

Upon a finding of probable cause of a violation within the disciplinary jurisdiction of MIAX Exchange and where further proceedings are warranted,[379] MIAX will conduct a hearing on disciplinary matters before a professional hearing officer[380] and two members of the Business Conduct Committee[381] (the "Panel").[382] The MIAX member (or their associated person) or the MIAX Exchange regulatory staff may petition for review of the decision of the Panel by the

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resolution services to MIAX members on behalf of MIAX, including operation of MIAX's arbitration program. See supra notes 113 - 114 and accompanying text.

379 See MIAX Rule 1004. If there is probable cause for finding a violation, MIAX Exchange regulatory staff will prepare a statement of charges including the allegations and specifying the provisions of the Act and/or MIAX Exchange rules, regulations or policies thereunder alleged to have been violated by the MIAX member or associated person. The CRO must approve the statement of charges.

380 See MIAX Rule 1015, Interpretation and Policy .01. As noted above, MIAX has entered into a RSA with CBOE to provide certain regulatory functions, including providing professional hearing officers. Under MIAX Rule 1006(a), the professional hearing officer is designated as the Chairman of the Panel. Under MIAX Rule 1006(e), the Panel Chairman has the sole responsibility to determine the time and place of all meetings of the Panel, and make all determinations with regard to procedural or evidentiary matters, as well as prescribe the time within which all documents, exhibits, briefs, stipulations, notices or other written materials must be filed where such is not specified in MIAX rules.

381 In Amendment No. 1, MIAX proposed new By-Law 4.7 to include additional specifics of the Business Conduct Committee, which shall be appointed by the Chairman of the Exchange Board. Specifically, the Committee, which will not be a Board Committee, will have a minimum of three members and will be composed of a number of individuals as determined by the MIAX Chairman, none of whom shall be Directors of MIAX. In addition, at least one member of the Business Conduct Committee and any panel thereof must be an officer, director or employee of a MIAX member. See Amendment No. 1; see also MIAX Exchange By-Laws Sections 4.1 and 4.7. See also BOX Bylaw 6.08(a) (containing an identical composition for the BOX Hearing Committee).

382 See MIAX Rule 1006. A Panel may make a determination without a hearing and may impose a penalty as to violations that the Member or associated person has admitted or has failed to answer or that otherwise do not appear to be in dispute. See MIAX Rule 1008. A Member or associated person alleged to have committed a disciplinary violation may submit a written offer of settlement to the Panel, or CRO if a Panel is not yet been appointed, which the Panel or CRO may accept or reject. If the second offer of settlement is rejected (such decision is not subject to review), a hearing will proceed in accordance with MIAX Rule 1006. See MIAX Rule 1009.

MIAX Exchange Board.[383] Any review would be conducted by the MIAX Exchange Board or a committee thereof composed of at least three Directors of the MIAX Exchange Board[384] (whose decision must be ratified by a majority of the MIAX Exchange Board) and such decision will be final.[385] In addition, the MIAX Exchange Board on its own motion may order review of a disciplinary decision.[386]

Appeals from any determination that impacts access to MIAX , such as termination or suspension of membership, will be instituted under, and governed by, the provisions in the Chapter XI of the MIAX Rules. MIAX's Chapter XI applies to persons economically aggrieved by any of the following actions of MIAX including, but not limited to: (a) denial of an application to become a Member; (b) barring a person from becoming associated with a Member; (c) limiting or prohibiting services provided by the MIAX or services of any exchange member.[387]

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383 See MIAX Rule 1010.

384 Specifically, the Chairman of the MIAX Board, with the approval of the Board, shall appoint an Appeals Committee to preside over all appeals related to disciplinary and adverse action determinations. See note 49 and accompanying text (detailing the composition of the Appeals Committee). If the Independent Director serving on the Appeals Committee recuses himself or herself from an appeal, due to conflict of interest or otherwise, the Independent Director may be replaced by a Non-Industry Director for purposes of the applicable appeal if there is no other Independent Director able to serve as the replacement. See MIAX Exchange By-Laws Section 4.5(d). See also Amended and Restated By-Laws of BATS Exchange, Inc., Section V, Article 6 (specifying a similar Appeals Committee).

385 See MIAX Rule 1010.

386 See id.

387 See MIAX Rule 1100. As noted above, MIAX has entered into a RSA with CBOE under which CBOE will perform certain regulatory functions on behalf of MIAX. CBOE may perform some or all of the functions specified in the Chapter XI of the MIAX Rules. See supra note 114. See also MIAX Rule 1106.

Any person aggrieved by an action of MIAX within the scope of the Chapter XI may file a written application to be heard within thirty days[388] after such action has been taken.[389] Applications for hearing and review will be referred to the Business Conduct Committee, which will appoint a hearing panel of no less than three members of such Committee.[390] The decision of the hearing panel made pursuant to Chapter XI of the MIAX rules is subject to review by the MIAX Exchange Board, either on its own motion within 30 days after issuance of the decision, or upon written request submitted by the applicant or the President of MIAX Exchange within 15 days after issuance of the decision.[391] The review would be conducted by the MIAX Exchange Board or a committee of the MIAX Exchange Board composed of at least three directors.[392]

The Commission finds that MIAX's proposed disciplinary and oversight rules and structure, as well as its proposed process for persons economically aggrieved by certain MIAX

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388 An applicant may file for an extension of time as allowed by the Chairman of the Business Conduct Committee within thirty days of the MIAX Exchange's action. An application for an extension will be ruled upon by the Chairman of the Business Conduct Committee, and his ruling will be given in writing. Rulings on applications for extensions of time are not subject to appeal. See MIAX Rule 1101.

389 The application must include: (1) the action for which review is sought; (2) the specific reasons for the applicant's exception to such action; (3) the relief sought; and (4) whether the applicant intends to submit any documents, statements, arguments or other material in support of the application, with a description of any such materials. See MIAX Rule 1101(a).

390 See MIAX Rule 1102. The decision of the hearing panel will be made in writing and sent to the parties to the proceedings. See MIAX Rule 1103.

391 See MIAX Rule 1104. The MIAX Exchange Board, or a committee of the MIAX Exchange Board, will have sole discretion to grant or deny either request. See id.

392 See MIAX Rule 1104(b). The MIAX Exchange Board or its designated committee may affirm, reverse, or modify in whole or in part, the decision of the hearing panel. The decision of the MIAX Exchange Board or its designated committee would be final, and must be in writing and would be sent to the parties to the proceeding. See MIAX Rule 1104(c).

actions, are consistent with the requirements of Sections 6(b)(6) and 6(b)(7) of the Act[393] in that they provide fair procedures for the disciplining of members and persons associated with members. The Commission further finds that the proposed MIAX rules are designed to provide MIAX Exchange with the ability to comply, and with the authority to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of MIAX.[394]

E. Listing

MIAX does not intend to offer original listings when it commences operations. Instead, MIAX will list and trade only equity options that are listed on other national securities exchanges and cleared by the Options Clearing Corporation. MIAX's listing rules, including the criteria for the underlying securities of the options to be traded, are substantially similar to the rules of other exchanges.[395] The Commission finds that MIAX's proposed initial and continued listing rules are consistent with the Act, including Section 6(b)(5), in that they are designed to protect investors and the public interest and to promote just and equitable principles of trade. Before beginning operation, MIAX will need to become a participant in the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options Submitted Pursuant to Section 11A(a)(3)(B) of the Act ("OLPP"). In addition, before beginning operation, MIAX will need to become a participant in the Options Clearing Corporation.

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393 15 U.S.C. 78f(b)(6) and (b)(7), respectively.

394 See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

395 See, e.g., ISE Rule 502 (Criteria for Underlying Securities).

IV. Exemption from Section 19(b) of the Act With Regard to CBOE and NYSE Rules Incorporated by Reference

MIAX proposes to incorporate by reference certain CBOE rules concerning arbitration. Thus, MIAX arbitration proceedings will be governed by the applicable CBOE arbitration rules. Specifically, as referenced in MIAX Rule 1107 (Arbitration), MIAX proposes to incorporate by reference Chapter XVIII of CBOE's rulebook (CBOE Arbitration Rules).[396] MIAX also proposes in Rule 1502 to incorporate by reference the CBOE or NYSE rules concerning initial and maintenance margin requirements.

In connection with the proposal to incorporate the CBOE and NYSE rules by reference, MIAX requested, pursuant to Rule 240.0-12 under the Act,[397] an exemption under Section 36 of the Act from the rule filing requirements of Section 19(b) of the Act for changes to the MIAX rules that are effected solely by virtue of a change to a cross-referenced CBOE or NYSE rules.[398] MIAX proposes to incorporate by reference categories of rules, rather than individual rules within a category, that are not trading rules. In addition, MIAX agrees to provide written notice to its members whenever CBOE or NYSE proposes a change to a rule within a cross-referenced category of rules[399] and whenever any such proposed changes are approved by the Commission or otherwise become effective.[400]

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396 In addition, with respect to pre-dispute arbitration agreements, MIAX Rule 1107(c) provides that CBOE Rule 18.35 would apply to disputes between MIAX members and their customers.

397 17 CFR 240.0-12.

398 See Letter from Barbara Comly, General Counsel, MIAX, to Elizabeth M. Murphy, Secretary, Commission, dated November 30, 2012 ("Section 19(b) Exemption Request").

399 See id.

400 MIAX will provide such notice through a posting on the same website location where MIAX posts its own rule filings pursuant to Rule 19b-4 under the Act, within the required time frame. The website posting will include a link to the location on the FINRA or CBOE website where FINRA's or CBOE's proposed rule change is posted. See id.

Using the authority under Section 36 of the Act,[401] the Commission previously exempted certain SROs from the requirement to file proposed rule changes under Section 19(b) of the Act.[402] The Commission is hereby granting MIAX's request for exemption, pursuant to Section 36 of the Act, from the rule filing requirements of Section 19(b) of the Act with respect to the rules that MIAX proposes to incorporate by reference. The exemption is conditioned upon MIAX providing written notice to MIAX members whenever CBOE or NYSE proposes to change an incorporated by reference rule. The Commission believes that the exemption is appropriate in the public interest and consistent with the protection of investors because it will promote more efficient use of Commission and SROs resources by avoiding duplicative rule filings based on simultaneous changes to identical rule text sought by more than one SRO.

V. Conclusion

IT IS ORDERED that the application of MIAX Exchange for registration as a national securities exchange be, and it hereby is, granted.

IT IS FURTHERED ORDERED that operation of MIAX Exchange is conditioned on the satisfaction of the requirements below:

A. Participation in National Market System Plans Relating to Options Trading. MIAX Exchange must join: (1) The Plan for the Reporting of Consolidated Options Last Sale Reports and Quotation Information (Options Price Reporting Authority); (2) the OLPP; (3) the Linkage Plan; and (4) the Plan of the Options Regulatory Surveillance Authority.

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401 15 U.S.C. 78mm.

402 See, e.g., DirectEdge Exchanges Order, BATS Order, and BOX Order, supra note 18, and C2 Order, supra note 41. In particular, the BOX Order granted relief for BOX's arbitration rule (which is substantively similar to MIAX's proposed rule), which also incorporates the same FINRA rules that MIAX proposes to incorporate.

B. Participation in Multiparty Rule 17d-2 Plans. MIAX Exchange must become a party to the multiparty Rule 17d-2 agreements concerning options sales practice regulation and market surveillance.

C. Participation in the Options Clearing Corporation. MIAX Exchange must become an Options Clearing Corporation participant exchange.

D. Participation in the Intermarket Surveillance Group. MIAX Exchange must join the Intermarket Surveillance Group.

E. Effective Regulation. MIAX Exchange must have, and represent in a letter to the staff in the Commission's Office of Compliance Inspections and Examinations that it has, adequate procedures and programs in place to effectively regulate MIAX.

F. Trade Processing and Exchange Systems. MIAX Exchange must have, and represent in a letter to the staff in the Commission's Division of Trading and Markets that it has, adequate procedures and programs in place, as detailed in Commission Automation Policy Review guidelines, to effectively process trades and maintain the confidentiality, integrity, and availability of MIAX's systems.[403]

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403 On November 16, 1989, the Commission published its first Automation Review Policy ("ARP I"), in which the Commission created a voluntary framework for SROs to establish comprehensive planning and assessment programs to determine systems capacity and vulnerability. On May 9, 1991, the Commission published its second Automation Review Policy ("ARP II") to clarify the types of review and reports expected from SROs. See Securities Exchange Act Release Nos. 27445 (November 16, 1989), 54 FR 48703 (November 24, 1989) and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

IT IS FURTHER ORDERED, pursuant to Section 36 of the Act,[404] that MIAX shall be exempted from the rule filing requirements of Section 19(b) of the Act with respect to the FINRA and CBOE rules that MIAX proposes to incorporate by reference, subject to the conditions specified in this Order.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

[404] 15 U.S.C. 78mm.

Commissioner Walter
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9371 / December 3, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15083

In the Matter of **the Registration Statement of** **Caribbean Pacific Marketing, Inc.,** **2295 Corporate Blvd., NW,** **Suite 131,** **Boca Raton, FL 33431**	**ORDER MAKING FINDINGS AND SUSPENDING THE EFFECTIVENESS OF REGISTRATION STATEMENT PURSUANT TO SECTION 8(d) OF THE SECURITIES ACT OF 1933**

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest to accept the Offer of Settlement (the "Offer") submitted by Caribbean Pacific Marketing, Inc. ("Respondent"), pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of these proceedings initiated against Respondent on October 29, 2012, pursuant to Section 8(d) of the Securities Act of 1933 (the "Securities Act").

II.

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 Suspending the Effectiveness of Registration Statement pursuant to Section 8(d) of the Securities Act of 1933 (the "Order"), as set forth below.

III.

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

A. Respondent filed a Form S-1 registration statement with the Commission on March 9, 2012 to register an offering of securities under the Securities Act, which it amended several times between March and August 24, 2012. The Registration Statement was declared effective on August 29, 2012.

B. The Registration Statement represented that Respondent sought to raise $150,000 through a self-underwritten offer and sale of up to 1 million shares of common stock at $0.15 per share, to conduct its business operations. Ultimately it appears no shares were sold pursuant to the Registration Statement. The Registration Statement lists the Respondent's president and its principal financial officer and includes background information for both officers.

C. The Registration Statement is materially misleading and deficient as it fails to disclose that William J. Reilly ("Reilly"), a disbarred attorney subject to an injunction is a de facto executive officer and control person of the Respondent. Specifically, in the civil action Securities and Exchange Commission v. Forest Resources Management Corp., Civil Action Number 09 Civ. 903 (JSR), in the United States District Court for the Southern District of New York, on October 15, 2009, the district court entered a final judgment against Reilly barring him from: (1) violating Section 5 of the Securities Act; (2) violating Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934; (3) acting as an officer or director of a public company; and (4) participating in an offering of penny stock. The Registration Statement failed to include any information about Reilly's position with Respondent and his business experience. A Form S-1 registration statement must include the identification of all officers and directors of the registrant, including their names, ages, positions and business experience. See Regulation S-K, Part I, Item 401.

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, pursuant to Section 8(d) of the Securities Act, that the effectiveness of the August 29, 2012 Registration Statement filed by the Respondent is suspended.

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. 68334 / December 3, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3509 / December 3, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15115

In the Matter of

ARNETT L. WATERS,

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 Arnett L. Waters ("Respondent" or "Waters").

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, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and 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. Arnett L. Waters is the president, chief executive officer, and owner of A.L. Waters Capital, LLC ("Waters Capital"), an investment adviser registered with the Commission. Waters was a registered representative with Waters Capital from April 2005 through March 9, 2012, when he was permanently barred from association with any FINRA member for failing to provide testimony in a FINRA investigation. He was associated with various brokerage firms off and on from 1983 to 1993, when he was censured and barred for two years by the New York Stock Exchange. Waters, 62 years old, is a resident of Milton, Massachusetts.

2. On October 2, 2012, Waters pled guilty to two counts of criminal contempt in violation of Title 18 United States Code, Section 401(3) before the United States District Court for the District of Massachusetts, in SEC v. A.L. Waters Capital, LLC, et al., Case No. 12-CV-10873-DJC.

3. The counts of the criminal information to which Waters pled guilty alleged, inter alia, that Waters knowingly and willfully disobeyed and resisted a lawful order and command of the Court in the underlying civil securities fraud action to submit an accounting of assets and of all accounts held at any bank in his name or for his benefit by purposely omitting a bank account in which he had deposited funds. The criminal information also alleged that Waters knowingly and willfully disobeyed and resisted a lawful order and command of the Court in the underlying civil securities fraud action to hold and retain all funds and other assets and prevent their dissipation by withdrawing funds and writing checks drawn upon that bank account.

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 and Section 203(f) of the Advisers Act that Respondent Waters 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.

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. 68335 / December 3, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3426 / December 3, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15116

In the Matter of **BDO China Dahua CPA Co., Ltd.;** **Ernst & Young Hua Ming LLP;** **KPMG Huazhen (Special General Partnership);** **Deloitte Touche Tohmatsu Certified Public Accountants Ltd.;** **PricewaterhouseCoopers Zhong Tian CPAs Limited** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e)(1)(iii) OF THE COMMISSION'S RULES OF PRACTICE AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice against BDO China Dahua CPA Co., Ltd.; Ernst & Young Hua Ming LLP; KPMG Huazhen (Special General Partnership); Deloitte Touche Tohmatsu Certified Public Accountants Ltd.; and PricewaterhouseCoopers Zhong Tian CPAs Limited (collectively "Respondents").[1]

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[1] Rule 102(e)(1)(iii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found...to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

II.

The Division of Enforcement alleges that:

A. RESPONDENTS

1. **BDO China Dahua CPA Co., Ltd.** ("BDO China") is located in Beijing, China, and is a PCAOB-registered member firm of BDO International Limited, a UK company limited by guarantee. BDO China audited the financial statements of an issuer client ("Client A") for the fiscal years ended December 31, 2010 and 2011.

2. **Ernst & Young Hua Ming LLP** (formerly known as Ernst & Young Hua Ming Certified Public Accountants) ("E&Y Beijing") is located in Beijing, China, and is a PCAOB-registered member firm of Ernst & Young Global Limited, a UK private company limited by guarantee. E&Y Beijing was engaged to audit the financial statements of an issuer client ("Client B") for the fiscal year ended December 31, 2010 and another issuer client ("Client C") for the fiscal years ended September 30, 2010 and 2011.

3. **KPMG Huazhen (Special General Partnership)** (formerly known as KPMG Huazhen) ("KPMG Beijing") is located in Beijing, China, and is a PCAOB-registered member firm of KPMG International Cooperative ("KPMG"), a Swiss entity. KPMG Beijing substantially assisted a KPMG affiliate in auditing the financial statements of an issuer client ("Client D") for the fiscal year ended December 31, 2010, another issuer client ("Client E") for the fiscal year ended December 31, 2010, and another issuer client ("Client F") for the fiscal years ended December 31, 2008, 2009 and 2010.

4. **Deloitte Touche Tohmatsu Certified Public Accountants Ltd.** ("DTTC") is located in Shanghai, China, and is a PCAOB-registered member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee. DTTC was engaged to audit the financial statements of an issuer client ("Client G") for the fiscal year ended June 30, 2010.

5. **PricewaterhouseCoopers Zhong Tian CPAs Limited** ("PwC Shanghai") is located in Shanghai, China, and is a PCAOB-registered member firm of PricewaterhouseCoopers International Limited, a UK private company limited by guarantee. PwC Shanghai was engaged to audit the financial statements of an issuer client ("Client H") for the fiscal year ended December 31, 2010 and another issuer client ("Client I") for the fiscal year ended December 31, 2010.

B. <u>FACTS</u>

<u>Summary</u>

6. The Division of Enforcement has ongoing fraud investigations concerning Clients A, B, C, D, E, F, G, H, and I, each of which is a U.S. issuer whose securities were registered with the Commission and whose principal operations were based in the People's Republic of China.

7. This action stems from Respondents' willful refusal, in response to Commission requests, to provide the Commission with audit workpapers and other materials prepared in connection with audit work or interim reviews performed for Clients A, B, C, D, E, F, G, H, and I, in contravention of their legal obligations as foreign public accounting firms.

<u>Commission's Section 106 Requests</u>

8. On February 1, 2012, pursuant to Section 106 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), as amended by Section 929J of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Section 106"), the Commission served BDO China, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client A]" for the fiscal years ended December 31, 2010.

9. On April 26, 2012, pursuant to Section 106, the Commission served E&Y Beijing, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client B]" for the fiscal year ended December 31, 2010.

10. On February 2, 2012, pursuant to Section 106, the Commission served E&Y Beijing, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client C]" for the fiscal years ended September 30, 2010 and 2011.

11. On February 6, 2012, pursuant to Section 106, the Commission served KPMG Beijing, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client D]" for the fiscal year ended December 31, 2010.

12. On February 9, 2012, pursuant to Section 106, the Commission served KPMG Beijing, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client E]" for the fiscal year ended December 31, 2010.

13. On February 3, 2012 pursuant to Section 106, the Commission served KPMG Beijing, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit reports issued, audit work

performed, or interim reviews conducted for [Client F]" for the fiscal years ended December 31, 2008, 2009, and 2010.

14. On February 14, 2012, pursuant to Section 106, the Commission served DTTC, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client G]" for the fiscal year ended June 30, 2010.

15. On February 8, 2012 pursuant to Section 106, the Commission served PwC Shanghai, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client H]" for the fiscal year ended December 31, 2010.

16. On February 16, 2012, pursuant to Section 106, the Commission served PwC Shanghai, through its designated U.S. agent for service of Section 106 requests, with a request for "[a]ll audit work papers and all other documents related to any audit work performed for [Client I]" for the fiscal year ended December 31, 2010.

17. Each of the Respondents has informed the Commission that it will not produce the documents to the Commission as requested in the Section 106 requests because, among other things, Respondents interpret the law of the People's Republic of China as prohibiting Respondents from doing so.

18. As of the date of this Order, the Commission does not have possession of the audit workpapers and other relevant documents sought in any of the Section 106 requests.

C. VIOLATIONS

19. Section 106(b) of Sarbanes-Oxley directs a foreign public accounting firm that "issues an audit report, performs audit work, or conducts interim reviews" to "produce the audit workpapers of the foreign public accounting firm and all other documents of the firm related to any such audit work or interim review" to the Commission upon request.

20. A willful refusal to comply, in whole or in part, with a request by the Commission under Section 106 is a violation of Sarbanes-Oxley. *See* Section 106(e).

21. A violation of Sarbanes-Oxley constitutes a violation of the Securities Exchange Act of 1934 ("Exchange Act"). *See* Sarbanes-Oxley Section 3(b)(1).

22. BDO China has willfully refused to provide the Commission with its audit workpapers and all other documents relating to BDO China's audit or interim review work for Client A.

23. E&Y Beijing has willfully refused to provide the Commission with its audit workpapers and all other documents relating to E&Y Beijing's audit or interim review work for Client B.

24. E&Y Beijing has willfully refused to provide the Commission with its audit workpapers and all other documents relating to E&Y Beijing's audit or interim review work for Client C.

25. KPMG Beijing has willfully refused to provide the Commission with its audit workpapers and all other documents relating to KPMG Beijing's audit or interim review work for Client D.

26. KPMG Beijing has willfully refused to provide the Commission with its audit workpapers and all other documents relating to KPMG Beijing's audit or interim review work for Client E.

27. KPMG Beijing has willfully refused to provide the Commission with its audit workpapers and all other documents relating to KPMG Beijing's audit or interim review work for Client F.

28. DTTC has willfully refused to provide the Commission with its audit workpapers and all other documents relating to DTTC's audit or interim review work for Client G.

29. PwC Shanghai has willfully refused to provide the Commission with its audit workpapers and all other documents relating to PwC Shanghai's audit or interim review work for Client H.

30. PwC Shanghai has willfully refused to provide the Commission with its audit workpapers and all other documents relating to PwC Shanghai's audit or interim review work for Client I.

31. As such, Respondents have each willfully violated Section 106 of Sarbanes-Oxley and therefore also the Exchange Act.

32. As a result of the conduct described above, it is appropriate that this proceeding be brought pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice to determine whether Respondents should be censured or denied the privilege of appearing and practicing before the Commission for having willfully violated Section 106 of Sarbanes-Oxley.

III.

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

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

B. What, if any, remedial action is appropriate against Respondents pursuant to Rule 102(e)(1)(iii) of Commission's Rules of Practice.

IV.

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

IT IS FURTHER ORDERED that each 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 any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, such Respondent may be deemed in default and the proceedings may be determined against such Respondent 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.

Under the authority conferred by Rule 141(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.141(a)(2), this Order shall be served upon Respondents through the respective domestic registered public accounting firms or other United States agents that Respondents have designated for service under Section 106(d) of Sarbanes-Oxley, 15 U.S.C. § 7216(d), or by any other method reasonably calculated to give notice to a Respondent, provided that the other method of service used is not prohibited by the law of the foreign country in which the Respondent is located.

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

SECURITIES EXCHANGE ACT OF 1934
Release No. 68345 / December 4, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15117

In the Matter of **HealthSport, Inc.,** **Home Director, Inc.,** **Home Theater Products International, Inc.,** **House of Taylor Jewelry, Inc. (n/k/a Global Jewelry Concepts, Inc.), and** **Huifeng Bio-Pharmaceutical Technology, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents HealthSport, Inc., Home Director, Inc., Home Theater Products International, Inc., House of Taylor Jewelry, Inc. (n/k/a Global Jewelry Concepts, Inc.), and Huifeng Bio-Pharmaceutical Technology, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. HealthSport, Inc. (CIK No. 777516) is a void Delaware corporation located in Oxnard, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HealthSport 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, 2010, which reported a net loss of over $5.5 million for the prior nine months. On September 23, 2011, the company filed a Chapter 11 petition in the

U.S. Bankruptcy Court for the District of Arizona, which was still pending as of October 5, 2012. As of November 28, 2012, the company's stock (symbol "HSPO") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Home Director, Inc. (CIK No. 715031) is a forfeited Delaware corporation located in Campbell, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Home Director 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 $6.7 million for the prior nine months. As of November 28, 2012, the company's stock (symbol "HMDO") 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. Home Theater Products International, Inc. (CIK No. 787793) is a forfeited Delaware corporation located in Anaheim, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Home Theater 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, 1995. As of November 28, 2012, the company's stock (symbol "HTPI") 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. House of Taylor Jewelry, Inc. (n/k/a Global Jewelry Concepts, Inc.) (CIK No. 1069249) is a revoked Nevada corporation located in West Hollywood, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). House of Taylor 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 $5.38 million for the prior nine months. As of November 28, 2012, the company's stock (symbol "HOTJ") 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. Huifeng Bio-Pharmaceutical Technology, Inc. (CIK No. 1119951) is a defaulted Nevada corporation located in Shaanxi Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Huifeng 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, 2010. As of November 28, 2012, the company's stock (symbol "HFGB") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. 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.

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

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 4, 2012

In the Matter of **HealthSport, Inc.,** **Home Director, Inc.,** **Home Theater Products International, Inc.,** **House of Taylor Jewelry, Inc. (n/k/a Global Jewelry Concepts, Inc.), and** **Huifeng Bio-Pharmaceutical Technology, 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 HealthSport, Inc. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Home Director, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Home Theater Products International, Inc. because it has not filed any periodic reports since March 31, 1995.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of House of Taylor Jewelry, Inc. (n/k/a Global Jewelry Concepts, Inc.) because it has not filed any periodic since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Huifeng Bio-Pharmaceutical Technology, Inc. because it has not filed any periodic reports since the period ended September 30, 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 the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on December 4, 2012, through 11:59 p.m. EST on December 17, 2012.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68348 / December 4, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3510 / December 4, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30289 / December 4, 2012

Admin. Proc. File No. 3-14697

In the Matter of LISA B. PREMO	ORDER GRANTING EXTENSION

I.

The Chief Administrative Law Judge, Brenda P. Murray, has moved, pursuant to Commission Rule of Practice 360(a)(3),[1] for an extension of time to issue an initial decision in this proceeding. For the reasons set forth below, we have determined to grant the law judge's motion.

On January 17, 2012, we issued an Order Instituting Administrative and Cease-and-Desist Proceedings against Lisa B. Premo, a registered investment adviser. The OIP alleges that from October 1996 to December 2008, Premo was employed with the Evergreen Investment Management Company, a registered investment adviser. Beginning in May 2003, Premo became the lead portfolio manager of the Evergreen Ultra Short Opportunities Fund, which primarily invested in commercial and residential fixed and variable rate mortgage backed securities. In December 2007, Premo became Evergreen's chief investment officer for liquidity and structured solutions as well as a member of the Evergreen Valuation Committee (the "EVC"). The EVC was established by the Ultra Fund's Board of Trustees to assist the board in determining the valuation of fair-valued securities.

[1] 17 C.F.R. § 201.360(a)(3).

The OIP alleges that, from at least May 2008 to early June 2008, the NAV of the Ultra Fund was materially overstated as a result of Premo's conduct. Specifically, in early February 2008, Premo learned that a collateralized debt obligation owned by the Ultra Fund had experienced an event of default. In late March 2008, Premo learned that, as a result of the event of default, the CDO would no longer make payments to the Fund. Premo did not convey this information to the EVC, which had been charged by the Board with the responsibility of calculating the value of the Ultra Fund's holdings. Additionally, Premo failed to disclose this information to the EVC in a June 4, 2008 report on the CDO. The OIP alleges that as a result of this conduct, Premo willfully violated Sections 206(1) and 206(2) of the Advisers Act.

The OIP also alleges that Premo willfully aided and abetted and caused Evergreen to violate Sections 206(1) and 206(2) of the Advisers Act. Through its failure to factor readily-available negative information concerning the CDO into its valuation of that security, Evergreen provided an overstated NAV to the Ultra Fund, which, in turn, generated higher advisory fees paid by the Ultra Fund to Evergreen. Through these actions, Evergreen breached its fiduciary duty to and defrauded the Ultra Fund in violation of Sections 206(1) and 206(2) of the Advisers Act. The OIP further alleges that Premo willfully aided and abetted and caused the Ultra Fund to violate Rule 22c-1(a) of the Investment Company Act, which requires registered investment companies to sell and redeem shares only at a price based on the current NAV of those shares.

The OIP directs the presiding law judge to hold a public hearing to take evidence regarding the allegations and the appropriate sanctions, and to issue an initial decision no later than 300 days from the date of service of the OIP, *i.e.*, by November 19, 2012. On October 1, 2012, Judge Murray filed a motion pursuant to Commission Rule of Practice 360(a)(3)[2] requesting an extension of time of sixty days to issue such decision.

II.

We adopted Rules of Practice 360(a)(2) and 360(a)(3) as part of an effort to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings,[3] setting mandatory deadlines for completion of administrative hearings. We further provided for the granting of extensions to those deadlines under certain circumstances, if supported by a motion from the Chief Administrative Law Judge.[4]

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[2] 17 C.F.R. § 201.360(a)(3).

[3] *See Adopting Release*, Securities Act Release No. 8240, 2003 WL 21354791, at *2 (June 11, 2003).

[4] While we intend to grant extensions sparingly, we may authorize an extension on the basis of the Chief Administrative Law Judge's motion, if we determine that "additional time is necessary or appropriate in the public interest." 17 C.F.R. § 201.360(a)(3).

Judge Murray supports her extension request by stating that she will not be able to issue an Initial Decision by November 19, 2012, because she has "spent most of September and [is] committed to spending the first three weeks of October presiding at hearings in other cases." It is Judge Murray's request "to extend the due date for sixty days, until January 18, 2013." Under the circumstances, it appears appropriate in the public interest to grant the Chief Law Judge's request and to extend the deadline for issuance of a decision in this matter.

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this matter is extended until January 18, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

Release No. 34-68357; File No. S7-44-10

RIN 3235-AK87

Extension of Dates for Certain Requirements of Rule 19b-4(n)(1) and Rule 19b-4(o)(2) and Amendment of Form 19b-4

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of dates for certain requirements.

SUMMARY: The Commission is amending Rule 19b-4(n)(1) and Rule 19b-4(o)(2) under the Securities Exchange Act of 1934 ("Exchange Act") to extend the dates for certain requirements therein and amending the General Instructions to Form 19b-4 (referenced in CFR 249.819) to clarify the process for submitting advance notices and security-based swap submissions to the Commission. The Commission is extending the dates with respect to the requirements that designated clearing agencies for which the Commission is the supervisory agency file advance notices and clearing agencies file security-based swap submissions with the Commission in an electronic format to dedicated email addresses to December 10, 2013 in order to prevent the scenario that such filings are required to be filed with the Commission through a system that is not yet technologically able to accept them.

DATES: The effective date for this release is December 10, 2012.

FOR FURTHER INFORMATION CONTACT: Kenneth Riitho, Special Counsel, at 551–5592; and Wyatt A. Robinson, Attorney-Adviser, at 551-5649, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

I. INTRODUCTION

On June 28, 2012, the Commission adopted amendments to Rule 19b-4 and Form 19b-4 to define and describe when notices of proposed changes to rules, procedures, or operations are required to be filed by designated financial market utilities in accordance with Section 806(e) of Title VIII of the Dodd-Frank Act1 ("Advance Notices"), to set forth the process for filing such Advance Notices with the Commission, and to specify the process for a clearing agency's submission for review of any security-based swap, or any group, category, type, or class of security-based swaps that the clearing agency plans to accept for clearing ("Security-Based Swap Submissions").[2] The effective date for the amendments to Rule 19b-4 was August 13, 2012. The effective date for all amendments to Form 19b-4 and 17 CFR 249.819 is December 10, 2012.

Rule 19b-4(n)(1)(i) requires a DCA[3] for which the Commission is the supervisory agency to provide an Advance Notice to the Commission of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by

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1 Section 806(e) of Title VIII of the Dodd-Frank Act requires any financial market utility designated by the Financial Stability Oversight Council ("Council") as systemically important to file with its supervisory agency 60 days advance notice of changes to its rules, procedures, or operations that could materially affect the nature or level of risk presented by the financial market utility. 12 U.S.C. 5465(e)(1)(A).

2 See Securities Exchange Act Release No. 67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) ("Adopting Release").

3 Six clearing agencies registered with the Commission are DCAs: Chicago Mercantile Exchange Inc. ("CME"), The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC"), ICE Clear Credit ("ICC"), National Securities Clearing Corporation ("NSCC"), and The Options Clearing Corporation ("OCC"). However, the Commission is the supervisory agency for only DTC, FICC, NSCC, and OCC.

such DCA.[4] Except as provided in Rule 19b-4(n)(1)(ii), a DCA for which the Commission is the supervisory agency is required to submit such Advance Notice to the Commission electronically on Form 19b–4. Rule 19b-4(n)(1)(ii) requires a DCA that files an Advance Notice with the Commission prior to December 10, 2012 to file such Advance Notice in an electronic format to a dedicated email address established by the Commission.[5]

Rule 19b-4(o)(2)(i) requires that except as provided in Rule 19b-4(o)(2)(ii), a clearing agency shall submit each Security-Based Swap Submission to the Commission electronically on Form 19b-4.[6] Rule 19b-4(o)(2)(ii) requires a clearing agency that files a Security-Based Swap Submission with the Commission prior to December 10, 2012 to file such Security-Based Swap Submission in electronic format to a dedicated email address established by the Commission.[7]

The amendments to Form 19b-4 contained in the Adopting Release provide that, among other things, after December 10, 2012, Advance Notices and Security-Based Swap Submissions, and amendments, extensions, and withdrawals thereto, shall be filed in an electronic format through the Electronic Form 19b-4 Filing System ("EFFS").[8]

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4 See 17 CFR 240.19b-4(n)(1)(i).

5 See 17 CFR 240.19b-4(n)(1)(ii). Currently, DCAs file Advance Notices with the Commission via the dedicated email address AdvanceNoticeFilings@sec.gov.

6 See 17 CFR 240.19b-4(o)(2)(i).

7 See 17 CFR 240.19b-4(o)(2)(ii). The Commission has established the dedicated email address SBSwapsSubmissions@sec.gov for Security-Based Swap Submissions.

8 Adopting Release at 41653, 41654. Currently, EFFS is used by self-regulatory organizations ("SRO"), which include registered clearing agencies, to file proposed rule changes electronically with the Commission pursuant to Exchange Act Section 19(b) and Rule 19b-4.

II. DISCUSSION

A. Rules 19b-4(n)(1)(ii) and 19b-4(o)(2)(ii)

The Commission stated in the Adopting Release that it was in the process of designing and implementing EFFS system upgrades that are necessary for Advance Notices and Security-Based Swap Submissions to be filed through EFFS.[9] The Commission anticipated in the Adopting Release that the EFFS system upgrades would be completed no later than December 10, 2012.[10] Prior to December 10, 2012, DCAs for which the Commission is the supervisory agency are required to file Advance Notices and clearing agencies are required to file Security-Based Swap Submissions through dedicated email addresses established by the Commission.[11]

Though the Commission has made progress on designing and implementing the EFFS system upgrades since the date of the Adopting Release, the Commission has determined that additional time is required to design, test, and implement the EFFS system upgrades. Therefore, the Commission is amending Rule 19b-4(n)(1)(ii) and Rule 19b-4(o)(2)(ii) to extend the dates with respect to the requirements that a DCA for which the Commission is the supervisory agency file an Advance Notice and a clearing agency file a Security-Based Swap Submission with the Commission in an electronic format to a dedicated email address established by the Commission to December 10, 2013. Extending the date prevents the scenario that DCAs for which the Commission is the supervisory agency are required to file Advance Notices and clearing

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9 See Adopting Release at 41606, 41620.

10 See id.

11 See id. The Commission has maintained a dedicated email address to receive Advance Notices and a dedicated email address to receive Security-Based Swap Submissions since July 19, 2012. The Commission has received five Advance Notices and zero Security-Based Swap Submissions through November 28, 2012.

agencies are required to file Security-Based Swap Submissions with the Commission through a system that is not yet technologically able to accept such filings. The Commission believes that an extension of the date to December 10, 2013, should provide the time necessary to complete implementation of the EFFS system upgrades.

In considering whether to extend the date with respect to the filing of Advance Notices and Security-Based Swap Submissions in an electronic format to a dedicated email address established by the Commission, the Commission's primary objective is to ensure that DCAs for which the Commission is the supervisory agency desiring to submit Advance Notices and clearing agencies desiring to submit Security-Based Swap Submissions to the Commission have a dependable mechanism with which to do so. As noted above, the Commission has maintained dedicated email addresses to receive Advance Notices and Security-Based Swap Submissions since July 19, 2012, and DCAs for which the Commission is the supervisory agency have developed a familiarity with this temporary mechanism to deliver Advance Notices to the Commission. Furthermore, the dedicated email address for submitting Advance Notices has operated according to design at all times during the period for which it has been in effect and the Commission has not received any complaints regarding the dedicated email address from DCAs for which the Commission is the supervisory agency.

B. General Instructions for Form 19b-4

In the Adopting Release, the Commission amended the General Instructions for Form 19b-4 to require, among other things, DCAs for which the Commission is the supervisory agency to submit Advance Notices and clearing agencies to submit Security-Based Swap Submissions to the Commission in an electronic format through EFFS.[12] The effective date of the amendments to Form 19b-4, including the amendments to the General Instructions, is December 10, 2012.

In this release, the Commission is amending the General Instructions for Form 19b-4 to continue the requirement that DCAs for which the Commission is the supervisory agency file Advance Notices and amendments, extensions, or withdrawals thereto, and clearing agencies file Security-Based Swap Submissions, and amendments, extensions, or withdrawals thereto, to the Commission through dedicated email addresses until December 10, 2013. Specifically, the Commission is amending section A, "Use of the Form," and section F, "Signature and Filing of the Completed Form," of the General Instructions for Form 19b-4 to require DCAs for which the Commission is the supervisory agency to file Advance Notices and amendments, extensions, and withdrawals thereto, with the Commission by using the dedicated email address AdvanceNoticeFilings@sec.gov and to require clearing agencies to file Security-Based Swap Submissions and amendments, extensions, and withdrawals thereto, with the Commission by using the dedicated email address SBSwapsSubmissions@sec.gov. Finally, to facilitate the filing of Form 19b-4 to the dedicated email addresses, the Commission is also amending section A of the General Instructions for Form 19b-4 to state that blank electronic and PDF versions of Form 19b-4 are available on EFFS and www.sec.gov.

To the extent that EFFS is available for such Advance Notices and Security-Based Swap Submissions before December 10, 2013, the Commission will issue a notice to inform DCAs for which the Commission is the supervisory agency that they may begin voluntarily to submit

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12 See Adopting Release at 41624.

Advance Notices and clearing agencies that they may begin voluntarily to submit Security-Based Swap Submissions through EFFS.

The Commission finds, for good cause, that notice and solicitation of comment regarding the extension of the dates and the conforming change to the General Instructions for Form 19b-4 set forth herein are impractical, unnecessary, and contrary to the public interest.[13] Notice and solicitation of comment is unnecessary because the extension of the dates and amendment to the General Instructions for Form 19b-4 simply preserve the status quo[14] until the EFFS system upgrade is completed by continuing the mechanism by which DCAs for which the Commission is the supervisory agency file Advance Notices with the Commission and clearing agencies file Security-Based Swap Submissions with the Commission. Notice and solicitation of comment is impractical and contrary to the public interest because it would temporarily create the scenario that DCAs for which the Commission is the supervisory agency are required to file Advance Notices and clearing agencies are required to file Security-Based Swap Submissions with the Commission through a system that is not yet technologically able to accept such filings.

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13 See Section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) (stating that an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impractical, unnecessary, or contrary to the public interest"). This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (stating that if a federal agency finds that notice and public comment are "impractical, unnecessary or contrary to the public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines"). Also, because the Regulatory Flexibility Act (5 U.S.C. 601-612) only requires agencies to prepare analyses when the Administrative Procedures Act requires general notice of rulemaking, that Act does not apply to the actions that we are taking in this release.

14 A dedicated email address has been used successfully for these purposes since the effective date of the Adopting Release. See supra note 11 and accompanying text.

III. PAPERWORK REDUCTION ACT

The rule amendments contain "collection of information" requirements as defined by the Paperwork Reduction Act of 1995, as amended ("PRA"),[15] but the Commission believes that these rule amendments will not impose any new burdens or costs upon DCAs or clearing agencies.

The rule amendments further modify recent amendments to Rule 19b-4 under the Exchange Act, by amending Rule 19b-4(n)(1)(ii) to extend the date with respect to the requirement that a DCA shall file an Advance Notice with the Commission in electronic format to a dedicated email address established by the Commission to December 10, 2013, and amending Rule 19b-4(o)(2)(ii) to extend the date with respect to the requirement that a clearing agency file Security-Based Swap Submissions with the Commission in an electronic format to a dedicated email address established by the Commission to December 10, 2013.

The Commission therefore does not believe that these amendments would require any new or additional "collection of information" as such term is defined in the PRA and will not impose any new burdens or costs upon DCAs or clearing agencies.

IV. ECONOMIC ANALYSIS

The Commission is sensitive to the economic effects of the amendments to Rule 19b-4, including its costs and benefits. Section 23(a)[16] of the Exchange Act 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) of the Exchange Act prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate

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15 44 U.S.C. 3501, et seq.

16 15 U.S.C. 78w(a).

in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act[17] 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 amendments to Rule 19b-4(n)(1)(ii) and Rule 19b-4(o)(2)(ii) will affect DCAs for which the Commission is the Supervisory Agency and clearing agencies registered with the Commission that clear security-based swaps. Four clearing agencies are DCAs for which the Commission is the supervisory agency (DTC, FICC, NSCC, and OCC) and three clearing agencies registered with the Commission currently clear security-based swaps (CME, ICC, and ICE Clear Europe).

The extension of the dates and amendment to the General Instructions for Form 19b-4 simply preserve the status quo that has operated without complaint[18] by continuing the method by which DCAs for which the Commission is the supervisory agency file Advance Notices and clearing agencies file Security-Based Swap Submissions with the Commission.[19] Though the Commission stated in the Adopting Release that Advance Notices and Security-Based Swap Submissions, and amendments, extensions, and withdrawals thereto, should be filed in an electronic format through EFFS starting on December 10, 2012, because the EFFS system upgrades that are necessary for Advance Notices and Security-Based Swap Submissions to be

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17 15 U.S.C. 78c(f).

18 See supra note 11 and accompanying text.

19 The Commission does not believe that there are any viable and more cost-efficient alternatives to extending the date of the use of the dedicated email addresses for the submission of Advance Notices and Security-Based Swap Submissions given the fact that the EFFS system upgrades that are necessary for Advance Notices and Security-Based Swap Submissions to be filed on EFFS will not be complete by December 10, 2012.

filed on EFFS were not complete when the Commission adopted Rule 19b-4(n) and Rule 19b-4(o), the Commission mandated through Rules 19b-4(n)(1)(ii) and 19b-4(o)(2)(ii) that a DCA for which the Commission is the supervisory agency that files an Advance Notice or a clearing agency that files a Security-Based Swap Submission with the Commission prior to December 10, 2012 shall file such Advance Notice or Security-Based Swap Submission in electronic format to a dedicated email address established by the Commission.[20] Because the Commission has determined that additional time is required to design, test, and implement the EFFS system upgrades, an extension of the December 10, 2012 date for the use of dedicated email addresses to file Advance Notices or Security-Based Swap Submissions is necessary and appropriate to prevent the scenario that DCAs for which the Commission is the supervisory agency are required to file Advance Notices and clearing agencies are required to file Security-Based Swap Submissions with the Commission through a system that is not yet technologically able to accept such filings and to ensure the Commission continues to obtain the information necessary to meet its statutory obligations in connection with Advance Notices and Security-Based Swap Submissions.

Theoretically, the cost of foregoing the ability to file Advance Notices and Security-Based Swap Submissions through the EFFS system could be incurred by DCAs for which the Commission is the supervisory agency and clearing agencies as a result of the amendments to the rules extending the dates with respect to the filing of Advance Notices and Security-Based Swap Submissions to dedicated email addresses established by the Commission. However, this theoretical cost is not a real cost of the rule because use of the EFFS system is not an option.

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20 See 17 CFR 240.19b-4(n)(1)(ii) and 17 CFR 240.19b-4(o)(2)(ii).

Instead, the amendments to the rules extending the dates for filing Advance Notices and Security-Based Swap Submissions to dedicated email addresses established by the Commission avoids the cost of eliminating the ability of DCAs for which the Commission is the supervisory agency to file Advance Notices and clearing agencies to file Security-Based Swap Submissions to the Commission through the only method that is currently technologically available. Furthermore, extending the dates also enables the Commission to continue to obtain the information that is necessary to meet its statutory obligations with respect to the enhanced oversight of systemically important financial market utilities and the mandatory clearing of security-based swaps.

The Commission believes that the rule amendments will not lead to any material increase in the costs associated with filing Advance Notices and Security-Based Swap Submissions. The Commission stated in the Adopting Release that it believed that the requirements to file Advance Notices and Security-Based Swap Submissions by email, as well as the temporary nature of such requirements, would impose relatively little additional burden on DCAs for which the Commission is the supervisory agency or clearing agencies, both of which can use their existing email systems to make such filings.[21] The Commission further believes that any additional negligible costs are justified because additional time is required to design, test, and implement the EFFS system upgrades that will facilitate the filing of Advance Notices and Security-Based Swap Submissions with the Commission in accordance with Rule 19b-4(n) and Rule 19b-4(o). As stated above, the Commission's primary objective is to ensure that clearing agencies desiring to submit Advance Notices or Security-Based Swap Submissions to the Commission have a

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21 See Adopting Release at 41642, 41645.

dependable mechanism with which to do so.

Because these rules merely extend the date for the process by which DCAs for which the Commission is the supervisory agency file Advance Notices and clearing agencies file Security-Based Swap Submissions, the Commission believes that the rules being adopted today will have a negligible, if any, impact on efficiency, competition, and capital formation. To the extent that the rule amendments impose a new burden upon market participants, such burden will result from the requirement that DCAs for which the Commission is the supervisory agency filing Advance Notices and clearing agencies filing Security-Based Swap Submissions with the Commission submit Form 19b-4 to a dedicated email address as opposed to submitting it through EFFS. Regardless of whether Form 19b-4 is submitted through EFFS or a dedicated email address, DCAs for which the Commission is the supervisory agency and clearing agencies will still be required to adequately and accurately complete such form. Furthermore, the Commission believes that the interest of gaining additional time to effectively develop, test, and implement the EFFS system upgrades necessary for filing Advance Notices and Security-Based Swaps Submissions in a manner that would be consistent with the requirements and goals of Rule 19b-4(n)(1)(i) and Rule 19b-4(o)(2)(i) justifies the risk of possibly imposing a negligible burden on DCAs for which the Commission is the supervisory agency and clearing agencies.

V. STATUTORY AUTHORITY

Pursuant to the Exchange Act, and particularly Sections 3C, 17A, and 19(b) thereof, 15 U.S.C. §§ 78c-3, 78q-1, and 78s(b), and Section 806(e) of the Clearing Supervision Act, 12 U.S.C § 5465(e), the Commission is amending Rule 19b-4 and Form 19b-4 as set forth below.

List of Subjects in 17 CFR Parts 240

Brokers, Reporting and recordkeeping requirements, Securities.

Text of the Final Rule

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

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

1. The general authority citation for part 240 is revised and a sub-authority is added in section number order to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78o-4, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 et seq.; 18 U.S.C. 1350, 12 U.S.C. 5221(e)(3), and Pub. L. 111-203, §939A, 124 Stat. 1376, (2010), unless otherwise noted.

* * *

Section 240.19b-4 is also issued under 12 U.S.C. 5465(e).

* * * * *

2. Section 240.19b-4 is amended by:

a. In paragraph (n)(1)(ii), removing the phrase "December 10, 2012" and adding in its place "December 10, 2013";

b. In paragraph (o)(2)(ii), removing the phrase "December 10, 2012" and adding in its place "December 10, 2013".

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for part 249 is revised and a sub-authority is added in section number order to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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Section 249.819 is also issued under 12 U.S.C. 5465(e).

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4. Form 19b-4 (referenced in § 249.819) is amended by revising General Instructions for Form 19b-4 Sections A and F to read as follows: [22]

Note: The text of Form 19b-4 does not and the amendments will not appear in the Code of Federal Regulations.

GENERAL INSTRUCTIONS FOR FORM 19b-4

A. Use of the Form

This form shall be used for all self-regulatory organization filings of proposed rule changes pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") (except filings with respect to proposed rule changes by self-regulatory organizations submitted pursuant to Section 19(b)(7)[1] of the Act), security-based swap submissions, and advance notices. National securities exchanges, registered securities associations, registered clearing agencies, and the Municipal Securities Rulemaking Board are self-regulatory organizations for purposes of this form. All proposed rule changes (except filings with respect to proposed rule changes by self-regulatory organizations submitted pursuant to Section 19(b)(7) of the Act) shall be filed in an electronic format through the Electronic Form 19b-4 Filing System ("EFFS"), a secure website

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1 Because Section 19(b)(7)(C) of the Act states that filings abrogated pursuant to this Section should be re-filed pursuant to paragraph (b)(1) of Section 19 of the Act, SROs are required to file electronically such proposed rule changes in accordance with this form.

operated by the Commission. All security-based swap submissions and advance notices shall be filed by submitting Form 19b-4 to a dedicated email address, SBSwapsSubmissions@sec.gov for security-based swap submissions and AdvanceNoticeFilings@sec.gov for advance notices. An electronic version of Form 19b-4 is available in EFFS. A PDF version of the Form is also available on www.sec.gov.

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F. Signature and Filing of the Completed Form

All proposed rule changes, amendments, extensions, and withdrawals of proposed rule changes shall be filed through the EFFS. All security-based swap submissions, advance notices, and amendments, extensions, and withdrawals of security-based swap submissions and advance notices shall be filed to a dedicated email address established by the Commission, SBSwapsSubmissions@sec.gov for security-based swap submissions and AdvanceNoticeFilings@sec.gov for advance notices. In order to file Form 19b-4 through EFFS, self-regulatory organizations must request access to the SEC's External Application Server by completing a request for an external account user ID and password. Initial requests will be received by contacting the Trading and Markets Administrator located on our website (http://www.sec.gov). An e-mail will be sent to the requestor that will provide a link to a secure website where basic profile information will be requested.

A duly authorized officer of the self-regulatory organization shall electronically sign the completed Form 19b-4 as indicated on Page 1 of the Form. In addition, a duly authorized officer of the self-regulatory organization shall manually sign one copy of the completed Form 19b-4, and the manually signed signature page shall be maintained pursuant to Section 17 of the Act. A registered clearing agency for which the Commission is not the appropriate regulatory agency also shall file with its appropriate regulatory agency three copies of the form, one of which shall be manually signed, including exhibits. A clearing agency that also is a designated clearing agency shall file with the Board of Governors of the Federal Reserve System ("Federal Reserve") three copies of any form containing an advance notice, one of which shall be manually signed, including exhibits; provided, however, that this requirement may be satisfied instead by providing the copies to the Federal Reserve in an electronic format as permitted by the Federal Reserve. The Municipal Securities Rulemaking Board also shall file copies of the form, including exhibits, with the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

* * * * *

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: December 5, 2012

Commissioner Walter not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68364 / December 5, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15118

In the Matter of **Martin Miles Werner,** **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 Martin Miles Werner ("Respondent" or "Werner") 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

[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, accountant, engineer, or other professional or expert who has been by name: (A) permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; . . . .

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 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. Werner, age 53, resides in Boca Raton, Florida. He is an attorney licensed to practice law in Florida since approximately 1985. In November 2003, Werner began serving as corporate counsel for Merendon Mining (Nevada) Inc. ("Merendon Nevada"), a Nevada corporation that offered and sold securities to investors. In April 2007, Werner became the president of Syndicated Gold Depository S.A. ("SGD"), a Bahamian registered corporation that operated from offices in Miami, Florida, which offered and sold securities to investors. In about November 2007, Werner became the president of Bearstone Capital Management Inc. ("Bearstone"), another company that offered and sold securities to investors.

2. On June 10, 2010, the Commission filed a complaint against Werner in *SEC v. Merendon Mining (Nevada), Inc. et al.*, et al. (W.D. Wash. civil action No. 2:10-cv-955-RAJ). On October 30, 2012, the court entered an order permanently enjoining Werner, by consent, from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. The Commission's complaint alleged, among other things, that Werner used SGD as a part of a fraudulent scheme to provide capital for Merendon Mining Corp. Ltd., a corporation formed in Alberta, Canada. The complaint also alleged that Werner, as the president of SGD, directly or indirectly offered and sold SGD's securities, and made false and misleading statements to salesmen and investors about, among other things, the rate of return paid by SGD securities, the use of investors' funds, the security of the investment, and independence of the various companies. The complaint alleged that during 2007, Werner also offered and sold securities of Merendon Nevada which made corresponding investments in SGD. Further, the complaint alleged that beginning in February or March 2007, Werner used one or more of his attorney trust accounts to receive funds from investors in SGD or the other selected companies, pay purported returns back to investors, and pay funds for the benefit of others involved in the scheme. The complaint also alleges that Werner knew from participation in various meetings that investors' funds were uses as part of a Ponzi scheme and that his trust account was used to hide the movement of the funds. The complaint further alleges that between November 2007 and March 2008, Werner caused Bearstone to make an offering of limited partnership interests to investors with the funds raised from the offering being directed to SGD.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that Werner 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, Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68370 / December 6, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15122

In the Matter of **Stephen Persad,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Stephen Persad ("Respondent").

II.

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

III.

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

Respondent

1. Respondent Persad, age 50, resides in Milwaukie, Oregon. From 1989 through 2003, Respondent was a registered representative associated with three Oregon broker-dealers registered with the Commission. He held Series 7 and 63 licenses from about March 1987 to April 2005. He is not currently associated with a registered broker-dealer. Persad is presently employed by Avior Funding Group, LLC, an Oregon company he co-founded, which business model is to serve as an intermediary for commercial funding.

Other Relevant Persons and Entities

2. Yusaf Jawed, age 44, resides in Portland, Oregon and is the principal, owner, and manager of Grifphon Asset Management, LLC ("GAM") and Grifphon Holdings, LLC ("Holdings"), both Portland-based investment advisory entities, which he used to manage various hedge funds he created and controlled, including Grifphon Alpha I Fund, L.P. and Grifphon Qualified Fund, L.P. (hereinafter, all Jawed managed hedge funds are referred to as the "Grifphon funds").

Background

3. On September 20, 2012, the Commission filed a lawsuit in federal district court for the District of Oregon against Yusaf Jawed, GAM, and Holdings, among others, for perpetrating a long-running Ponzi scheme that raised over $37 million from more than 100 investors in the Pacific Northwest and across the country. In its complaint, the Commission alleged that Jawed used false marketing materials that boasted double-digit returns to lure people to invest their money into several hedge funds he managed. In reality, he invested very little of the $37 million and, instead, used the money to pay back other investors, to fund his lifestyle, and to pay for the operations of the entities he controlled. The Commission further alleged that Jawed created phony assets, sent bogus account statements to investors, and manufactured a sham buyout of the funds to make investors believe their hedge fund interests would soon be redeemed. *See SEC v. Jawed, et al.*, Civ. Action No. 12-1696 (D. Oregon, Sep. 20, 2012).

Persad's Conduct

4. Jawed retained Persad as an independent consultant to help him raise money for his purported funds. From 2006 through 2009, Persad placed approximately 26 investors, who invested about $9 million, in the Grifphon funds. Certain of these investors were Persad's former clients. Others were individuals who Persad cold-called and introduced to the Grifphon funds.

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

5. While acting as a broker, Persad went beyond identifying potential investors who might be interested in purchasing interests in the Grifphon funds. For example, Persad served as the primary point of contact between certain investors and the Grifphon funds. Persad discussed with investors the Grifphon funds' purported high rates of returns, the purported nature of the investments, and also attested to Jawed's reputable and trustworthy character. He also provided to investors Grifphon funds private placement memoranda and other marketing materials. Some investors relied solely on Persad's representations in deciding to invest in the Grifphon funds. Indeed, some of them never met or spoke with Jawed or other GAM employees before they invested.

6. During the relevant period, Jawed paid Persad four to six percent of any investment made by any investor for whom Persad served as a broker. Jawed paid Persad approximately $386,720 in transaction-based compensation.

Violations

7. Section 15(a) of the Exchange Act makes it unlawful for any broker or dealer to use the means of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission. Section 3(a)(4) of the Exchange Act defines as "broker" as any person, other than a bank, "engaged in the business of effecting transaction in securities for the account of others."

8. Based on the conduct described above, Persad acted as a broker without being registered or associated with a registered broker or dealer.

9. As a result, Persad willfully violated Section 15(a) of the Exchange Act.[2]

Disgorgement and Civil Penalties

10. Respondent has submitted a sworn Statement of Financial Condition dated August 28, 2012, and other evidence and has asserted his inability to pay disgorgement, prejudgment interest, and a civil penalty.

IV.

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

[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)).

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

A. Respondent Persad cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Persad 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;

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;

with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

D. Respondent shall pay disgorgement of $386,720 and prejudgment interest of $28,705, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated August 28, 2012, and other documents submitted to the Commission. Based upon Respondent's sworn representations in his Statement of Financial Condition dated August 28, 2012, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. 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 disgorgement, pre-judgment interest, and the maximum civil penalty allowable under the law. 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, interest, and a civil penalty should not be ordered; (3) contest the amount of disgorgement and interest to be ordered or the imposition of the maximum penalty allowable under the law; 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

Commissioner Walter
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68371 / December 6, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15123

In the Matter of DOMINIC O'DIERNO Respondent.	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Dominic O'Dierno ("Respondent").

II.

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

III.

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

Respondent

1. Respondent O'Dierno, age 45, resides in Portland, Oregon. From 1989 to 1994, Respondent was a registered representative associated with an Oregon broker-dealer registered with the Commission. He held Series 7 and 63 licenses from about 1989 to 1996. He is not currently associated with a registered broker-dealer. Respondent is presently self-employed.

Other Relevant Person

2. Yusaf Jawed, age 44, resides in Portland, Oregon and is the principal, owner, and manager of Grifphon Asset Management, LLC ("GAM") and Grifphon Holdings, LLC ("Holdings"), both Portland-based investment advisory entities, which he used to manage various hedge funds he created and controlled, including Grifphon Alpha I Fund, L.P. and Grifphon Qualified Fund, L.P. (hereinafter, all Jawed managed hedge funds are referred to as the "Grifphon funds").

Background

3. On September 20, 2012, the Commission filed a lawsuit in federal district court for the District of Oregon against Yusaf Jawed, GAM, and Holdings, among others, for perpetrating a long-running Ponzi scheme that raised over $37 million from more than 100 investors in the Pacific Northwest and across the country. In its complaint, the Commission alleged that Jawed used false marketing materials that boasted double-digit returns to lure people to invest their money into several hedge funds he managed. In reality, he invested very little of the $37 million and, instead, used the money to pay back other investors, to fund his lifestyle, and to pay for the operations of the entities he controlled. The Commission further alleged that Jawed created phony assets, sent bogus account statements to investors, and manufactured a sham buyout of the funds to make investors believe their hedge fund interests would soon be redeemed. *See SEC v. Jawed, et al.*, Civ. Action No. 12-01696 (D. Oregon, Sep. 20, 2012).

O'Dierno's Conduct

4. Jawed retained O'Dierno as an independent consultant to help him raise money for his purported funds. From 2005 through 2008, O'Dierno placed seven investors, who invested about $2.3 million in the Grifphon funds.

5. While acting as a broker, O'Dierno went beyond identifying potential investors who might be interested in purchasing interests in the Grifphon funds. For example,

[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.

O'Dierno served as the point of contact between certain investors and the Grifphon funds. O'Dierno answered investor questions about the funds, including repeating the statements made by Jawed about Grifphon funds' investment strategy and the types of investments made, and provided Grifphon fund marketing materials to investors and potential investors.

6. During the relevant period, Jawed paid O'Dierno a percentage of any investment made by any investor for whom O'Dierno served as a broker. Jawed paid O'Dierno approximately $118,770 in transaction-based compensation.

7. In early 2011, Jawed asked O'Dierno to pay for certain of Grifphon's expenses. Jawed claimed that a third-party would soon purchase the assets of the Grifphon funds and that the money was necessary to keep Grifphon funds afloat. O'Dierno agreed to pay for those expenses. From March through June 2011, O'Dierno paid, from his own resources, $82,728 for the purported expenses of the Grifphon funds.

Violations

9. Section 15(a) of the Exchange Act makes it unlawful for any broker or dealer to use the means of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission. Section 3(a)(4) of the Exchange Act defines as "broker" as any person, other than a bank, "engaged in the business of effecting transaction in securities for the account of others."

10. Based on the conduct described above, O'Dierno acted as a broker without being registered or associated with a registered broker or dealer.

11. As a result, O'Dierno willfully violated Section 15(a) of the Exchange Act.[2]

Disgorgement and Civil Penalties

12. Respondent has submitted a sworn Statement of Financial Condition dated September 13, 2012, supplemented on September 28, 2012, and other evidence and has asserted his inability to pay a civil penalty.

IV.

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

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

[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)).

A. Respondent O'Dierno cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent O'Dierno 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;

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;

with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

D. Respondent shall pay disgorgement of $36,042 and prejudgment interest of $9,519, for a total of $45,561, to be paid in eight quarterly installments over a two-year period, in the following installments:

Payment Date	**Amount**
30 days after issuance of Order	$5,695.12
120 days after issuance of Order	$5,695.13
210 days after issuance of Order	$5.695.12
300 days after issuance of Order	$5,695.13
390 days after issuance of Order	$5,695.12
480 days after issuance of Order	$5,695.13
570 days after issuance of Order	$5,695.12
660 days after issuance of Order	$5,695.13
TOTAL	**$45,561.00**

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, plus any additional interest accrued pursuant to SEC Rule of Practice 600, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Dominic O'Dierno as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Erin Schneider, Associate Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

E. Based upon Respondent's sworn representations in his Statement of Financial Condition dated September 13, 2012, supplemented on September 28, 2012, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

F. The 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. 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 should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; 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

Commissioner Walter
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68369 / December 6, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15121

In the Matter of BENJAMIN R. DANIELS Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Benjamin Daniels ("Respondent").

II.

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

III.

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

Respondent

1. Respondent Daniels, age 35, resides in Indio, California. From about 2001 through 2007, Respondent was a registered representative associated with three Oregon broker-dealers and one California broker-dealer registered with the Commission. He held Series 7, 9, 10, and 66 licenses from about late 2000 to May 2009. He is not currently associated with a registered broker-dealer. Daniels is presently self-employed.

Other Relevant Person

2. Yusaf Jawed, age 44, resides in Portland, Oregon and is the principal, owner, and manager of Grifphon Asset Management, LLC ("GAM") and Grifphon Holdings, LLC ("Holdings"), both Portland-based investment advisory entities, which he used to manage various hedge funds he created and controlled, including Grifphon Alpha I Fund, L.P. and Grifphon Qualified Fund, L.P. (hereinafter, all Jawed managed hedge funds are referred to as the "Grifphon funds").

Background

3. On September 20, 2012, the Commission filed a lawsuit in federal district court for the District of Oregon against Yusaf Jawed, GAM, and Holdings, among others, for perpetrating a long-running Ponzi scheme that raised over $37 million from more than 100 investors in the Pacific Northwest and across the country. In its complaint, the Commission alleged that Jawed used false marketing materials that boasted double-digit returns to lure people to invest their money into several hedge funds he managed. In reality, he invested very little of the $37 million and, instead, used the money to pay back other investors, to fund his lifestyle, and to pay for the operations of the entities he controlled. The Commission further alleged that Jawed created phony assets, sent bogus account statements to investors, and manufactured a sham buyout of the funds to make investors believe their hedge fund interests would soon be redeemed. *See SEC v. Jawed, et al.*, Civ. Action No. 12-01696 (D. Oregon, Sep. 20, 2012).

Daniels's Conduct

4. Jawed retained Daniels as an independent consultant to help him raise money for his purported funds. From 2007 through 2009, Daniels placed approximately 20 investors, who invested a total of about $4.3 million in the Grifphon funds. Certain of these investors were Daniels's former clients and others were his family and friends. His family invested approximately $1.2 million in the Grifphon funds.

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

5. While acting as a broker, Daniels went beyond identifying potential investors who might be interested in purchasing interests in the Grifphon funds. For example, Daniels served as the primary point of contact between certain investors and the Grifphon funds. Daniels discussed with investors the Grifphon funds' purported high rates of returns, the purported nature of the investments, and also attested to Jawed's reputable and trustworthy character. He also provided to investors Grifphon funds' private placement memoranda and other marketing materials. Several investors relied solely on Daniels's representations in deciding to invest in the Grifphon funds. Daniels helped some of the investors establish accounts in self-directed IRAs to enable them to make investments in the Grifphon funds. Indeed, several of them never met or spoke with Jawed or other GAM employees before they invested.

6. During the relevant period, Jawed paid Daniels four to ten percent of any investment made by any investor for whom Daniels served as a broker. Jawed paid Daniels approximately $286,683 in transaction-based compensation.

Violations

7. Section 15(a) of the Exchange Act makes it unlawful for any broker or dealer to use the means of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission. Section 3(a)(4) of the Exchange Act defines a "broker" as any person, other than a bank, "engaged in the business of effecting transaction in securities for the account of others."

8. Based on the conduct described above, Daniels acted as a broker without being registered or associated with a registered broker or dealer.

9. As a result, Daniels willfully violated Section 15(a) of the Exchange Act.[2]

Disgorgement and Civil Penalties

10. Respondent has submitted a sworn Statement of Financial Condition dated August 28, 2012, and other evidence and has asserted his inability to pay disgorgement, prejudgment interest, and a civil penalty.

IV.

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

[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)).

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

A. Respondent Daniels cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Daniels 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;

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;

with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

D. Respondent shall pay disgorgement of $286,683 and prejudgment interest of $5,934, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated August 24, 2012, and other documents submitted to the Commission. Based upon Respondent's sworn representations in his Statement of Financial Condition dated August 24, 2012, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. 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 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.

F. Based upon Respondent's sworn representations in his Statement of Financial Condition dated August 24, 2012, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

G. The 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. 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 should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITES EXCHANGE ACT OF 1934
Release No. 68374 / December 6, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15126

In the Matter of WILLIAM J. REILLY, ESQ. Respondent.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against William J. Reilly, Esq. ("Reilly" or "Respondent") pursuant to Section 4C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

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1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

Rule 102(e)(1)(ii) provides, in pertinent part, that:

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

II.

After an investigation, the Office of General Counsel alleges that:

A. RESPONDENT

1. Reilly, age 58, was from 1979 until May 8, 2012, an attorney licensed to practice in the State of New York.

B. IMPROPER PROFESSIONAL CONDUCT

2. On October 27, 2009, with Reilly's consent, the Commission entered an order (the "2009 Order") pursuant to Rule 102(e)(3)(i) of its Rules of Practice that suspended Reilly from appearing or practicing before the Commission as an attorney with the right to apply for reinstatement after three years from the date of the Order. *In the Matter of William J. Reilly, Esq.*, Exchange Act Rel. No. 60890, Admin. Proc. 3-13666 (Oct. 27, 2009).

3. On June 21, 2011, Madison Ave. Media Inc. ("Madison"), a public company required to make certain filings with the Commission, filed a Form S-8 registration statement with the Commission that incorporated as an exhibit a legal opinion signed by Reilly and dated June 21, 2011 in which Reilly opined that the shares to be issued pursuant this registration statement "will have been duly authorized, legally issued, fully paid and nonassessable, . . . will be a valid and binding obligation of the corporation, and . . . do not require a permit from any governmental agency." This legal opinion stated that Reilly "was counsel to Madison Ave. Media, Inc. (the 'Company') in connection with the filing of its registration statement on Form S-8 (the 'Registration Statement')" and that Reilly consented "to the use of this opinion as an exhibit to the Registration Statement and to the reference to this opinion under the caption 'Legal Opinion' thereunder."

4. On April 16, 2012, the United States District Court for the Southern District of Florida entered an order finding that by providing an opinion letter supporting Madison's Form S-8 registration statement, Reilly knowingly practiced before the Commission and violated the 2009 Order suspending him from appearing or practicing before the Commission as an attorney. *SEC v. William J. Reilly*, 11-81322-CIV (DMM) (S.D. Fla.).

5. Reilly violated the 2009 Order by engaging in conduct that constitutes appearing and practicing before the Commission as an attorney, including, while he was suspended by the Commission, preparing and/or providing advice regarding documents that he had notice would be, and in fact were, filed by Madison with the Commission.

6. Reilly's knowing conduct described above constitutes improper professional conduct under Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

C. VIOLATIONS

As a result of the conduct described above, Respondent engaged in improper professional conduct under Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

III.

In view of the allegations made by the Office of General Counsel, the Commission deems it appropriate that public administrative proceedings be instituted to determine:

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice including, but not limited to, denying him, temporarily or permanently, the privilege of appearing or practicing before the Commission.

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Walter,
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9373 / December 6, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 68373 / December 6, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30294 / December 6, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15125

In the Matter of

David R. Smith,

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, 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, Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against David R. Smith ("Smith" or "Respondent").

II.

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

These proceedings arise out of Smith's role in selling IV Capital, a Ponzi scheme investment. Between 2006 and 2009, Smith raised at least $2.6 million from 8 investors and earned at least $139,000 in commissions from selling IV Capital. In March 2011, the Commission brought an action relating to IV Capital, Ltd. ("IV Capital") alleging that Larry Michael Parrish, a recidivist, operated a Ponzi scheme through his trading company IV Capital from November 2005 through October 2009 which raised $9.2 million from at least 70 investors across the country for purported trading in commodities, stocks, and options. Smith acted as an unregistered broker for IV Capital. Smith also negligently ignored numerous red flags of fraud when selling the IV Capital investment to his investors.

Respondent

1. David R. Smith, age 35, is currently a resident of Seattle, Washington. He was the co-owner of S&Y Strategies, Inc. ("S&Y"), which handled investors' funds that had been invested in IV Capital. Smith is not registered with the Commission as a broker-dealer or investment adviser and is not associated with a registered broker-dealer or investment adviser, but he acted as an unregistered broker in selling the IV Capital investments.

Other Relevant Entities and Individuals

2. **IV Capital, Ltd. ("IV Capital")** is a Nevis corporation owned and managed by Parrish. IV Capital purported to be a proprietary trading company with traders in the U.S. and U.K. IV Capital has never registered with the Commission. The Commission brought a federal court action against Parrish on March 7, 2011 alleging that IV Capital was a Ponzi scheme. The Commission obtained a default judgment against Parrish on September 25, 2012.

3. **S&Y Strategies LLC ("S&Y")** is a Nevada LLC that was owned and operated by Smith and a partner. S&Y was involved in the entertainment industry, and also handled funds in connection with Smith acting as a broker for the IV Capital investment. S&Y has never registered with the Commission.

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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.

4. **Richard Dalton ("Dalton")**, age 65, is a resident of Golden, Colorado. Dalton was the Director of Finance, general manager and only employee of Universal Consulting Resources, LLC ("UCR"). Dalton never registered with the Commission as a broker-dealer or investment adviser and was not associated with a registered broker-dealer or investment adviser. The Commission brought a federal court action against Dalton and UCR on November 16, 2010 and received a default judgment against him on December 7, 2011. SEC v. Universal Consulting Resources and Richard Dalton, 10-cv-2794-REB-KLM (D. Colo). Dalton is currently in federal custody awaiting his criminal trial in connection with his UCR Ponzi scheme.

5. **Larry Michael Parrish ("Parrish")**, age 47, is a resident of Walkersville, Maryland. Parrish was the President and sole Director of IV Capital, Ltd. The Commission brought an action against Parrish in connection with his IV Capital Ponzi scheme on March 7, 2011 and the Court granted the Commission's motion for default judgment on September 25, 2012. SEC v. Larry Michael Parrish, Civil Action No. 11-cv-00558-WJM-MJW (D. Colo.). Parrish is now out on bond awaiting his criminal trial in connection with his IV Capital Ponzi scheme. Previously, in April 2005, the Commission alleged that Parrish and others engaged in another fraudulent scheme which raised $8.2 million from investors. In May 2005, Parrish consented to a preliminary injunction and an asset freeze, under which he returned $7.5 million to investors. In May 2007, Parrish consented to a permanent injunction and administrative order barring him from associating with any broker or dealer with the right to reapply after at least five years.

6. **John "Jay" O. Young ("Young")**[2], age 69, is a resident of Superior, Colorado. Young is not registered with the Commission as a broker-dealer or investment adviser and is not associated with a registered broker-dealer or investment adviser, but he acted as an unregistered broker in selling the IV Capital and UCR investments.

Facts

7. In 2005, Smith was approached by Young, a family friend, who told him about the IV Capital investment and asked him whether he would be interested in investing. Dalton had introduced Young to Parrish around 2005 and Young had spoken with Parrish about the investment. In 2005, Smith was working as an assistant golf professional in California and had insufficient funds to invest in IV Capital. Smith had no prior investment experience. Young introduced Smith to Dalton, who was acting as a sales agent for IV Capital at that time.

8. Smith had a series of additional conversations about IV Capital with Young and Dalton in 2005 and 2006, and they suggested that Smith could market the IV Capital investment to potential investors and receive a commission for any sales. Smith started selling the IV Capital investment in 2006.

[2] Jay Young is the subject of a separate litigated Commission enforcement action being brought at the same time as this action against Smith.

9. Between 2006-2008, Smith recruited 8 investors into the IV Capital Ponzi scheme. These investors invested over $2.6 million in IV Capital. Smith sold the IV Capital investment to them, and he encouraged his investors to find other new potential investors.

10. When Smith discussed IV Capital with potential investors, he explained the basics of the purported investment to them, including that it involved trading by a highly experienced trader, investor funds were held in escrow, the investment had minimal risk, and investors were guaranteed a return of 2.5 % per month. Smith also provided investors with various investment documents and forwarded those documents to Parrish.

11. Smith also recommended the investment to some investors, describing its strong performance history and its safety.

12. Smith's investors generally sent their money directly to IV Capital to make an investment. In 2006 and 2007, Smith's investors received their monthly earning payments from Dalton.

13. At the end of 2007, Dalton told Smith that he no longer wanted to be involved with IV Capital, and Smith took over making monthly payments to his own investors. Smith formed an entity, S&Y Strategies LLC, to handle return payments to investors. IV Capital would send him the monthly returns for his investor group, and he would then send the profit payments to the individual investors.

14. Smith paid out over $450,000 to IV Capital investors from 2007 through 2009. Smith also prepared monthly statements for investors.

15. Smith was compensated for his work in soliciting investors for IV Capital and handling the payout of profits. On a monthly basis, Smith was paid 20% of his investors' earnings as a commission. In addition, Young also had a compensation arrangement with Smith to compensate him for his role in introducing Smith to Parrish. Specifically, Young received 30% of the all the commission payments received by Smith every month from Parrish. After paying 30% of his commission payments to Young, Smith earned approximately $139,000 between 2007 and 2009. These payments represented the majority of Smith's income between 2007 and 2009.

16. Smith sent monthly emails to Parrish telling him the commissions he was owed and the amount his investors were owed. Smith prepared a spreadsheet for Parrish detailing these calculations based on the purported rate of return Parrish told him IV Capital had earned in any particular month.

17. Smith also negligently ignored red flags of fraud when selling the IV Capital investment. To begin with, Smith ignored the unreasonably high rates of return and commissions guaranteed by IV Capital, which Smith testified made him concerned that the investment was "too good to be true." Smith also ignored: a) Parrish's refusal to provide any

detailed information about the trades being made to support the high guaranteed monthly profits, b) the fact that IV Capital never produced any monthly or yearly statements documenting his clients' investments, and c) that Parrish required him to prepare a spreadsheet every month for calculating what his investors were owed. Finally, after one of Smith's investors alerted Smith to a 2005 Commission complaint against Parrish, Smith negligently dismissed that concern after Parrish denied he was the same Parrish named in the Commission complaint. In that action, SEC v. Larry Michael Parrish, et al., 05 Civ. 1031 (D. Md.), the Commission had obtained a temporary restraining order against Parrish in April 2005. The Commission's complaint alleged that Parrish and others raised approximately $8.2 million through the sale of fictitious prime bank debt instruments. In a follow-on Administrative Proceeding, Parrish consented to a bar from association with any broker or dealer with the right to reapply after five years.

18. At the time of the offers and sales of the securities in the IV Capital program, there were no registration statements filed and in effect for them. No registration exemption applied to the IV Capital securities.

19. As a result of the conduct described above, Smith willfully[3] violated Sections 17(a)(2) and (a)(3) of the Securities Act, which prohibit negligent conduct in the offer or sale of securities.

20. As a result of the conduct described above, Smith willfully violated Section 15(a) of the Exchange Act, which makes it unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless such broker or dealer is registered or associated with a registered broker-dealer.

21. As a result of the conduct described above, Smith willfully violated Sections 5(a) and (c) of the Securities Act, which makes it unlawful for any person, directly or indirectly, to sell or to offer to sell a security for which a registration statement is not filed or not in effect or there is not an applicable exemption from registration.

Disgorgement and Civil Penalties

22. Respondent has submitted a sworn Statement of Financial Condition dated August 3, 2012 and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest.

23. Respondent has submitted a sworn Statement of Financial Condition dated August 3, 3012 and other evidence and has asserted his inability to pay a civil penalty.

[3] 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)).

IV.

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

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

A. Respondent Smith cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), 17(a)(2) and 17(a)(3) of the Securities Act, and Section 15(a) of the Exchange Act.

B. Respondent Smith 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;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor or principal underwriter;

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 the purposes of issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock;

With the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

D. Respondent shall pay disgorgement of $139,407 and prejudgment interest of $19,234, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated August 3, 2012 and other documents submitted to the Commission.

E. 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 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.

F. Based upon Respondent's sworn representations in his Statement of Financial Condition dated August 3, 2012 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

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 ACT OF 1933
Release No. 9372 / December 6, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 68372 / December 6, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30293 / December 6, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3511 / December 6, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15124

In the Matter of **DAVID F. BANDIMERE and JOHN O. YOUNG,** **Respondents.**	**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 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND SECTIONS 203(f) AND (k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND NOTICE OF HEARING**

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 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), and Sections 203(f) and (k) of the Investment Advisers Act of 1940 ("Advisers Act") against David F. Bandimere ("Bandimere"), and pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act against John O. Young ("Young") (collectively "Respondents").

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II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. Between 2006 and 2010, Bandimere and Young violated the antifraud provisions of the Securities Act and Exchange Act while operating as unregistered brokers in selling unregistered investments in IV Capital Ltd. ("IV Capital") and Universal Consulting Resources LLC ("UCR"), two Ponzi schemes which the Commission brought actions against in 2011 and 2010 respectively. These violations occurred through direct sales of IV Capital and UCR securities and/or sales of interests in three limited liability companies ("LLCs") formed by Bandimere.

2. Between 2006 and 2010, Bandimere raised at least $9.3 million from over 60 investors while acting as an unregistered broker for these Ponzi schemes and earned at least $735,000 in transaction-based compensation, which provided the vast majority of his income during that time period. He initially sold IV Capital directly to investors, but then formed three LLCs to facilitate bringing in investors for both IV Capital and UCR. He also encouraged the investment of the investors' retirement funds by setting up self-directed IRA accounts through a third-party provider. Bandimere misled potential investors by presenting only a one-sided, positive view of the IV Capital and UCR investments while failing to disclose numerous red flags and potentially negative facts relating to those investments. Once Bandimere described IV Capital and UCR to potential investors in a materially positive way, he was under a duty to make fair and complete disclosure of these material red flags and negative facts. Moreover, Bandimere acted recklessly in selling these investments because these red flags should have alerted Bandimere that IV Capital and UCR were likely frauds. In so doing, Bandimere violated Section 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and/or Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

3. Between 2007 and 2010, Young raised approximately $2.5 million from at least 20 investors while acting as unregistered broker for UCR and IV Capital, earning at least $400,000 in transaction-based compensation from IV Capital and UCR. Young made numerous misrepresentations to investors, including misrepresentations about the nature and history of UCR, claiming that he was a partner in UCR (when he was not), and claiming that he and his family had significantly invested in UCR (when they had not invested at all). In so doing, Young violated Section 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder.

4. Finally, Bandimere and Young both violated Section 5 of the Securities Act by selling unregistered securities in UCR and IV Capital and/or the three LLCs formed by Bandimere when no exemption applied to the registration requirements.

B. RESPONDENTS

5. **David F. Bandimere ("Bandimere")**, age 67, is a resident of Golden, Colorado. Bandimere is not registered with the Commission as a broker-dealer or investment adviser and is not associated with a registered broker-dealer or investment adviser, but he acted as an unregistered broker in selling the IV Capital and UCR investments and/or interests in the LLCs.

6. **John "Jay" O. Young ("Young")**, age 69, is a resident of Superior, Colorado. Young is not registered with the Commission as a broker-dealer or investment adviser and is not associated with a registered broker-dealer or investment adviser, but he acted as an unregistered broker in selling the IV Capital and UCR investments.

C. OTHER RELEVANT ENTITIES AND INDIVIDUALS

7. **Universal Consulting Resources LLC ("UCR")** is a New Mexico limited liability company. Its principal place of business was Richard Dalton's home in Golden, Colorado. UCR purported to engage in international note and diamond trading. UCR never registered with the Commission. The Commission brought a federal court action against UCR and Richard Dalton on November 16, 2010 alleging that UCR was operating a Ponzi scheme. The Commission obtained a default judgment against UCR and Dalton on December 1, 2011.

8. **IV Capital, Ltd. ("IV Capital")** is a Nevis corporation owned and managed by Larry Michael Parrish. IV Capital purported to be a proprietary trading company with traders in the U.S. and U.K. IV Capital has never registered with the Commission. The Commission brought a federal court action against Parrish on March 7, 2011 alleging that IV Capital was a Ponzi scheme. The Commission obtained a default judgment against Parrish on September 25, 2012.

9. **Richard Dalton ("Dalton")**, age 65, is a resident of Golden, Colorado. Dalton was the Director of Finance, general manager and only employee of UCR. Dalton never registered with the Commission as a broker or investment adviser and was not associated with a registered broker-dealer or investment adviser. The Commission brought a federal court action against Dalton on November 16, 2010 and received a default judgment against him on December 7, 2011. Dalton is currently in federal custody awaiting his criminal trial in connection with his UCR Ponzi scheme.

10. **Larry Michael Parrish ("Parrish")**, age 47, is a resident of Walkersville, Maryland. Parrish was the President and sole Director of IV Capital, Ltd. The Commission brought an action against Parrish in connection with his IV Capital Ponzi scheme on March 7, 2011 and the Court granted the Commission's motion for default judgment on September 25, 2012. Parrish is now out on bond awaiting his criminal trial in connection with his IV Capital Ponzi scheme. Previously, in April 2005, the Commission alleged that Parrish and others engaged in another fraudulent scheme which raised $8.2 million from investors. In May 2005, Parrish consented to a preliminary injunction and an asset freeze, under which he returned $7.5 million to investors. In May 2007, Parrish consented to a permanent injunction and administrative order

barring him from associating with any broker or dealer with the right to reapply after at least five years.

11. **David R. Smith ("Smith")**, age 35, is currently a resident of Seattle, Washington. Smith is not registered with the Commission as a broker-dealer or investment adviser and is not associated with a registered broker-dealer or investment adviser, but he acted as an unregistered broker in selling the IV Capital investment and is a respondent in a separate settled Commission action.

12. **Exito Capital LLC ("Exito")** is a Colorado LLC formed on June 27, 2007 with a business address in Greenwood Village, Colorado. Exito was used by Bandimere to collect investor funds to invest in UCR and IV Capital. Exito has never registered with the Commission.

13. **Victoria Investors LLC ("Victoria")** is a Colorado LLC formed on April 3, 2007 with a business address in Golden, Colorado. Victoria was used by Bandimere to collect investor funds to invest in UCR and IV Capital. Victoria has never registered with the Commission.

14. **Ministry Minded Investors LLC ("MMI")** is a Colorado LLC formed on September 18, 2008 with a business address in Golden, Colorado. MMI was used by Bandimere to collect investor funds to invest in UCR and IV Capital. MMI has never registered with the Commission.

D. BACKGROUND ON UCR AND IV CAPITAL PONZI SCHEMES

15. Between November 2005 and October 2009, Parrish raised $9.2 million for IV Capital from at least 70 investors across the country. Parrish promised to earn a monthly minimum return of 5%, with half being paid to the investor and IV Capital retaining the other half. Parrish represented that investor funds would be safely escrowed while the trades in commodities, stocks, and options were made with funds from a line of credit secured by those investor funds. Parrish claimed that he and several partners, all of whom were successful traders, owned and operated IV Capital as an offshore company. In reality, Parrish invested only a fraction of investor funds and misappropriated investor money for his own personal use. In addition to soliciting investors directly, Parrish also established a sales force by offering commissions to individuals who brought in new investors. One of the original IV Capital sales agents, Dalton, left to operate a separate Ponzi scheme through his company UCR. Parrish paid brokers, including Bandimere and Young, for bringing in new investors

16. The Commission obtained a default judgment against Parrish on September 25, 2012. SEC v. Larry Michael Parrish, Civil Action No. 11-cv-00558-WJM-MJW (D. Colo.). Parrish was ordered to pay disgorgement of $4,139,858, plus prejudgment interest of $847,919 and a penalty of $4,987,777. Among other violations, the Court found that Parrish had violated Section 5(a) and 5(c) of the Securities Act by offering unregistered securities in IV Capital. Specifically, the Court found that there was no registration statement in effect for IV Capital and that no exemption applied to the registration requirements for the IV Capital securities.

17. From at least March 2007 through June 2010, Dalton, through his company UCR, raised approximately $12 million from at least 129 investors in 13 states. Dalton conducted two offerings which were referred to as the "Trading Program" and the "Diamond Program." The Trading Program began around March 2007 when Dalton solicited investors to place their money with UCR in order to fund a purported overseas bank note trading program. Dalton told investors that their funds were held in an escrow account at a bank in the United States and that a European Trader would use the value of that account, but not the actual funds, to obtain leveraged funds to purchase and sell bank notes. According to Dalton, the trading was profitable enough that he was able to guarantee returns of at least 48 percent per year to investors. Dalton offered the Diamond Program beginning in 2008 when he told investors that UCR facilitated the funding of diamond transactions in Africa. Similar to the Trading Program, investor funds were to be held in an escrow account at a bank in the United States and a diamond trader would use the value of that account, but not the actual funds, to obtain leveraged funds to purchase and sell diamonds. Dalton told investors that UCR would participate in one transaction per month with a minimum return of 10 percent per month. In reality, Dalton invested only a fraction of investor funds and misappropriated investor money for his own personal use, while using new investor funds to make monthly earnings payments to existing investors. Dalton paid brokers, including Bandimere and Young, for bringing in new investors.

18. The Commission obtained a default judgment against Dalton, UCR, and Dalton's wife on December 1, 2011. SEC v. Universal Consulting Resources and Richard Dalton, 10-cv-2794-REB-KLM (D. Colo). Dalton was ordered to pay $7,549,458 in disgorgement, prejudgment interest of $744,032, and a penalty of $7,549,458. Among other violations, the Court found that Dalton had violated Section 5 of the Securities Act by offering unregistered securities in the UCR Trading Program and UCR Diamond Program. Specifically, the Court found that there was no registration statement in effect for these UCR securities and that no exemption applied to the registration requirements for these UCR securities.

E. BANDIMERE

Background

19. Bandimere first learned of Parrish and IV Capital in 2005 from his friend Dalton. Dalton assisted in arranging a meeting in which Parrish came to Denver and met with Bandimere, and explained the IV Capital investment to him. In November 2005, Bandimere invested $100,000 with IV Capital, and in 2006 he invested another $100,000.

20. Based on encouraging statements made by Bandimere, several family members and friends also decided to invest in IV Capital during 2006. Bandimere pooled the funds from his family and friends, totaling approximately $400,000, and invested it with IV Capital under his name. IV Capital paid the monthly returns of 2.5% to Bandimere, who would then make payments to the individual investors who invested through him.

21. Parrish agreed to compensate Bandimere for bringing in these investors and for handling the distribution of monthly returns. The compensation was directly tied to the amount of funds from investors and set at 10 percent of the monthly returns to investors (i.e., assuming

$400,000 was invested under Bandimere's name, IV Capital promised to pay 2.5% or $10,000 per month to investors, which resulted in a $1,000 commission per month paid to Bandimere by IV Capital).

22. Around the end of 2006, Bandimere realized that there was significant interest in the IV Capital investment and that he could sell the IV Capital investment to many more investors. In the beginning of 2007, he formed two LLCs, Exito and Victoria, in order to facilitate the handling of investor funds he expected to bring for IV Capital. Bandimere was the sole manager of Victoria, and was the co-manager of Exito with the attorney who drafted the LLC agreements. From that point, instead of Bandimere pooling investor funds in his account under his personal name for investment in IV Capital, he collected investor capital to make investments with IV Capital under the name of each LLC. Bandimere maintained the existing compensation agreement with Parrish (10 percent of returns paid by IV Capital) with commission payments now being made to each of the LLCs. These initial investors in Exito and Victoria generally understood that the LLCs had been created as a vehicle to make investments in IV Capital.

23. Bandimere often found people to invest in IV Capital (and later UCR) by mentioning his investing success at various church, religious, and social club activities or events, or general gatherings with friends. Once he sparked a potential new investor's interest in his recent investing success, he would explain the IV Capital investment to them and explain how they could invest through him in the program. In addition, on at least one occasion, Bandimere invited a group of potential investors to his home to attend a presentation by Parrish about IV Capital. Bandimere also relied on referrals from other friends and family to build his investor base.

24. In 2008, Bandimere began selling UCR's Trading Program to investors, offering it as another investment option with the LLCs. Bandimere explained the program, and told investors that the investment manager had been a longtime personal friend (he often did not specifically tell investors' Dalton name, telling investors that the manager of the program wanted his name to be kept confidential). Bandimere told investors that they would earn a guaranteed annual return of 48 percent. Bandimere and Dalton agreed that UCR would pay Bandimere an additional 24 percent annual commission on all investor funds paid at 2% per month (i.e. if a Bandimere investor invested $100,000, Bandimere would earn a $24,000 commission per year paid at a rate of $2000 per month).

25. The investment return of Bandimere's investors depended entirely on which investment program they had selected, IV Capital or the UCR Trading Program. This arrangement -- allowing investors to specifically allocate their investment capital to particular investment programs -- was contrary to the written terms of each LLC's operating agreement, which provided for a pro-rata sharing of all investment income and losses of all the investments made by each LLC. Bandimere's handling of returns, while inconsistent with the written agreements, was consistent with the verbal representations Bandimere made to investors about how returns would be handled and thus was consistent with investors' understanding that they were investing in IV Capital and UCR rather than the LLC. Bandimere also did not follow the LLC agreements with regard to his compensation, which provided that he was entitled as manager to the excess of funds earned by the LLC beyond the annual targeted returns stated in the operating agreements (which

were generally between 24%-30% per year). Instead, as noted above, Bandimere had separate compensation agreements with Parrish and Dalton, tied directly to the amount his investors placed in IV Capital and UCR. Overall, therefore, the LLCs were simply a mechanism created by Bandimere to facilitate his sales of IV Capital and UCR directly to investors.

26. In 2008, Bandimere also began assisting investors in setting up self-directed IRAs through an outside company which allowed investors to access their retirement accounts for investment with the LLCs.

27. In 2008, Bandimere also formed a third LLC, MMI, which he marketed to potential UCR and IV Capital investors as the LLC for those interested in investing for religious or charitable purposes.

28. Beginning in 2009, Bandimere offered the UCR Diamond Program as another investment option with his LLCs for investors, promising returns of potentially 10% per month. Similar to the Trading Program, Bandimere would receive a commission of 2% per month on the LLCs' capital invested in the Diamond Program.

29. In total, Bandimere had at least 60 investors invest approximately $800,000 in the UCR Diamond Program, $2.7 million in the UCR Trading Program, and $5.7 million in IV Capital. Bandimere therefore raised approximately 62% of the total raised by Parrish ($5.7 million out of $9.2 million) and 29% of the total raised by Dalton ($3.5 million out of $12 million). Investors in Bandimere's LLCs ultimately lost all of the money they had invested in the UCR and IV Capital programs, other than what was paid to them as purported returns or returns of capital, when those Ponzi schemes collapsed.

Bandimere Acted as an Unregistered Broker

30. Bandimere was involved throughout the entire investment process with investors. He met with potential investors, explained the investment programs, answered questions, set up the LLCs to facilitate administration of the investments, had them sign the relevant documents, accepted investor deposits, worked with the self-directed IRA provider, determined the monthly returns due for the IV Capital and UCR investments and provided that information to Dalton and Parrish, created and maintained individual account records for each investor, handled return payments to investors, and handled internal accounting and tax returns for the LLCs.

31. Bandimere's investors rarely if ever met or spoke with Dalton, and many never met or spoke with Parrish. Most of the investors relied upon Bandimere for all of their information about these investments. Bandimere also provided investment advice to certain investors by stating that the investments were low risk and very good investments.

32. Bandimere was neither registered as a broker nor associated with a registered broker-dealer at the time of the sales.

33. Bandimere raised approximately $9.3 million from at least 60 different investors and received at least $735,000 in transaction-based compensation, which represented the majority of his income between 2007 and 2010.

Bandimere Misled Investors and Recklessly Ignored Red Flags of Fraud

34. When describing IV Capital and UCR to potential investors, Bandimere presented a one-sided view and highlighted only positive material characteristics: a) the consistent rates of return, b) the established track record of performance, c) the experienced and successful traders, d) his personal dealings with Dalton and Parrish which gave him confidence in their abilities, and e) with regard to Dalton, his long-standing personal relationship.

35. Yet, Bandimere knew about numerous material red flags and negative facts associated with IV Capital and UCR that he never disclosed to investors. These negative facts together suggested a far different picture than the generally rosy view presented by Bandimere, and, at a minimum, would have demonstrated to investors that IV Capital and UCR had very significant risks. Once Bandimere described IV Capital and UCR to potential investors in a materially positive way, he was under a duty to make materially fair and complete disclosure rather than presenting only a one-sided and unbalanced view of the investment. Specifically, Bandimere knew and failed to disclose that:

a. Parrish had previously been sued by the Securities and Exchange Commission in 2005. Bandimere admitted to an investor that he knew that the Commission had previously sued Parrish at the time that Bandimere was offering the IV Capital investment.

b. Dalton told Bandimere that he stopped working with IV Capital and Parrish because of problems with getting paid commissions.

c. IV Capital paid Bandimere large commissions tied to the amount of funds Bandimere brought in for investment.

d. The UCR Trading Program paid Bandimere large commissions tied to the amount of funds Bandimere brought in for investment.

e. The UCR Diamond Program paid Bandimere large commissions tied to the amount of funds Bandimere brought in for investment.

f. While Bandimere initially signed written agreements with UCR and IV Capital when the LLCs made their initial investments, there was no subsequent written documentation provided by UCR or IV Capital when additional investments were made.

g. Bandimere knew that neither UCR nor IV Capital had any financial statements nor were they audited by any accounting firm. In fact, Bandimere testified that it seemed like Dalton and Parrish did not appear to have <u>any</u> accounting records whatsoever.

h. Bandimere knew that neither UCR nor IV Capital had any third-party service providers: brokerage firms, accountants, etc., which could be verified by him.

i. Dalton and Parrish refused to provide Bandimere with any documents confirming trading, their traders, or any other aspects of the investments.

j. Neither IV Capital nor UCR ever provided <u>any</u> account statements documenting the investments or purported monthly earnings.

k. Each month, Bandimere had to calculate how much the LLCs were owed based upon the purported returns and then he had to direct Parrish and Dalton to wire those amounts, rather than being provided this information by Parrish and Dalton.

l. Even after receiving notice of the monthly amounts owed, Parrish and Dalton often wired insufficient funds to the LLCs.

m. Parrish and Dalton regularly violated their agreements to compensate Bandimere, and Bandimere was paid significantly less than he was promised by Parrish and Dalton.

n. Bandimere knew that Dalton had no experience with managing a large, successful investment program; and in fact, Dalton had been involved in multiple failed investment schemes.

o. Bandimere knew that Dalton had serious financial problems as a result of his unsuccessful investments. Bandimere had loaned Dalton money to participate in a multilevel marketing program after Dalton lost his money in a different multilevel marketing program that had gone bankrupt. Bandimere also rented Dalton an inexpensive apartment in a complex Bandimere owned, a living situation inconsistent with the high level of income Dalton claimed to be earning from his UCR investments.

36. These numerous material red flags and negative facts cited above should have alerted Bandimere to the fact that IV Capital and UCR were likely frauds. These facts would have been important to investors in determining whether to invest, as these facts would have seriously called into question the legitimacy and quality of IV Capital and UCR. Bandimere recklessly ignored these obvious signs of fraud. Bandimere continued to recruit new investors to these schemes without disclosing these facts to current or new investors, which was a highly misleading sales approach. Bandimere hid these obvious signs of fraud from his investors while baselessly assuring investors that the investments were "low risk" and "very good investments."

Bandimere Sold Unregistered Securities

37. Bandimere sold unregistered securities in the UCR Trading Program, the UCR Diamond Program, and IV Capital. There was no registration statement in effect for these securities and no exemption applied to the registration requirements for these securities.

38. In the alternative, Bandimere sold interests in Exito, Victoria, and MMI. Those interests were unregistered securities, and there was no registration statement in effect for these securities and no exemption applied to the registration requirements for these securities. Bandimere pooled investor funds and transferred the comingled funds to UCR and IV Capital. He functioned as an investment adviser to the LLCs and received compensation with respect to securities.

F. <u>YOUNG</u>

Background

39. <u>IV Capital</u>: Dalton introduced Young to Parrish around 2005. Young spoke with Parrish about the investment, and introduced one of his son's best friends, David Smith ("Smith"), to Parrish. Between 2006 and 2009, Young directly offered IV Capital to at least five potential investors but only one person actually made an investment in IV Capital. With regard to that investor, Young handled all the paperwork, answered questions, and handled the monthly payouts to the investor after receiving the money from Parrish. Finally, Young also had a compensation arrangement with Smith to compensate him for his role in introducing Smith to Parrish. Specifically, Young received 30% of all the commission payments received by Smith every month from Parrish.

40. <u>UCR</u>: Young was a friend of Dalton for over 20 years, and had some previous business relationships with him throughout that time period. In 2007, Dalton explained his UCR Trading Program to Young and asked Young whether he would be interested in selling the UCR Trading Program to potential investors. He offered Young a commission for bringing in investors. Between 2007 and 2010, Young solicited approximately 20 investors to invest over $2.5 million in UCR's Trading Program.

Young Acted as an Unregistered Broker

41. Between 2007 and 2010, Young actively recruited and solicited potential investors in IV Capital and the UCR Trading Program, and encouraged those investors to find other investors. For example, Young sent an email to an investor in 2008 stating that "as a friend, and in light of the current turmoil in the financial markets, I hope that you would give me a call sometime at your convenience. We are not in the traditional markets. Our clients' funds are secured in an escrow account at a major bank and do not move. Our returns are exceptional (really exceptional) and distributed monthly....and our clients are grateful they can sleep at night." He later wrote to that investor that if she had "any associates who might enjoy a legitimate and serious ROI, I would appreciate an opportunity to sit down with them."

42. When Young discussed the UCR and IV Capital investment with potential investors, he described the guaranteed returns, the trader, and generally how the program worked. He provided the investment agreement to investors, answered their questions, and sometimes sent that signed agreement to UCR or IV Capital.

43. Many of Young's investors in UCR never spoke with Dalton before making the investment. The investors generally sent their money directly to UCR and received their profit payments directly from UCR. However, for a few months in 2010, Dalton sent a single payment to Young for all of Young's investors and then Young distributed the profit payments to each investor. As noted above, Young handled all the payments to his single investor in IV Capital.

44. Young was paid a commission by Dalton for bringing in new investors of between 1% - 2% per month of each investor's capital investment in UCR. In addition, a few investors that Young brought in also recruited additional investors, and Young agreed to split his commission with them. Dalton would generally pay Young the commission, and then Young would send the payment to the downstream broker. Young also received commissions directly from Parrish for his single investor as well as from Smith for his role in introducing Smith to Parrish. In total, Young received at least $400,000 in net commission payments between 2007 and 2010 (after subtracting payments made to downstream sales agents), representing the vast majority of his income during that period.

Young Made Several Misrepresentations When Selling UCR

45. Young made several representations to investors that he knew or should have known were false or misleading when he was selling the investment:

a. He told some investors that Dalton's UCR program had been in existence 7-9 years, when he knew Dalton did not start UCR until 2007;

b. He told some investors that he and his family members had invested in UCR when they did not;

c. He told some investors that he was a partner of Dalton when he was not a partner; and

d. He told some investors that Dalton's access to the investment program was based upon special access to investments given to former military members without any evidence that such a program existed.

46. Overall, these specific material misrepresentations were critical in convincing potential investors to invest in UCR. The representations that Young was a partner and had invested both his money and his family's money gave investors' confidence that Young truly understood UCR's business and believed strongly in its ability to earn high profits. The representation about the long history of UCR gave investors' confidence in the security and performance of the investment over a long period of time. Finally, the representation about Dalton's access to former military members provided investors with a potential explanation about why Dalton was able to earn such high returns.

Young Sold Unregistered Securities

47. Young sold unregistered securities in the UCR Trading Program and IV Capital. There was no registration statement in effect for these securities and no exemption applied to the registration requirements for these securities.

G. VIOLATIONS

48. As a result of the conduct described above, Bandimere and Young 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.

49. As a result of the conduct described above, Bandimere and Young willfully violated Section 15(a) of the Exchange Act, which makes it unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless such broker or dealer is registered or associated with a registered broker-dealer.

50. As a result of the conduct described above, Bandimere and Young willfully violated Sections 5(a) and (c) of the Securities Act, which makes it unlawful for any person, directly or indirectly, to sell or to offer to sell a security for which a registration statement is not filed or not in effect or there is not an applicable exemption from registration.

51. In the alternative, as a result of the conduct described above, Bandimere also willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit fraudulent conduct by an investment adviser to a pooled investment vehicle.

III.

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

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

B. What, if any, remedial actions are appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial actions are appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act;

D. In the alternative, what, if any, remedial actions are appropriate in the public interest against Bandimere pursuant Section 203(f) of the Advisers Act including, but not limited to disgorgement and civil penalties pursuant to Section 203(i) of the Advisers Act.

E. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Adviser Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 5 and 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement plus prejudgment interest thereon and provide an accounting pursuant to Section 8A of the Securities Act, Sections 21B and 21C of the Exchange Act, Section 203(k) of the Advisers Act, and Section 9 of the Investment Company Act.

F. Whether, pursuant to Section 308 of the Sarbanes-Oxley Act of 2002, a Fair Fund should be established for the benefit of defrauded investors to distribute to affected investors any disgorgement, prejudgment interest, and civil penalty payments that may be made.

IV.

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Paredes Disapproved
Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 30300 / December 10, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15127

In the Matter of J. Kenneth Alderman, CPA; Jack R. Blair; Albert C. Johnson, CPA; James Stillman R. McFadden; Allen B. Morgan Jr.; W. Randall Pittman, CPA; Mary S. Stone, CPA; and Archie W. Willis III, Respondents.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against the former members of the boards of directors of the five registered investment companies listed in paragraph 10 below (the "Funds"). The former members of the boards of directors of the Funds are: J. Kenneth Alderman ("Alderman"); Jack R. Blair ("Blair"); Albert C. Johnson ("Johnson"); James Stillman R. McFadden ("McFadden"); Allen B. Morgan Jr. ("Morgan"); W. Randall Pittman ("Pittman"); Mary S. Stone ("Stone"); and Archie W. Willis III ("Willis") (collectively "the Respondents" or "the Directors").

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

1. Between at least January 2007 and August 2007 (the "Relevant Period"), significant portions of the Funds' portfolios contained below-investment grade debt securities, some of which were backed by subprime mortgages, for which market quotations were not readily available. Under the Investment Company Act, those securities were required to be valued at fair value as determined in good faith by the Directors. In discussing fund directors' statutory fair valuation obligations, the Commission has stated that directors must "determine the method of arriving at the fair value of each such security. To the extent considered necessary, the board may appoint persons to assist them in the determination of such value, and to make the actual calculations pursuant to the board's direction. The board must also, consistent with this responsibility, continuously review the appropriateness of the method used in valuing each issue of security in the company's portfolio."[1] The Directors did not specify a fair valuation methodology pursuant to which the securities were to be fair valued. Nor did they continuously review the appropriateness of the method to be used in valuing each issue of security in the company's portfolio. Instead, the Directors delegated their responsibility to determine fair value to a valuation committee without providing any meaningful substantive guidance on how those determinations should be made. In addition, they made no meaningful effort to learn how fair values were actually being determined. They received at best only limited information on the factors considered in making fair value determinations and almost no information explaining why particular fair values were assigned to portfolio securities. These failures were particularly egregious given that fair valued securities made up the majority—and in most cases upwards of 60%—of the Funds' net asset values ("NAVs").

A. RESPONDENTS

2. J. Kenneth Alderman, 60 years of age and a resident of Birmingham, Alabama, was an interested director of the Funds beginning in 2003 and during the entire Relevant Period. He is a Certified Public Accountant ("CPA"), licensed in Florida and Alabama, and is a Chartered Financial Analyst.

3. Jack R. Blair, 70 years of age and a resident of Germantown, Tennessee, was an independent director and a member of the Audit Committee of the Funds beginning in 2005 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Blair has never held any professional licenses.

4. Albert C. Johnson, 68 years of age and a resident of Hoover, Alabama, was an independent director and a member of the Audit Committee of the Funds beginning in 2005 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Johnson is a CPA currently licensed in Alabama and Texas.

5. James Stillman R. McFadden, 55 years of age and a resident of Germantown, Tennessee, was an independent director and a member of the Audit Committee of the Funds

[1] Accounting Series Release No. 118 ("ASR 118").

beginning in 2002 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. He has never held any professional licenses.

6. Allen B. Morgan Jr., 70 years of age and a resident of Memphis, Tennessee, was an interested director of the Funds beginning in 2002 and during the entire Relevant Period, and was Chairman and CEO of Morgan Keegan until he retired in December 2003.

7. W. Randall Pittman, 59 years of age and a resident of Birmingham, Alabama, was an independent director and a member of the Audit Committee of the Funds beginning in 2003 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Pittman is a CPA licensed in Alabama.

8. Mary S. Stone, 62 years of age and a resident of Birmingham, Alabama, was an independent director and Chairman of the Audit Committee of the Funds beginning in 2003 and during the entire Relevant Period. She was also designated as an Audit Committee Financial Expert. Stone is a CPA licensed in Florida.

9. Archie W. Willis III, 54 years of age and a resident of Memphis, Tennessee, was an independent director and a member of the Audit Committee of the Funds beginning in 2002 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Willis has never held any professional licenses.

B. OTHER RELEVANT ENTITIES

10. The Funds consisted of five registered investment companies: (i) RMK High Income Fund, Inc.; (ii) RMK Multi-Sector High Income Fund, Inc.; (iii) RMK Strategic Income Fund, Inc.; (iv) RMK Advantage Income Fund, Inc.; and (v) Morgan Keegan Select Fund, Inc. ("Select Fund"). The Select Fund was an open-end company with a fiscal year end of June 30 that contained three open-end series—the Select High Income portfolio, the Select Intermediate Bond portfolio, and the Select Short Term Bond portfolio. The other funds were closed-end funds with a fiscal year end of March 31. During the Relevant Period, each Fund had a board of directors that consisted of two interested directors and six independent directors. All of the independent directors sat on each Fund's Audit Committee. The closed-end funds calculated and published daily NAVs, although these were not the basis of transactions in their shares.

11. Morgan Asset Management, Inc. ('Morgan Asset") is an investment adviser registered with the Commission, and Morgan Keegan & Company, Inc. ("Morgan Keegan") is a broker-dealer and an investment adviser registered with the Commission. Both were headquartered in Memphis, Tennessee. During the Relevant Period, Morgan Asset served as the investment adviser for the Funds and Morgan Keegan provided accounting services to the Funds through its Fund Accounting group ("Fund Accounting").

C. <u>OVERVIEW OF THE FUNDS</u>

12. As of March 31, 2007, the Funds held securities with a combined net asset value of approximately $3.85 billion. The Funds owned many of the same securities and almost all of the Funds invested the majority of their total assets in complex securities known as structured products that included collateralized debt obligations, collateralized mortgage obligations, collateralized loan obligations, home-equity loan-backed securities, various types of asset-backed securities, and certificate-backed obligations.

13. The Funds' filings with the Commission disclosed that their assets would be concentrated in below-investment grade debt securities, which carried inherent risks such as more frequent and pronounced changes in the perceived creditworthiness of issuers, greater price volatility, reduced liquidity, and the presence of fewer dealers in the market for such securities. Another, particularly relevant characteristic of the Funds' holdings was their significant concentrations in mortgage-backed securities.

14. A significant number of the structured products held by the Funds were subordinated tranches of various securitizations, for which market quotations were not readily available during the Relevant Period. As a result, a large percentage of the Funds' portfolios had to be fair valued as determined in good faith by the Funds' boards, in accordance with the requirements of Section 2(a)(41)(B) of the Investment Company Act. As of March 31, 2007, more than 60% of the NAV of each of the four closed-end funds was required to be fair valued. As of June 30, 2007, more than 50% of the NAV of each of the two largest open-end series was fair valued.

D. <u>RESPONDENTS DELEGATE THEIR VALUATION RESPONSIBILITIES WITH MINIMAL GUIDANCE</u>

15. In the Funds' Policy and Procedure Manual (the "Manual"), the Directors delegated to Morgan Asset "the responsibility for carrying out certain functions relating to the valuation of portfolio securities . . . in connection with calculating the NAV per share of the Funds." The Manual also stated that "portfolio securities for which market quotations are readily available are valued at current market value [while] . . . . [a]ll other portfolio securities will be valued at 'fair value' as determined in good faith by [Morgan Asset] in accordance with the Funds' Valuation Procedures.

16. The Funds' Valuation Procedures within the Manual stated more specifically that "[w]hen price quotations for certain securities are not readily available from the sources noted above [<u>i.e.</u>, sources of market prices] or if the available quotations are not believed to be reflective of market value, those securities shall be valued at "fair value" *as determined in good faith by [Morgan Asset's] Valuation Committee*." [Emphasis added] The Valuation Procedures then listed various general and specific factors, which the Valuation Committee was supposed to consider when making fair value determinations. The "General Factors" listed were (i) the fundamental analytical data relating to the investment; (ii) the nature and duration of restrictions on disposition

of the securities; and (iii) an evaluation of the forces which influence the market in which these securities are purchased and sold." The "Specific Factors" listed were: (i) type of security; (ii) financial statements of the issuer; (iii) cost at date of purchase (generally used for initial valuation); (iv) size of the Fund's holding; for restricted securities, (v) any discount from market value of restricted securities of the same class at the time of purchase; (vi) the existence of a shelf registration for restricted securities; (vii) information as to any transactions or offers with respect to the security; (viii) special reports prepared by analysts; (ix) the existence of merger proposals, tender offers or similar events affecting the security; and (x) the price and extent of public trading in similar securities of the issuer or comparable companies."

17. Other than listing these factors, which were copied nearly verbatim from ASR 118, the Valuation Procedures provided no meaningful methodology or other specific direction on *how* to make fair value determinations for specific portfolio assets or classes of assets. For example, there was no guidance in the Valuation Procedures on how the listed factors should be interpreted, on whether some of the factors should be weighed more heavily or less heavily than others, or on what specific information qualified as "fundamental analytical data relating to the investments" or "forces that influence the market in which these securities are bought and sold" for particular types of securities held by the Funds. Additionally, the Valuation Procedures did not specify what valuation methodology should be employed for each type of security or, in the absence of a specified methodology, how to evaluate whether a particular methodology was appropriate or inappropriate. Also, the Valuation Procedures did not include any mechanism for identifying and reviewing fair-valued securities whose prices remained unchanged for weeks, months and even entire quarters.

18. The Directors did not provide any other guidance—either written or oral—on how to determine fair value beyond what was stated in the Valuation Procedures.

19. The "Written Reports of Fair Value Determinations" subsection of the Valuation Procedures contained the only procedures regarding information required to be provided to the Directors. It stated that "[u]pon making a determination as to the fair value of a security, the Valuation Committee shall maintain a written report documenting the manner in which the fair value of a security was determined and the accuracy of the valuation made based on the next reliable public price quotation for that security," and further required that the Valuation Committee create and provide to the Directors for review "[q]uarterly reports listing all securities held by the Fund that were fair valued during the quarter under review, along with explanatory notes for the fair values assigned to the securities."

E. THE FUNDS' ACTUAL FAIR VALUATION PRACTICES

20. In practice, the task of assigning fair values on a daily basis was performed by Fund Accounting, which consisted of Morgan Keegan employees.

21. In determining fair value, Fund Accounting did not use any reasonable analytical method to arrive at fair value. For example, neither Fund Accounting nor the Valuation

Committee used a pricing model or made any real effort to analyze future cash flows that a particular bond in the portfolio would likely generate.

22. Under the actual fair valuation process, Fund Accounting typically set a security's initial fair value as its purchase price (its cost) and, thereafter, left that fair value unchanged unless a sale or a price confirmation indicated a more than 5% variance from the previously assigned fair value. In addition, Kelsoe occasionally contacted Fund Accounting, by email or other means, and specified prices for particular securities. Without any explanation of his basis for such prices, Fund Accounting routinely accepted the prices provided by Kelsoe.

23. Shortly after each month end, Fund Accounting randomly selected and sought price confirmations for as few as 10% of the Funds' securities that were required to be fair valued, except for March and June when, in connection with annual audits, confirmations were sought for 100% of the fair valued securities. The price confirmations were essentially opinions on price from broker-dealers, rather than bids or firm quotes. The price confirmations virtually always contained disclaimers explicitly making clear that the dealer providing the price confirmation was not offering to buy the security at the stated price. In addition, the price confirmations were generally sought for month-end prices, but were obtained several weeks after the respective month-ends. Accordingly, they could not have sufficed as the primary valuation method, given the open-end Fund series' obligation to timely price the securities.

24. Although these monthly price confirmations could not suffice as the primary valuation method, Fund Accounting regularly relied on them when making daily fair value determinations. For example, if a month end price confirmation showed a price more than 5% different than the Funds' current price for that security, Fund Accounting would typically consult the portfolio manager on how to price that security.

25. The Valuation Procedures contained a section entitled "Price Override Procedures," which provided that the Adviser could "override prices provided by a pricing service or broker-dealer only when it had a reasonable basis to believe that the price . . . does not accurately reflect the fair value of the portfolio security." The section further provided that "the basis for overriding the price shall be documented and provided to the Valuation Committee for its review." Because the Valuation Committee and Fund Accounting interpreted this provision as applying only to broker-dealer quotes (i.e., actual offers to buy or sell), the Valuation Committee did not receive notice or explanation when Fund Accounting chose to ignore the price confirmations. The Respondents knew or should have known that Fund Accounting relied heavily on price confirmations when making fair valuation decisions, but that there was nothing requiring Fund Accounting to identify or explain those instances where the price confirmations differed materially from the Funds' price.

26. In the event a price confirmation indicated a more than 5% variance from the previously assigned fair value, Fund Accounting effectively allowed the portfolio manager to select the fair value. The portfolio manager took advantage of the fact that Fund Accounting allowed him to arbitrarily set values without a reasonable basis and did so in a way that postponed

the degree of decline in the NAVs of the Funds which should have occurred during the Relevant Period.

27. The Valuation Committee, which consisted of Fund officers and Fund Accounting employees, was responsible according to the Funds' procedures for overseeing the fair valuation process. During most of the Relevant Period, the Valuation Committee met monthly, but received insufficient information as to the basis of the fair values assigned to various securities. Specifically, the Valuation Committee received Security Sales reports for the Funds (described in greater detail below), brief explanations for greater-than-5% variances therein, and price confirmations obtained from broker-dealers.

28. The Valuation Committee reviewed pricing information provided by Fund Accounting. The pricing test typically employed by the Valuation Committee was a comparison included in the Security Sales reports of sales prices to previously assigned fair values. And while the Valuation Committee did receive the price confirmations that Fund Accounting solicited from independent broker-dealers, the Valuation Committee did not perform any additional tests to validate the fair values of portfolio securities that had not been sold or confirmed from a broker-dealer. Less than 25% of the approximately 350 securities held by the Funds that were required to be fair valued were actually sold in the first six months of 2007 and price confirmations were sought for as few as 10% of the fair valued securities through broker-dealers on a monthly basis.

F. THE DIRECTORS FAILED TO SATISFY THEIR FAIR VALUATION OBLIGATIONS

29. Throughout the Relevant Period, the Directors did not know and did not inquire what methodology was used by Fund Accounting and the Valuation Committee to fair value particular securities or types of securities. The information and reports provided to Directors at their board meetings did not provide sufficient information for the Directors to understand whatever methodology was being used by Fund Accounting to fair value securities. For example, at each quarterly board meeting the Directors received a list of the Funds' portfolio securities that were required to be fair valued and the fair values assigned to each security. However, there was no way a Director could determine from the list the type of security, the basis for a particular assigned fair value, or whether that price had changed from prior quarters. Furthermore, while the Directors did meet more frequently to discuss the Funds' holdings and did inquire about liquidity and valuation after being contacted by the SEC staff with valuation-related concerns in July 2007, the Directors still never asked specific questions about how the Funds' assets were being valued and how those values were being tested.

30. The Directors received at each quarterly board meeting three other documents relating to fair value determinations. The three documents were: (i) a "Report from the Joint Valuation Committee [of the Funds];" (ii) a "Fair Valuation Form" for each of the Funds; and (iii) "Security Sales" reports for each of the Funds.

31. The *Report from the Joint Valuation Committee* was a one-page, two-paragraph, narrative that was largely uninformative. Typical language contained in this report for the

quarterly board meetings in November 2006, January 2007 and May 2007, said: "The Valuation Committee met three times during the [preceding] calendar quarter[.] . . . The values of internally-priced securities were randomly confirmed with third parties and no material exceptions were noted. The Valuation Committee feels that all securities are being fairly priced and there are no material misstatements." The report did not, however, state how fair values were determined, and gave no details on how fair valued securities, which it referred to as "internally-priced securities," were "randomly confirmed with third parties."

32. Although price confirmations played a significant role in the Funds' fair valuation process, the Directors never established any guidelines regarding the use of price confirmations, such as how frequently they should be requested for any particular type of security, or the selection of broker-dealers used to provide such price confirmations. Nor did the Directors require any review to identify those securities for which no price confirmation had been obtained for a particular length of time.

33. The second document received quarterly by the Directors for each of the Funds was called a "*Fair Valuation Form*," which also contained boilerplate phraseology. Specifically, next to the words "Basis/Source/Method For Determining Price Used" was the same reoccurring phrase: "[i]nternal matrix based on actual dealer prices and/or Treasury spread relationships provided by dealers." There was no explanation of the "internal matrix" and no indication of what was meant by the terms "actual dealer prices" or "Treasury spread relationships provided by dealers." The Directors did not understand how the matrix operated.

34. Meaningful "explanatory notes for the fair values assigned to the securities" were not presented, quarterly or otherwise, to the Directors, despite the fact that the Valuation Procedures required that the Directors receive them on a quarterly basis. Furthermore, the Directors never followed up to request that such explanatory notes or any other specific information regarding the basis for the values assigned be provided to them.

35. Contrary to the statements in the Fair Valuation Form, the internal matrix was only used to price approximately 12% of the securities held by the four closed-end Funds' that were required to be fair valued as of March 31, 2007.

36. The "*Security Sales*" report for the Funds listed information about the securities sold in each Fund in the preceding quarter, including: (1) par value sold; (2) sales price; (3) the previous day's assigned price; (4) whether it was priced externally or internally, *i.e.*, fair valued; (5) the resulting variance; and (6) the impact on the Fund.

37. The utility of the Security Sales reports in the review of valuations was limited, because the reports included no information about securities that *had not been sold*—a very important category given the fact that securities that were required to be fair valued constituted a majority of Fund assets and less than 25% of the securities held by the Funds that were required to be fair valued were sold in the first six months of calendar 2007.

38. As a result of the Directors' causing the Funds to fail to adopt and implement reasonable procedures, the NAVs of the Funds were materially misstated at least from March 31, 2007 through August 9, 2007. Consequently, the prices at which the open-end Fund sold, redeemed, and repurchased its shares were also inaccurate. Additionally, at least one registration statement and other reports filed with the Commission by the Funds contained NAVs as of dates within the Relevant Period that were materially misstated. Included among these was a Form N-1A, filed by the Select Fund on October 29, 2007 that contained NAVs as of June 30, 2007 that were materially misstated.

G. VIOLATIONS

39. As a result of the conduct described above, Respondents caused the open-end Fund series' violations of Rule 22c-1 under the Investment Company Act, which makes it unlawful for registered investment companies issuing redeemable securities, persons designated in such issuer's prospectus as authorized to consummate transactions in such securities, and principal underwriters of, or dealers in such securities, to sell, redeem, or repurchase such securities except at a price based on the current net asset value of such security.

40. As a result of the conduct described above, Respondents caused the Funds' violations of Rule 30a-3(a) under the Investment Company Act. That rule requires that registered management investment companies maintain internal control over financial reporting. The term "internal control over financial reporting" is defined in paragraph (d) of the rule as a process designed by or under the supervision of the registered management investment company that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

41. As a result of the conduct described above, Respondents caused the Funds' violations of Rule 38a-1 under the Investment Company Act. That rule requires that registered investment companies adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund, including policies and procedures that provide for the oversight of compliance by the fund's investment adviser. The Funds failed to adopt and implement meaningful fair-valuation methodologies and related procedures.

42. As a result of the conduct described above, Respondents willfully caused to be made in a registration statement filed with the Commission under the Investment Company Act a statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to a material fact, or omitted to state in such registration statement a material fact which was required to be stated therein.

III.

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

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

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

C. Whether, pursuant to Section 9(f) of the Investment Company Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Rules 22c-1, 30a-3(a) and 38a-1, promulgated under the Investment Company Act.

IV.

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

IT IS FURTHER ORDERED that Respondents shall file 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 a 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 Respondents personally or by certified mail.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 12, 2012

In the Matter of **Encore Clean Energy, Inc.,** **Energy & Engine Technology Corp.,** **Equity Media Holdings Corporation,** **eTotalSource, Inc.,** **Extensions, Inc.,** **Firepond, Inc., and** **GNC Energy Corporation,** **File No. 500-1**	**ORDER WITHDRAWING TRADING SUSPENSION AS TO EXTENSIONS, INC.**

The Securities and Exchange Commission hereby withdraws the trading suspension order as to the securities of Extensions, Inc. ("EXTI") entered November 29, 2012 ("November 29, 2012 Order").

This order shall be effective immediately.

The remainder of the November 29, 2012 Order remains in full force and effect according to its original terms.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 12, 2012

In the Matter of The Hartcourt Companies, Inc., Hawksdale Financial Visions, Inc. (n/k/a Advanced Medical Institute, Inc.), Healthcare Providers Direct, Inc., Heartland Oil & Gas Corp., Hellenic Solutions Corp., and HIV-VAC, Inc. (n/k/a Grupo International, Inc.), File No. 500-1	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of The Hartcourt Companies, Inc. because it has not filed any periodic reports since the period ended November 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Hawksdale Financial Visions, Inc. (n/k/a Advanced Medical Institute, Inc.) because it has not filed any periodic reports since the period ended December 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Healthcare Providers Direct, Inc. because it has not filed any periodic reports since September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Heartland Oil & Gas Corp. because it has not filed any periodic since the period ended June 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Hellenic Solutions Corp. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of HIV-VAC, Inc. (n/k/a Grupo International, Inc.) because it has not filed any periodic reports since the period ended December 31, 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 the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on December 12, 2012, through 11:59 p.m. EST on December 26, 2012.

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. 68409 / December 12, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15128

In the Matter of **The Hartcourt Companies, Inc.,** **Hawksdale Financial Visions, Inc. (n/k/a Advanced Medical Institute, Inc.),** **Healthcare Providers Direct, Inc.,** **Heartland Oil & Gas Corp.,** **Hellenic Solutions Corp., and** **HIV-VAC, Inc. (n/k/a Grupo International, 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 The Hartcourt Companies, Inc., Hawksdale Financial Visions, Inc. (n/k/a Advanced Medical Institute, Inc.), Healthcare Providers Direct, Inc., Heartland Oil & Gas Corp., and HIV-VAC, Inc. (n/k/a Grupo International, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The Hartcourt Companies, Inc. (CIK No. 949427) is an expired Utah corporation located in Shanghai, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hartcourt 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 November 30, 2009. As of December 3, 2012, the company's stock (symbol "HRCT") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Hawksdale Financial Visions, Inc. (n/k/a Advanced Medical Institute, Inc.) (CIK No. 1096620) is a revoked Nevada corporation located in Alexandria, New South Wales, Australia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hawksdale is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for period ended December 31, 2009, which reported a net loss of over $4.24 million for the prior three months. As of December 3, 2012, the company's stock (symbol "AVMD") 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. Healthcare Providers Direct, Inc. (CIK No. 1305748) is a revoked Nevada corporation located in Stone Harbor, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Healthcare Providers 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 over $2.75 million for the prior nine months. On July 9, 2010, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of New Jersey, which was terminated on November 30, 2010. As of December 3, 2012, the company's stock (symbol "HPRD") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Heartland Oil & Gas Corp. (CIK No. 1075636) is a revoked Nevada corporation located in Jacksboro, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Heartland 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 over $28.6 million for the prior six months. As of December 3, 2012, the company's stock (symbol "HTOG") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Hellenic Solutions Corp. (CIK No. 1368195) is a Cayman Islands corporation located in Athens, Greece with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hellenic Solutions 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, 2010. As of December 3, 2012, the company's stock (symbol "AEGZF") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. HIV-VAC, Inc. (CIK No. 1103252) (n/k/a Grupo International, Inc.) (CIK No. 1082576) is a revoked Nevada corporation located in Collingwood, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). On May 11, 2000, HIV-VAC filed a Form 8-K12G3, reporting itself as the successor registrant of Lifeplan (CIK No. 1103252). HIV-VAC was issued a new CIK

number (1082576). Thus, the issuer has two CIK numbers. HIV-VAC (f/k/a Lifeplan) (CIK No. 1103252) 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 January 20, 2000, which reported a net loss of $7,228 for the year ended December 31, 1999. HIV-VAC (n/k/a Grupo International, Inc.) (CIK No. 1082576) 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, 2010, which reported a net loss of over $7.26 million from its January 10, 1997 inception to March 31, 2011. As of December 3, 2012, the company's stock (symbol "GRPI") 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

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.

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

Commissioner Walter
not participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 30303 / December 12, 2012

In the Matter of

WELLS FARGO BANK, N.A.
101 North Phillips Avenue
Sioux Falls, SD 57104

ALTERNATIVE STRATEGIES BROKERAGE SERVICES, INC.
401 South Tryon Street
Charlotte, NC 28202

ALTERNATIVE STRATEGIES GROUP, INC.
401 South Tryon Street, TH 3
Charlotte, NC 28202

FIRST INTERNATIONAL ADVISORS, LLC
30 Fenchurch Street
London, England
UK EC3M 3BD

GALLIARD CAPITAL MANAGEMENT, INC.
800 LaSalle Avenue, Suite 1100
Minneapolis, MN 55402

GOLDEN CAPITAL MANAGEMENT, LLC
5 Resource Square
Suite 400
10715 David Taylor Drive
Charlotte, NC 28262

METROPOLITAN WEST CAPITAL MANAGEMENT, LLC
610 Newport Center Drive
Suite 1000
Newport Beach, CA 92660

PEREGRINE CAPITAL MANAGEMENT, INC.
800 LaSalle Avenue, Suite 1850
Minneapolis, MN 55402

WELLS CAPITAL MANAGEMENT INCORPORATED)
525 Market Street, 10th Floor)
San Francisco, California 94105)
)
WELLS FARGO FUNDS DISTRIBUTOR, LLC)
525 Market Street, 12th Floor)
San Francisco, California 94105)
)
WELLS FARGO FUNDS MANAGEMENT, LLC)
525 Market Street, 12th Floor)
San Francisco, California 94105)
)
(812-14074))

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

Wells Fargo Bank, N.A. ("Wells Fargo Bank"), Alternative Strategies Brokerage Services, Inc., Alternative Strategies Group, Inc., First International Advisors, LLC, Galliard Capital Management, Inc., Golden Capital Management, LLC, Metropolitan West Capital Management, LLC, Peregrine Capital Management, Inc., Wells Capital Management Incorporated, Wells Fargo Funds Distributor, LLC, and Wells Fargo Funds Management, LLC (collectively, "Applicants") filed an application on August 31, 2012, and amended the application on September 21, 2012, 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 Wells Fargo Bank 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 Columbia on September 20, 2012.

On September 21, 2012, the Commission issued a temporary conditional order exempting Applicants from section 9(a) of the Act with respect to the above-referenced injunction from September 20, 2012 until the Commission took final action on an application for a permanent order or, if earlier, November 16, 2012 (Investment Company Act Release No. 30210). On November 16, 2012, 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. 30266) 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 Wells Fargo Bank et al. (File No. 812-14074), 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 District of Columbia on September 20, 2012.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: . ·vin M. O'Neill
Deputy Secretary

Commissioner Paredes
Commissioner Gallagher
not participating

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3513 / December 13, 2012

Admin. Proc. File No. 3-14162

In the Matter of

JOHN W. LAWTON

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

Grounds for Remedial Action

Injunction

Former associated person of investment adviser was permanently enjoined from antifraud violations of the federal securities laws. *Held*, it is in the public interest to bar former associated person from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

APPEARANCES:

John W. Lawton, *pro se*.

John E. Birkenheier, *Adolph J. Dean, Jr.*, and *Merlene B. Key*, for the Division of Enforcement.

Appeal filed: May 26, 2011
Last brief received: August 31, 2011

I.

The Division of Enforcement (the "Division") appeals from the decision of an administrative law judge barring John W. Lawton from association with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent following a district court order permanently enjoining him from violating antifraud provisions of the securities laws.[1] The Division appeals the law judge's decision not to bar Lawton from association with a municipal advisor or nationally recognized statistical rating organization (NRSRO). We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

A. Civil Injunction

On February 18, 2009, the Commission filed a complaint ("Complaint") in an injunctive action in the U.S. District Court for the District of Minnesota against Lawton, Crossroad Capital Management, LLC, a Delaware limited liability company ("Crossroad"), and Paramount Partners, LP, a Delaware limited partnership ("Paramount"). We summarize the Complaint below.

During the period at issue, Lawton controlled and was 50% owner of Crossroad, an investment adviser as defined under the Investment Advisers Act of 1940.[2] Crossroad, in turn, was general partner and investment manager for Paramount, a hedge fund. As of December 2008, about fifty-four investors had invested a net amount of approximately $9 million in Paramount limited partnership interests. Through Crossroad, Lawton directed the "day to day management" of Paramount, controlled its investment decisions, and executed its securities transactions. Lawton and Crossroad's compensation was tied to Paramount's performance; they received an annual management fee of 1% of Paramount's net asset value and an annual performance fee of 25% of any positive total return received by Paramount.

Lawton marketed Paramount as a "boutique for wealthy investors," representing that the fund "maximize[d] investment returns while minimizing risks by using a 'long/short' investment strategy" involving "direct equity purchases and offsetting option based positions." Lawton promoted the fund by claiming success in generating impressive returns. For instance, in 2008 Lawton, directly and through others in his employ, marketed the fund to prospective investors

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[1] *John W. Lawton*, Initial Decision Rel. No. 419 (Apr. 29, 2011), 100 SEC Docket 40872.

[2] *See* 15 U.S.C. § 80b-2(a)(17) (defining "person associated with an investment adviser"); *Gary M. Kornman*, Securities Exchange Act Rel. No. 59403 (Feb. 13, 2009), 95 SEC Docket 14245, 14251 & nn.16-17, *petition denied*, 592 F.3d 173 (D.C. Cir. 2010) (finding that general partner of a hedge fund is an investment adviser).

through "fact sheets" touting its purported investment success. These fact sheets fraudulently claimed that Paramount had far outperformed the S&P 500 Index, had generated annual returns of between 19% and 65% since 2001, and had only one year of losses, 2004, in which the fund purportedly declined in value by approximately 5%. In a December 2008 fact sheet (the "December 2008 Fact Sheet"), Lawton represented that Paramount held $21 million in assets.

Lawton also misled Paramount's existing investors about the firm's investment success. For example, in 2007 and 2008, Lawton and others in his employ sent Paramount investors account statements showing "substantial increases" in the value of their investments. In January 2009, Lawton sent account statements to Paramount investors showing that the investor accounts purportedly were worth a total of approximately $17 million as of December 31, 2008 (the "January 2009 Account Statements"). Lawton continued to make similar oral statements to current and prospective investors regarding Paramount's trading strategy, performance, and use of investor funds as late as January 2009.

Through these marketing efforts and account statements, Lawton successfully generated new investments in Paramount. Several investors made additional investments in Paramount during 2008 based on the returns reflected on their account statements. During 2008, Paramount received approximately $5.8 million in new investor money, and as much as $2.2 million in the last three months of the year.

Lawton was dramatically overstating the value of Paramount's assets. According to Lawton, Paramount's investments were held at four brokerage firms: Merrill Lynch, Jefferies, Interactive Brokers, and Goldman Sachs. Although Lawton represented in the December 2008 Fact Sheet that Paramount held $21 million and represented in the January 2009 Account Statements that Paramount held $17 million, the four brokerage firms independently verified that Paramount's accounts at these firms held only a total of $5.3 million as of December 31, 2008. The account balances rapidly fell to less than $2 million as of February 13, 2009.

A Division investigation discovered an approximately $12 million shortfall in the firm's accounts. This $12 million shortfall represented the difference between the $17 million in cumulative total assets reflected on the January 2009 Account Statements and the $5.3 million actually held in Paramount's accounts as of December 31, 2008. In early February 2009, as part of its investigation, the Division requested documents to verify the value of the firm's assets. In response, Lawton created and produced a December 2008 account statement showing a total Paramount Goldman Sachs account balance of over $12 million, roughly the amount of the shortfall (the "Falsified Investigation Statement"). But representatives of Goldman Sachs later "informed the [Division] that the[se] documents" were not genuine. In fact, Paramount had closed its Goldman Sachs account in or about June 2008.

On February 18, 2009, about a week after receiving the Falsified Investigation Statement, the Division filed the Complaint against Lawton, Paramount, and Crossroad. The next day, the district court issued a temporary restraining order, ordered a sworn accounting by each defendant, and ordered a freezing of all of the defendants' assets.[3] On July 9, 2009, Lawton consented to the entry of a permanent injunction ("Consent Agreement") by the district court. In an order that incorporated this Consent Agreement, the district court permanently enjoined Lawton from violations of Sections 17(a)(1), (2), and (3) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5; Sections 206(1), (2), and (4) of the Investment Advisers Act of 1940 and Advisers Act Rule 206(4)-8; and from aiding and abetting violations of Advisers Act Sections 206(1), (2), and (4) and Advisers Act Rule 206(4)-8.[4]

In June 2010, Lawton moved to vacate the permanent injunction. In a memorandum opinion and order issued on February 7, 2011, the district court ruled on Lawton's motion and on a Division motion to determine disgorgement and other monetary relief. The court denied Lawton's motion to vacate. It found that Lawton "entered his consent knowingly and voluntarily and with the advice of counsel," and stated that "[i]f Lawton did not wish to be subject to the [permanent injunction], he should not have consented to it." The court found that $1,758,788 was transferred from Paramount and Crossroad accounts to Lawton between January 2006 and the freezing of his assets in February 2009, and that this amount was a reasonable approximation of his ill-gotten gains. The court ordered Lawton to disgorge these ill-gotten gains along with prejudgment interest and to pay a $100,000 penalty.[5] In May 2011, Lawton appealed the permanent injunction to the U.S. Court of Appeals for the Eighth Circuit. On January 6, 2012, the Eighth Circuit affirmed the district court injunction and disgorgement calculation.[6]

B. Criminal Conviction

On November 24, 2009, more than four months after entering into the Consent Agreement, Lawton also pleaded guilty to criminal charges of mail fraud and making a false statement in a federal government investigation.[7] In his plea colloquy, Lawton admitted that,

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3 We take official notice of the February 19, 2009, October 19, 2010, and February 7, 2011 district court orders pursuant to Rule 323 of our Rules of Practice, 17 C.F.R. § 201.323.

4 15 U.S.C. § 77q(a)(1), (2), and (3); 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5; 15 U.S.C. § 80b-6(1), (2), and (4); 17 C.F.R. § 275.206(4)-8.

5 Crossroad was also ordered to pay disgorgement of $2,075,670 and a civil penalty of $500,000.

6 We take official notice of the January 6, 2012 and July 19, 2011 Eighth Circuit orders pursuant to Rule of Practice 323, 17 C.F.R. § 201.323.

7 18 U.S.C. § 1341 (mail fraud); 18 U.S.C. § 1001(a)(3) ("knowingly and willfully mak[ing] or us[ing] any false writing or document knowing the same to contain any materially

(continued...)

beginning in 2006, he falsely represented Paramount's assets by overstating trading gains and understating trading losses orally and in writing. He made these false statements both to induce new investors to make investments and to encourage existing Paramount investors to maintain their investments in the fund. He specifically admitted that the January 2009 Account Statements falsely overstated the value of investors' interests in the fund. He also admitted that he knowingly prepared the Falsified Investigation Statement. After entering this guilty plea, Lawton received concurrent sentences of seventy months' imprisonment for the mail fraud count and sixty months' imprisonment for the false statement count, to be followed by three years of supervised release. He was also ordered to pay restitution in an amount of $7,091,230.75.

During the plea colloquy, Lawton acknowledged that he had no right to appeal his guilty plea. Nevertheless, Lawton later appealed the criminal conviction to the Eighth Circuit, which dismissed his appeal on July 19, 2011.

C. Institution of Administrative Proceedings and Initial Decision

Based on the permanent injunction, we issued an order instituting these administrative proceedings on December 14, 2010 pursuant to Advisers Act Section 203(f).[8] On April 29, 2011, a law judge issued an initial decision by summary disposition.[9] The law judge found that the injunction established the statutory basis for sanctions, that Lawton was estopped in this proceeding from collaterally attacking the basis for the federal court injunction, and that his Eighth Circuit appeal of the injunctive order, which was pending at the time, did not justify a delay in the follow-on proceeding.

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7 (...continued)
false, fictitious, or fraudulent statement or entry" in a matter within the jurisdiction of the federal government). Although these administrative proceedings were instituted based on the injunction entered in the Commission's civil enforcement action against Lawton, in assessing the public interest we also consider Lawton's criminal conviction, his admissions in connection with his criminal plea agreement, and his appeals of the civil and criminal cases. *See Don Warren Reinhard*, Exchange Act Rel. No. 63720 (Jan. 14, 2011), 100 SEC Docket 36940, 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).

8 15 U.S.C. § 80b-3(f).

9 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).

The law judge barred Lawton from associating with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent but did not bar him from associating with a municipal advisor or NRSRO. She noted that the conduct on which the injunction was based occurred before the Commission was authorized under Section 925 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to impose collateral bars, *i.e.*, bars from associating in capacities other than those in which the respondent was associated at the time of the violative conduct.[10] The law judge analyzed whether imposing the collateral bars requested by the Division would be impermissibly retroactive. She found no retroactive effect in barring Lawton from association with brokers, dealers, municipal securities dealers, and transfer agents, citing the Commission's pre-existing authority under the Exchange Act to impose such bars in subsequent proceedings. But because municipal advisor and NRSRO bars were not authorized when Lawton engaged in the conduct triggering the injunction, the law judge found that these bars were impermissibly retroactive. The law judge noted that the Supreme Court has recognized that certain statutes affecting the propriety of prospective relief do not have retroactive effect but declined to decide whether collateral bars are prospective rather than retroactive remedies, stating that the distinction between "prospective remedial relief [and] a punitive sanction" is "fact-specific and the case law is ambiguous." The Division contends on appeal that all of the collateral bars may be applied without retroactive effect because such bars constitute prospective remedies and that the law judge accordingly erred in declining to bar Lawton from associating with any municipal advisor or NRSRO.

III.

Advisers Act Section 203(f) authorizes the Commission to initiate administrative proceedings against a person who is, among other things, enjoined from "engaging in or continuing any conduct or practice . . . in connection with the purchase or sale of any security," and who was, at the time of the misconduct underlying the injunction, associated with or seeking association with, an investment adviser.[11] We find that Lawton is enjoined from conduct relating to the purchase or sale of securities, and this injunction is based on his conduct while associated with an investment adviser. Thus, the requirements for applying Advisers Act Section 203(f) sanctions have been met.

After the Division filed its opening brief in this appeal, Lawton filed a one-page document titled "Respondent's Motion to Deny Plaintiff's Petition and Motion for Summary Affirmance,"[12] to which he attached a copy of his brief to the Eighth Circuit in his appeal of the

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

11 15 U.S.C. § 80b-3(e)(4) and (f).

12 Although this document was filed with the law judge, under the circumstances and in recognition of Lawton's status as a *pro se* respondent, we are treating this document as his (continued...)

injunction. He suggests that his appeal should have precluded summary disposition, claiming that "there are genuine material facts in dispute" and that "unsupported inconclusive assertions based on the interpretation of the partial facts should not carry a day before this tribunal."

The record supports the law judge's summary disposition in this case. Follow-on proceedings are not an appropriate forum to "revisit the factual basis for," or legal challenges to, an order issued by a federal court,[13] and challenges to such orders do not present genuine issues of material fact in our follow-on proceedings.[14] In the Consent Agreement, Lawton consented to entry of the permanent injunction without admitting or denying the allegations in the complaint (except as to jurisdiction) and waived findings of fact, conclusions of law, and any right to appeal from the order of permanent injunction. Having consented to the entry of an injunction on the basis of the Complaint's allegations, Lawton may not use this proceeding to collaterally attack the allegations.[15] By attaching a copy of his Eighth Circuit brief, Lawton invites consideration of his arguments for vacating the district court order, which are appropriately reserved for the federal courts. We decline to do so. In any case, the Eighth Circuit ultimately resolved these claims when it affirmed the district court order.

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12 (...continued)
brief in opposition to the Division's petition for review.

13 *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1109-11 (D.C. Cir. 1988); *see also Schield Mgmt. Co.*, 58 S.E.C. 1197, 1213 (2006) (declining to consider assertions "in conflict with the allegations" in the injunctive complaint); *Jose P. Zollino*, Exchange Act Rel. No. 55107 (Jan. 16, 2007), 89 SEC Docket 2598, 2605; *Sherwin Brown,* Investment Advisers Act Rel. No. 3217 (June 17, 2011), 101 SEC Docket 42692, 42697 (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) (finding that respondent "cannot re-litigate the issues adjudicated by the District Court here").

14 *See Marshall E. Melton*, 56 S.E.C. 695, 712 (2003); *see also Kornman v. SEC*, 592 F.3d 173, 183 (D.C. Cir. 2010) (finding that a summary proceeding was appropriate in a follow-on proceeding when the "record in [the respondent's] criminal case . . . disposed of the central issue regarding the nature of his 'alleged misconduct' for administrative enforcement purposes").

15 *Martin Armstrong*, Advisers Act Rel. No. 13121 (Sept. 17, 2009), 96 SEC Docket 20556, 20560; *see also Schield Mgmt.*, 58 S.E.C. at 1213.

IV.

A. Follow-On Proceedings under the Advisers Act: Pre- and Post-Dodd-Frank

The Advisers Act authorizes us to censure, place limitations on, suspend, or bar an associated person if we find that such sanction is in the public interest.[16] Section 925 of Dodd-Frank, enacted on July 21, 2010, amended the scope of bars available in administrative proceedings under Section 203 of the Advisers Act. Prior to Dodd-Frank, in an administrative proceeding pursuant to the Advisers Act, the Commission could suspend or bar respondents only from association with an investment adviser. Dodd-Frank expanded the relief available under the Advisers Act. As amended, Section 203 of the Advisers Act authorizes the Commission to impose "collateral bars," that is, to simultaneously bar the individual from association with brokers, dealers, municipal securities dealers, municipal advisors, transfer agents, and NRSROs. Before Section 925 was enacted, if an individual was subject to an investment adviser suspension or bar and then sought to associate with a broker, dealer, transfer agent, or municipal securities dealer, the same action could also serve as a basis for an additional follow-on proceeding—this time under the Exchange Act—to address the public interest in censuring, suspending, or barring the individual from the respective capacity in which he or she was seeking to associate.[17] Section 925 authorizes such bars in proceedings predicated on a respondent's violative conduct while associated in another securities industry capacity, rather than requiring separate proceedings to impose such bars only when and if the individual later seeks to associate himself or herself in the relevant capacity.

Section 203, as amended by Dodd-Frank, also authorizes suspensions and bars from association with municipal advisors and NRSROs—remedies not previously available under the securities laws. This was one of many provisions in Dodd-Frank devoted to expanding regulatory investor protections regarding municipal advisors and NRSROs. For instance, Subtitles IX.C. and IX.H. of Dodd-Frank, respectively, significantly increase the regulation of NRSROs and create a regulatory regime for municipal advisors that did not previously exist. The collateral bar authority in Section 925 reflects Dodd-Frank's broader recognition of the public interest in creating regulatory requirements—including registration, licensing, and associational restrictions—for persons associated with municipal advisors and NRSROs comparable to the regulatory requirements for broker-dealers, municipal securities dealers, and investment advisers.[18]

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16 15 U.S.C. § 80b-3(f).

17 Exchange Act §§ 15(b)(6)(A) (also covers penny stock bar), 17A(c)(4)(C), 15B(c)(4); 15 U.S.C. §§ 78*o*(b)(6)(A), 78q-1(c)(4)(C), 78*o*-4(c)(4).

18 *See, e.g.*, Dodd-Frank § 931 (making statutory findings regarding the public interest in NRSRO regulation); § 936 (imposing NRSRO training and substantive qualification

(continued...)

The Division seeks a full collateral bar against Lawton, *i.e.*, a bar from association with any broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or NRSRO. As the law judge noted in considering the appropriate remedies, the injunction underlying these proceedings was based on Lawton's conduct in 2008 and 2009—prior to the passage of the Dodd-Frank amendment authorizing such relief. Accordingly, we must determine whether the remedies Dodd-Frank added to Section 203 are available in this proceeding.

B. Standards for Determining Retroactivity

The leading case for determining when a federal statute may be applied to events predating the statute's enactment is the Supreme Court's decision in *Landgraf v. USI Film Products.*[19] *Landgraf* sets forth a two-part analysis for determining whether applying a statute would be impermissibly retroactive. The first part analyzes whether Congress expressly prescribed the temporal scope of the statute. If the statute does not clearly state whether it is to be applied retroactively, we proceed to the second part of the *Landgraf* analysis to consider whether the proposed interpretation would have a "genuinely retroactive effect."[20] A presumption against retroactivity counsels against application of a statute that would result in such a genuinely retroactive effect if there is no evidence of contrary Congressional intent.[21]

The *Landgraf* court acknowledged that remedies do not operate retroactively "merely because [they are] applied in a case arising from conduct antedating the statute's enactment."[22] Among other examples, *Landgraf* explained that applying a new statute "passed after the events in suit is unquestionably proper" when the statute "authorizes or affects the propriety of

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18 (...continued)
requirements); § 975(a) (adding municipal advisor registration requirements); § 975(g) (authorizing deregistration of municipal advisors); § 975(c) (authorizing suspensions and bars of persons associated with municipal advisors).

19 511 U.S. 244 (1994).

20 *Id.* at 268.

21 *Id.*

22 *Id.* at 269; *see also id.* at 270 n.24 (stating that "a statute 'is not made retroactive merely because it draws upon antecedent facts for its operation'" (quoting *Cox v. Hart*, 260 U.S. 427, 435 (1922))).

prospective relief," such as an injunction.[23] This is the case even though "uncontroversially prospective statutes may unsettle expectations and impose burdens on past conduct."[24]

More recently, in *Vartelas v. Holder*, the Supreme Court affirmed that statutes authorizing prospective remedies may consider conduct pre-dating the statute without a genuinely retroactive effect.[25] *Vartelas* addressed a provision of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA) restricting the ability of lawful permanent residents who have been convicted of certain crimes to return to the United States after foreign travel. A majority of the Court held that applying IIRIRA against a lawful permanent resident based on his pre-statute conviction was impermissibly retroactive. The majority found that applying the law to a pre-enactment conviction imposed a new disability in the form of a restraint on travel, and that Vartelas's post-enactment travel was an "'innocent' act, burdened only because of his pre-IIRIRA offense." [26]

The dissent disagreed, stating that it could "imagine countless laws that, like [IIRIRA], impose new disabilities related to 'past events' and yet do not operate retroactively."[27] As examples, the dissent listed laws that disqualify sex offenders from working in jobs involving contact with minors, prevent the mentally unstable from purchasing guns, and restrict the student loan eligibility of persons convicted of drug crimes. The majority agreed that the dissent's examples were prospective. The majority noted that, although pre-enactment conduct may be the predicate for these prospective limitations, their purpose is not to address the harm already caused by the completed conduct but rather to "address dangers that arise postenactment," such as the risks of sex offenders working in close proximity to children or mentally unstable persons

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23 *Landgraf*, 511 U.S. at 273-74, describing *Am. Steel Foundries v. Tri-City Cent. Trades Council*, 257 U.S. 184, 201 (1921) (explaining that a statute "govern[ing] the propriety of injunctive relief against labor picketing" could be applied to modify a pre-enactment injunction because "relief by injunction operates in futuro" and the plaintiff "had no 'vested right' in the [injunctive] decree" that was entered by the court before the statute's enactment); *see also Cookeville Reg'l Med. Ctr. v. Leavitt*, 531 F.3d 844, 847 (D.C. Cir. 2008) (noting that *Landgraf* discusses a "host of exceptions that weaken the anti-retroactivity principle").

24 *Landgraf*, 511 U.S. at 270 n.24.

25 132 S. Ct. 1479 (Mar. 28, 2012). The *Vartelas* decision was issued after the initial decision in this proceeding.

26 Id. at 1490. Dodd-Frank Section 925 protects the regulated securities professions from persons who have demonstrated unfitness for the industry. As discussed, collateral bars are appropriate when a respondent's future entry into the industry in a collateral capacity would not be an "innocent act" but would expose the investing public to future risks.

27 *Id.* at 1495.

purchasing guns.[28] Because these statutes consider the public interest in remedying future risks, their remedies may consider pre-enactment conduct without raising retroactivity concerns.[29]

C. Retroactivity Analysis of Collateral Bars

Dodd-Frank does not unambiguously state whether its collateral bar provision may be applied in cases involving pre-enactment conduct.[30] The Division argues that the presumption against retroactivity does not apply because the relief authorized under the statute is prospective. The Division contends that collateral bars are prospective relief that we may impose under the amended statute because such limitations would protect the public from a risk of future harm. Lawton has not challenged the application of Section 925 to this proceeding.

In *Landgraf* and *Vartelas*, the Supreme Court stated that prospective relief does not implicate retroactivity concerns because it addresses future risks and applies to future actions—not to events that were already past when the statute was enacted. Collateral bars address future risks and apply to future actions: the harm to the investing public posed by the future securities industry association of a person who has demonstrated unfitness to act as a securities professional. The Commission is authorized to impose a bar not to punish the respondent for past misconduct or to remedy past harms suffered by victims of that misconduct, for example, in the form of disgorgement or damages. Rather, the Commission's bars are authorized to protect the investing public from the respondent's possible future actions by restricting access to other areas of the securities industry where a demonstrated propensity to engage in violative conduct may cause further investor harm.

The language and structure of the securities statutes, both pre- and post-Dodd-Frank, show that Congress has authorized the Commission to bar individuals from areas of the securities industry to protect investors from future harm. The Commission has long had authority to bar individuals based on past misconduct and a determination that such misconduct, among other factors, demonstrates a sufficient future risk to the investing public to justify exclusion from the

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[28] *Id.* at 1489 n.7.

[29] The majority distinguished statutes addressing post-enactment dangers from the travel restriction at issue in *Vartelas*, observing that it was not "plausible that Congress' solution to the problem of dangerous lawful permanent residents would be to pass a law that would *deter* such persons from ever leaving the United States." *Id.* at 1489 n.7 (emphasis added).

[30] Under Section 4 of Dodd-Frank, the collateral bar provision was effective on July 22, 2010. The Dodd-Frank collateral bar provision affected only the remedies for a pre-existing cause of action, not the legal basis or defenses for the cause of action.

industry.[31] Reflecting the prospective rather than retrospective focus of the statute, this authority includes the ability to impose bars in proceedings predicated on misconduct unrelated to the securities laws and outside the scope of the individual's participation in the securities industry—such as criminal convictions for non-securities related larceny, theft, or robbery and other crimes punishable by imprisonment for a year or more[32]—even though the Commission is not authorized to punish the underlying criminal activity or remedy the harm suffered by its victims.[33] This statutory authority constitutes further evidence that Congress intended the Commission's administrative bars to provide prospective relief from harm to investors and the markets.[34] Otherwise stated, the relevant events for purposes of a retroactivity analysis are not

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[31] *See infra* note 33.

[32] *See* Investment Advisers Act Section 203(f); 15 U.S.C. § 80b-3(f) (incorporating Section 203(e)(2)(C) (covering any felony or misdemeanor involving "larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation") and 203(e)(3)(A) (covering "any crime that is punishable by imprisonment for 1 or more years")); Exchange Act Section 15(b)(6)(A); 15 U.S.C. § 78*o*(b)(6)(A) (incorporating Section 15(b)(4)(B)(iii) (covering any felony or misdemeanor involving "larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion or misappropriation")).

[33] *See McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005) (quoting *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940)) (stating that the Exchange Act "authorizes an order of expulsion not as a penalty but as a means of protecting investors, if in the Commission's opinion such action is necessary or appropriate to that end. . . . The purpose of the order is remedial, not penal."). The "relevant activity that the [statute] regulates" in these cases is future conduct in the securities industry rather than the past, non-securities related conduct. *See Landgraf*, 511 U.S. at 291 & 293 (Scalia, J., concurring) (stating that "[t]he critical issue . . . is not whether the rule affects 'vested rights,' or governs substance or procedure, but rather what is the relevant activity that the rule regulates" and that because "the purpose of prospective relief is to affect the future rather than remedy the past, the relevant time for judging its retroactivity is the very moment at which it is ordered").

[34] *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996), found that a Commission suspension was a "penalty" for purposes of the statute of limitations under 28 U.S.C. § 2462. It based this conclusion on its finding that the rationale for the sanction was "solely in view of Johnson's past misconduct" and was "not focused on Johnson's current competence or the degree of risk she posed to the public." *Id.* at 489, 490. In this case, our focus is on the risk of future harm Lawton poses to the public. As *Johnson* acknowledged, occupational bars are not necessarily punitive in contexts other than the statute of limitations, particularly when such a bar is "motivated by a *bona fide* goal of protecting the public." *Id.* at 491 (citing, *e.g.*, *United States*

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the past misconduct but the ongoing regulation of the securities industry and certain persons' future association with the industry.

We find further support for the prospective nature of the municipal advisor and NRSRO bars in the extensive provisions in Dodd-Frank creating and overhauling, respectively, the municipal advisor and NRSRO regulatory regimes. Through this legislation, Congress directed the Commission to increase its regulatory presence in these industries. At the time Lawton engaged in the misconduct that was the subject of the injunctive proceeding, the securities laws did not did authorize the Commission to bar him or others from association with municipal advisors and NRSROs. Section 925 of Dodd-Frank, which confers this authority, however, does not reflect a decision by Congress to increase the penalty for Lawton's misconduct or any other conviction or injunction triggering follow-on proceedings under Section 203 the Advisers Act. Rather, it makes the Commission's ability to protect the public in the municipal advisor and NRSRO areas of the securities industry more consistent with the protections available in other areas of the industry.[35] As a result of his misconduct, Lawton could not have reasonably expected that he could seek to enter those other areas of the securities industry, and therefore Dodd-Frank's only effect was to include municipal advisors and persons associated with NRSROs as part of the regulated securities industry from which he could be excluded. Congress's decision to authorize the Commission to bar individuals from future participation in these capacities is, therefore, best viewed as having a "prospective thrust" like the examples of statutes the Supreme Court deemed to be without retroactive effect in *Vartelas*.[36]

The United States Court of Appeals for the District of Columbia Circuit decision in *Boniface v. Homeland Security* provides further support for our conclusion that collateral bars may be imposed based on pre-Dodd Frank conduct. *Boniface* held that denying future occupational opportunities based on a prior court order did not trigger "any of the effects deemed retroactive in *Landgraf*."[37] *Boniface*, who had been criminally convicted for possession of an unregistered explosive device more than thirty years earlier, "sought a renewed" authorization

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[34] (...continued)
v. Stoller, 78 F.3d 710, 724 (1st Cir. 1996) (finding that bar of individual from banking industry was not punishment for purposes of the double jeopardy clause)).

[35] *See, e.g.*, Dodd-Frank § 931 (finding that "the activities of credit rating agencies . . . should be subject to the same standards of liability and oversight as apply to auditors, securities analysts and investment bankers"); Dodd-Frank § 975(a) & (c) (amending Exchange Act Section 15B to make the municipal advisor registration and disciplinary requirements comparable to those applicable to municipal securities dealers).

[36] *See supra* note 28 and accompanying text.

[37] 613 F.3d 282, 288 (D.C. Cir. 2010); *see id.* at 290 (remanding to the agency to consider evidence submitted by Boniface in support of a waiver of the rule).

from the TSA to transport hazardous material in 2008 because his commercial driver's license was set to expire. The agency denied the renewal application under a newly enacted rule that created an "evidentiary presumption" that a past conviction demonstrates "a security threat in the present."[38] On appeal, the court rejected Boniface's claim that applying this rule to consider his thirty-year-old conviction was impermissibly retroactive under *Landgraf.* Applying *Landgraf*'s guidance that a "regulation is not retroactive in effect 'merely because it draws upon antecedent facts for its operation,'"[39] the court found that it was appropriate to consider the past conviction during the proceeding as evidence of the future risk posed by the respondent.[40]

Our analysis of when a bar is in the public interest is similar to the framework described in *Boniface*. In each case in which an administrative bar is sought, we consider the record evidence to determine whether such a remedy is necessary or appropriate to protect investors and markets from the risk of future misconduct by the respondent and to preserve the fair and effective functioning of the securities markets.[41] As in *Boniface*, a court order establishes part of the statutory predicate for instituting the follow-on proceeding, and also may be considered as evidence of the future risk posed by the respondent. But, as the courts have held, the existence of a past violation, without more, is not a sufficient basis for imposing a bar.[42] Rather, during this proceeding we consider pre-enactment actions as evidence in a broader inquiry into whether a person presents a future risk to the public interest because, as the Supreme Court has recognized,

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38 *Id.* at 288.

39 *Boniface*, 613 F.3d at 288 (citing *Landgraf*, 511 U.S. at 270 n.24).

40 *Id.* at 288.

41 *See Paz Sec., Inc. v. SEC*, 566 F.3d 1172, 1175 (D.C. Cir. 2009) (indicating that an administrative bar or suspension "may be used to protect investors but not to punish a regulated person or firm"); *Kornman*, 592 F.3d at 188 (bars may be appropriate for occupations presenting "opportunities for future misconduct").

42 *See, e.g.*, *McCarthy*, 406 F.3d at 189 (finding that sanctions determinations should show "individual attention to the unique facts and circumstances of [the] case" or "findings that would indicate any additional protection the trading public would receive" as a result of the sanction); *Paz*, 566 F.3d at 1175-76 (citing *McCarthy*, 406 F.3d at 189) (indicating that the Commission must make "findings regarding the protective interests to be served" by expulsion); *see also* Exchange Act § 203(f) (stating that the basis for a Commission bar are findings that such sanction, as relevant here, "is in the public interest *and* that such person . . . is enjoined from any [specified] action, conduct, or practice" (emphasis added)). *Cf. Boniface*, 613 F.3d at 288 (finding that the evidentiary presumption of future risk created by a past conviction under the rule could be rebutted through the waiver process).

the "degree of intentional wrongdoing evident in a defendant's past conduct" is an important indication of the defendant's propensity to subject the trading public to future harm.[43]

Our public interest analysis traditionally considers, 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.[44] We consider the nature of the respondent's past violative conduct—e.g., its egregiousness, recurrence, and scienter—not to evaluate whether such conduct merits punishment but rather to evaluate the risk of future harm to the public and remedies that will protect investors and the markets from such future harm.[45] The risk of future harm similarly drives our consideration of more recent conduct, such as any assurances against future violations, subsequent disciplinary history, the likelihood that the respondent would be presented with opportunities for similar misconduct in a collateral capacity, and any other evidence of the public interest in limiting association in that capacity. This same analysis is used in determining whether to impose a collateral bar. In order to impose a collateral bar, the Commission must consider not only past misconduct, but the broader question of the future risk the respondent poses to investors.

This finding is also consistent with the Supreme Court's longstanding view that statutes barring individuals from a profession or other activity based on prior convictions are not unconstitutional under the Ex Post Facto Clause. For instance, in *Hawker v. New York*, the Court upheld a law barring a doctor from a medical profession based on a prior conviction, reasoning that such limitations, rather than serving as a punishment for past conduct, come about as a "relevant incident to a regulation of a present situation, such as the proper qualifications for a profession."[46] Similarly, in *DeVeau v. Braisted*, the Court upheld a statute barring individuals who had been convicted of certain crimes from holding union positions.[47]

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43 *Aaron v. SEC*, 446 U.S. 680, 701 (1980).

44 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

45 *See, e.g., Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004) (finding that egregious violative conduct supported an inference that violative conduct was likely to be repeated).

46 170 U.S. 189, 200 (1898).

47 363 U.S. 144, 159-160 (1960).

Retroactivity decisions involving other Commission remedies are not to the contrary. In *Koch v. SEC*,[48] the court found that an Exchange Act amendment authorizing penny stock bars was impermissibly retroactive as applied to a person enjoined from violating the securities laws. *Koch* acknowledged the prospective relief exception to the presumption against statutory retroactivity, but explicitly declined to address whether the exception was relevant to the facts of that case because that argument was not before the court.[49] Based on the retroactivity analysis in *Koch*, the court in *Sacks v. SEC* found that applying a Financial Industry Regulatory Authority (FINRA) rule that prohibited non-attorneys who had been banned from the securities industry from representing parties in securities-related arbitration was impermissibly retroactive.[50] Neither of these decisions addressed whether the amended provision authorized prospective relief or whether the relief at issue would have remedied a risk of future misconduct by the respondents.[51]

* * *

Accordingly, we find that collateral bars imposed pursuant to Section 925 of Dodd-Frank are not impermissibly retroactive as applied in follow-on proceedings addressing pre-Dodd-Frank conduct because such bars are prospective remedies whose purpose is to protect the investing public from future harm.[52]

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[48] 177 F.3d 784 (9th Cir. 1999) (noting that the Commission was not authorized to impose a penny stock bar when the respondent engaged in the violative conduct).

[49] 177 F.3d at 289 n.7; *see also SEC v. Platform Wireless Intern., Corp.*, 2007 U.S. Dist. LEXIS 47775, Fed. Sec. L. Rep. (CCH) P94,423 (S.D. Cal. 2007) (noting that *Koch* did not address the prospective relief exception to the presumption against retroactivity and concluding that "since the penny stock bar affects prospective relief, the exception is applicable").

[50] 648 F.3d 945 (9th Cir. 2011) (noting that banned non-attorneys could represent parties in FINRA proceedings before the rule was adopted).

[51] While we therefore find these cases inapposite, we also note that any reliance interest claimed by respondent here is even more attenuated than that of Koch and Sacks, who, unlike respondent, had been associated in each of the professional capacities for which the bar at issue in the case was sought.

[52] The law judge declined to decide whether collateral bars are "prospective remedial relief or a punitive sanction." Instead, the law judge found that the collateral bars from association with brokers, dealers, municipal securities dealers, and transfer agents are not retroactive because prior to Dodd-Frank, the Commission could impose such bars in a subsequent follow-on proceeding if the person sought to associate in such a capacity. The law judge found that authorizing bars in a single proceeding (rather than requiring separate

(continued...)

V.

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.[53] While "no one [Steadman] factor is dispositive,"[54] we consider these factors to determine whether the proposed remedy would "protect[] the trading public from further harm."[55] The Division seeks a collateral bar that would bar Lawton from associating with brokers, dealers, municipal securities dealers, municipal advisors, transfer agents, and NRSROs. For the reasons set forth below, we find the collateral bars sought by the Division are warranted here.

A. Fraudulent Statements to Investors and Potential Investors

Lawton's fraudulent conduct was egregious, repeated, and conducted with a high degree of scienter. As an associated person of an investment adviser, he owed a fiduciary duty to the Paramount investors, including an "affirmative duty of 'utmost good faith and full and fair disclosure of all material facts,' as well as [an] affirmative obligation to employ reasonable care to avoid misleading clients."[56] Lawton breached his duties to the investors by repeatedly and

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52 (...continued)
proceedings) does not attach new legal consequences because Lawton could not have reasonably expected to associate in those capacities in light of his injunction. As a result, the law judge concluded that these collateral bars were not impermissibly retroactive. *See Landgraf*, 511 U.S. at 278 (explaining *Bradley v. School Bd. of Richmond*, 416 U.S. 696 (1974) (finding statute authorizing attorney fees not retroactive given the "the prior availability of a fee award" under equitable principles and the "likelihood that fees would be assessed under pre-existing theories")). We agree that such bars do not impose new or unforeseeable legal consequences.

53 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

54 *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).

55 *McCarthy*, 406 F.3d at 188 (quoting also *Rubin*, 58 SEC Docket at 1479 ("When we suspend or bar a person, it is to protect the public from future harm at his or her hands.")); *see also Paz*, 566 F.3d at 1175-76.

56 *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *see, e.g.*, *Brown*, 100 SEC Docket at 42700; *Conrad P. Seghers*, Advisers Act Rel. No. 2656 (Sept. 26,
(continued...)

knowingly sending them false account statements inflating the value of their Paramount investments accounts. Lawton also "egregious[ly] abuse[d] the trust placed in him as a securities professional" by sending prospective investors fraudulent marketing materials.[57] He used these fraudulent account and marketing statements to attract and maintain millions of dollars under his management in a pattern of fraud that began in 2006, continued for years, and ended only after a federal court issued a temporary injunctive order in February 2009.

This ongoing fraud financially enriched Lawton while he knowingly concealed millions of dollars in Paramount losses. The civil proceedings found that, as a result of his fraudulent conduct, Lawton was unjustly enriched by approximately $1.76 million, and the criminal proceedings found the investors entitled to more than $7 million in restitution from Lawton for their net Paramount losses from January 2006 to February 2009.

The proper functioning of the securities industry and markets depends on the integrity of industry participants and their commitment to transparent disclosure. Securities industry participation by persons with a history of fraudulent conduct is antithetical to the protection of investors. Here, the longstanding pattern, self-serving nature, and egregiousness of Lawton's fraud demonstrates his ongoing unfitness to participate in the securities markets in any capacity. Moreover, Lawton violated anti-fraud provisions of the securities laws, including the Securities Act and Exchange Act, that apply broadly to all securities-related professionals, and his injunction applies to any future securities-related conduct. He also engaged in criminal mail fraud. This was not a technical or isolated violation based solely on his status as an investment adviser.

We have long held that a history of egregious fraudulent conduct demonstrates unfitness for future participation in the securities industry even if the disqualifying conduct is not related to the professional capacity in which the respondent was acting when he or she engaged in the misconduct underlying the proceeding.[58] The industry relies on the fairness and integrity of all persons associated with each of the professions covered by the collateral bar to forgo opportunities to defraud and abuse other market participants.

Lawton's occupation as an investment adviser presents opportunities for future illegal conduct in the securities industry. Municipal advisors, like investment advisers, are bound by

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56 (...continued)
2007), 91 SEC Docket 2293, 2304 n.44, *petition denied*, 548 F.3d 129 (D.C. Cir. 2008).

57 *John S. Brownson*, 55 S.E.C. 1021, 1029 (2002), *petition denied*, 66 F. App'x 687 (9th Cir. 2003) (unpublished).

58 *See, e.g.*, *Kornman*, 95 SEC Docket at 14255-56 & n.28 (citing cases).

fiduciary duties to their clients.[59] Lawton's willingness to violate his fiduciary duty to his clients is more than sufficient to demonstrate his unfitness to take on another role as a fiduciary. His fraudulent conduct also demonstrates unfitness for other associations in the industry. Brokers, dealers, municipal securities dealers, and transfer agents routinely gain access to sensitive financial and investment information of investors and other market participants, and persons associated with municipal advisors and NRSROs routinely learn confidential and potentially market-moving information about securities, issuers, and potential transactions. In order to gain access to such information, securities professionals must take on heightened responsibilities to safeguard that information and to avoid temptations to fraudulently misuse their access for inappropriate—but potentially lucrative or self-serving—ends. Lawton is unfit for such heightened responsibilities.

B. Preparing the Falsified Investigation Statement to Subvert the Fraud Investigation

During the Division's investigation, Lawton attempted to conceal his fraud by creating the Falsified Investigation Statement.[60] Lawton's admissions in district court confirm that his criminal conduct was egregious, that he acted with a high degree of scienter, and that his fraudulent activity was recurrent. In offering his guilty plea, Lawton admitted that he prepared the Falsified Investigation Statement knowing it to be false and that he gave it to his attorney so that it could be provided to the Division during its investigation of his conduct. As we have previously held, the egregiousness of such dishonest conduct is compounded when it involves a "false statement to Commission staff during an ongoing investigation."[61] Moreover, if accepted as genuine, the Falsified Investigation Statement would have obscured his longstanding fraud. And by creating this document, Lawton continued his pattern of fraudulently misrepresenting the investment success of the firm. Lawton's criminal attempt to subvert an investigation into his ongoing fraud reveals an attitude toward regulatory oversight that is fundamentally incompatible with the principles of investor protection and with association in any capacity covered by the collateral bar.

The duty to cooperate with regulatory investigations is not limited to a particular aspect of the securities industry. Regulatory efforts to detect violative conduct require full cooperation by persons associated with each of the professions covered by the collateral bar. Persons who fail to cooperate with such efforts may be deemed "presumptively unfit for employment in the securities industry" because such non-cooperation "frustrates . . . efforts to detect misconduct, and such

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59 Dodd-Frank Section 975(c); 124 Stat. at 1851. Lawton's past conduct violating his fiduciary duty to his clients is more than sufficient to demonstrate his unfitness to take on another role as a fiduciary.

60 *See supra* note 7.

61 *Kornman*, 95 SEC Docket at 14256.

inability in turn threatens investors and markets."[62] Here, Lawton not only failed to cooperate, he actively attempted to undermine an investigation into securities fraud. We have consistently held that such attempts to deceive regulatory authorities justify a bar and "have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or securities business."[63]

Lawton's conduct demonstrates that allowing him to enter the securities industry in *any capacity* would create too great a risk that future efforts to detect securities violations would be impaired, causing harm to the public. It also demonstrates a lack of remorse for his fraudulent conduct, further heightening the risk that Lawton will cause future harm in the industry.

C. Post-Injunction Conduct

Lawton's conduct since the entry of the permanent injunction is further evidence of his lack of remorse and his failure to understand the duties of a securities professional. As a result, his future participation in the securities industry would pose an unacceptable risk of future harm to the investing public. During his criminal plea hearing, he admitted that he falsely overstated Paramount's investment success to current and potential investors to induce new investments and prevent withdrawals. He specifically admitted his guilt for wire fraud and for "knowingly and willfully" preparing a "materially false, fictitious or fraudulent" document to be provided to the government. In light of these admissions, Lawton's later attempts to minimize this conduct, including by attempting to withdraw his consent to the injunction, and his failure to offer assurances against future violations, suggest that he does not fully understand the seriousness of securities fraud, wire fraud, and misleading government investigators and how such conduct violated the duties of a securities professional. As we have held, such "failure[s] to recognize the wrongfulness of his conduct presents a significant risk that, given th[e] opportunity, he would commit further misconduct in the future."[64] This risk is particularly significant here because

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62 *Paz Sec., Inc.*, Exchange Act Rel. No. 57656 (Apr. 11, 2008), 93 SEC Docket 5122, 5126; *see also, e.g., R.E. Bassie & Co.*, Accounting and Auditing Enforcement Rel. No. 3354 (Jan. 10, 2012), 102 SEC Docket 50082, 50100 (finding that noncooperation with Public Company Accounting Oversight Board investigations "indicates a lack of sufficient regard for Board processes and authority designed by statute to protect investors"); *CMG Institutional Trading, LLC*, Exchange Act Rel. No. 59325 (Jan. 30, 2009), 95 SEC Docket 13802, 13816 ("[F]ailure to cooperate during [an] investigation threatens the self-regulatory system and, in turn, investors by impeding NASD's detection of violative conduct.").

63 *Kornman*, 95 SEC Docket at 14256 & n.28 (barring person associated with investment adviser and broker-dealer in follow-on proceedings predicated on Kornman's conviction under 18 U.S.C. § 1001, a criminal conviction also considered in this proceeding).

64 *Michael J. Markowski*, 55 S.E.C. 21, 30-31 (2001), *petition denied*, 2002 U.S.
(continued...)

opportunities for similar misconduct arise in each of the associational capacities covered by the collateral bar and Lawton's admitted conduct demonstrates fundamental and ongoing unfitness for any such association.

Given Lawton's egregious, longstanding, deliberate, and escalating pattern of violative conduct and his unwillingness to acknowledge the wrongfulness of this conduct or to offer credible assurances against future violations, we find ample evidence of his ongoing unfitness and risk that he would engage in further misconduct if given future opportunities in the industry. Allowing his participation in the securities industry would unduly risk exposing the public to further misconduct threatening the fairness, transparency, and regulatory oversight of the securities markets. As the Supreme Court has explained, "[t]he primary objective of the federal securities laws [is the] protection of the investing public and the national economy through the promotion of 'a high standard of business ethics . . . in every facet of the securities industry.'"[65] We find that the record demonstrates Lawton's unfitness to uphold the ethical standards required throughout the securities industry.

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64 (...continued)
App. LEXIS 12484 (D.C. Cir. Apr. 25, 2002) (unpublished opinion); *see also Geiger*, 363 F.3d at 489 (noting that respondent's continuing assertion that "he did nothing wrong . . . casts doubts on his promise that he will mend his ways"); *Gann v. SEC*, 361 F. App'x 556, 560 (2d Cir. 2010) (per curiam) (affirming permanent associational bar and stating "if [Gann] doesn't know right from wrong in this industry, how can he avoid wrongdoing in the future?"). Like the law judge, we treat a refusal to acknowledge 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").

65 *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315 (1985) (quoting *Capital Gains Research Bureau*, 375 U.S. at 186-87).

Accordingly, we hold that it is in the public interest to bar Lawton from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. An appropriate order will issue.[66]

By the Commission (Chairman SCHAPIRO and Commissioners WALTER and AGUILAR); Commissioners PAREDES and GALLAGHER, concurring in part and dissenting with respect to the bar from association with municipal advisors and nationally recognized statistical rating organizations. A dissenting opinion will issue separately.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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[66] 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. 3513/December 13, 2012

Admin. Proc. File No. 3-14162

In the Matter of

JOHN W. LAWTON

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that John W. Lawton be, and he hereby is, barred from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Paredes
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68432 / December 13, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3428 / December 13, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15129

In the Matter of **DELOITTE & TOUCHE (SOUTH AFRICA),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice against Deloitte & Touche (South Africa) ("Respondent," "DT-SA," or the "Firm").

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 the Firm and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

This matter arises from an independence-impairing business relationship between DT-SA – acting through its wholly-owned consulting affiliate, Deloitte Consulting (Pty) Ltd. ("DC-SA") – and Director (defined below). In April 2006, DC-SA entered into a consulting contract with Director. At that time, the relationship was not a prohibited business relationship; Director did not serve on the board of directors of, or otherwise in a decision-making capacity for, any DT-SA audit client. When, in 2007, Director joined the board of Company A, an SEC-registrant audit client of DT-SA – and notwithstanding Director's neither serving on Company A's audit committee nor interacting with DT-SA's audit team – Director's relationship with DC-SA thereby became a prohibited business relationship under Commission Rule 2-01 of Regulation S-X.[2] DT-SA did not have adequate controls in place to identify, and otherwise did not identify, the creation of the prohibited relationship. While the prohibited relationship was in place, DT-SA issued audit reports with respect to Company A, and DC-SA also renewed the contract with the Director. DC-SA did not identify the prohibited relationship until August 2008, whereupon DT-SA initiated a review of the matter that ultimately resulted in the termination of the relationship in October 2008 (but effective September 30, 2008).

As a result, DT-SA engaged in improper professional conduct, violated Rule 2-02(b) of Regulation S-X and caused its audit client Company A to file periodic reports with the Commission that failed to include independently audited financial statements as required by Exchange Act Section 13(a), Exchange Act Rule 13a-1, and Regulation S-X.

Respondent

1. DT-SA, a member firm of Deloitte Touche Tohmatsu Limited, is a registered public accounting firm headquartered in Johannesburg, South Africa. At all relevant times and continuing to the present, DT-SA has provided audit and other professional services to a variety of companies, including Company A, whose securities are registered with the Commission and trade in U.S. markets. DT-SA wholly owns DC-SA, which provides consulting services to various companies in South Africa.

Relevant Issuer

2. At all relevant times, Company A's ordinary shares were registered with the Commission pursuant to Section 12(b) of the Exchange Act, and its American

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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.

2 This Order makes no finding with respect to Company A's reported financial statements for any fiscal year in which the matter discussed herein occurred.

Depositary Shares were listed on the New York Stock Exchange. DT-SA served as Company A's auditor throughout the relevant period and continues to serve in that role.

The Director

3. Director was an independent consultant hired by DC-SA to assist its work in the energy industry. Director joined the Board of Directors of Company A on September 1, 2007, and Director remains in that position to this day.

Facts

A. The Relationship Between DT-SA And Director

4. DC-SA hired Director in April 2006 as an independent contractor with expertise in the energy industry. At that time, DC-SA performed a conflict and background check on Director. Director was not then on the board of directors of, and did not otherwise serve in a decision-making capacity for, any DT-SA audit client; thus, the check did not identify any conflict of interest or independence concern related to the Firm's relationship with Director. DC-SA renewed or extended Director's contract several times, but it did not conduct any further conflicts checks or inquire about Director's business relationships after Director's initial retention.

5. On September 1, 2007, Director was appointed to the Board of Directors of Company A, a Commission-registered audit client of DT-SA. DT-SA did not have adequate controls in place to identify, and otherwise did not identify, the creation of the prohibited relationship on a timely basis. DC-SA subsequently renewed Director's contract with the Firm, but, not having conducted any new conflicts checks, and in the absence of any identification of the relationship as potentially problematic by DC-SA personnel, did not recognize that Director's simultaneous work for DC-SA and service as a director of Company A would impair DT-SA's auditor independence with respect to Company A.

6. Director openly referred to Director's role on Company A's board in several communications with various DC-SA personnel, and several internal DC-SA communications among the consulting personnel also included references to Director's professional experience, including Director's service on Company A's Board of Directors. DC-SA's personnel, however, did not recognize their significance despite having been trained that the Firm's having a direct business relationship with an audit client director was inconsistent with auditor independence standards. Consequently, they did not recognize that Director's appointment to Company A's Board created an independence concern and thus did not consult with the audit team or with the Firm's independence personnel. As a result, and because they did not learn of it through inquiry, the Firm's controls, or otherwise, the members of the DT-SA audit team assigned to work on Company A's audits were not aware of Director's business relationship with DC-SA prior to the identification of the issue as described below.

B. Identification of Prohibited Relationship

7. On August 11, 2008, as a part of its ongoing independence education efforts, DT-SA's director of independence sent an e-mail to personnel at DT-SA and DC-SA notifying them of recently announced Commission enforcement actions in a case finding a direct business relationship between an auditor and an audit client director, and reminding them about business relationship requirements. In response to that e-mail, a DC-SA consultant identified the relationship with Director as raising a potential independence concern.

8. DT-SA initiated a review of the matter. As a result of its review of the relationship with Director, DT-SA terminated the relationship in October 2008 (but effective September 30, 2008).

9. DT-SA subsequently informed Company A's audit committee of the business relationship with Director.

Legal Analysis

A. Independence Principles Governing the Relationship between DT-SA and Director

10. The basic elements of an auditor independence violation in the business-relationship context are (1) an independence-impairing relationship; (2) existing during all or part of the period covered by the audit, or the period of the audit work, or both; followed by (3) issuance of an audit report asserting the auditor's independence from the client. *See* Rule 2-01(c)(3) of Regulation S-X.[3] Business relationships with persons associated with the audit client in a decision-making capacity, such as audit client directors, officers and substantial stockholders are embraced by this prohibition. *See* Rule 2-01(c)(3). Section 6.02.02.e of the Commission's Codification of Financial Reporting Policies ("Codification") (available at 7 Fed. Sec. L. Rep. (CCH) ¶ 73,272) provides, among other things, that:

> In addition to the relationships specifically prohibited by Rule 2-01, joint business ventures, limited partnership agreements, investments in supplier or customer companies, leasing interests (except for immaterial landlord-tenant relationships) and sales by the accountant of items other than professional services are examples of other connections which are also included within this classification.

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[3] Rule 2-01(c)(3) provides:

> An accountant is not independent if, at any point during the audit and professional engagement period, the accounting firm or any covered person in the firm has any direct or material indirect business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. The relationships described in this paragraph do not include a relationship in which the accounting firm or covered person in the firm provides professional services to an audit client or is a consumer in the ordinary course of business.

11. DT-SA's direct business relationship with Director falls within Reg. S-X's prohibition. Director served as an audit-client director while simultaneously serving as a paid consultant to DT-SA. Although Rule 2-01(c)(3) provides an exception for business relationships involving a consumer in the ordinary course of business, that exception has no application here where neither party was acting in the capacity of a consumer; a cooperative service arrangement like that presented here does not qualify for this exception.

B. Violation of Rule 2-02(b) of Regulation S-X and of Issuer Reporting Provisions

12. Because DT-SA's business relationship with Director impaired DT-SA's independence, it both constituted and caused certain statutory and regulatory violations. Each time DT-SA signed an audit report for Company A where either the period covered by the audit or the period of the audit work (or both) overlapped with DT-SA's business relationship with Director, DT-SA directly violated Rule 2-02(b) of Regulation S-X. *See* Rule 2-02(b) (requiring accountant's report to "state whether the audit was made in accordance with generally accepted auditing standards"). The DT-SA year-end audit reports for Company A's fiscal years ending in September 2007 and September 2008 each incorrectly stated that they were performed in accordance with the independence standards of GAAS reflected in Rule 2-02(b). Thus, DT-SA's failure to comply with Rule 2-02(b) of Regulation S-X caused its audit client Company A to file annual reports with the Commission that failed to include independently audited financial statements as required by Exchange Act Section 13(a) and Exchange Act Rule 13a-1. DT-SA is responsible for causing Company A's reporting violations with respect to annual reports filed in January 2008 and 2009, for the aforementioned fiscal years, because DT-SA should have known that the Firm's business relationship with Director would cause Company A to lack independence for the corresponding audits.

C. Improper Professional Conduct

13. DT-SA's failure to comply with Rule 2-01 of Regulation S-X described above also constitutes improper professional conduct under Exchange Act Section 4C and Rule 102(e)(1)(ii) of the Commission's Rules of Practice, which provides, in pertinent part, that the Commission may "censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it…to any person who is found…to have engaged in…improper professional conduct."

14. DT-SA's conduct constituted improper professional conduct on account of DC-SA's failure (a) at the point when Director joined the board of directors of Company A, to identify the independence-impairing relationship; (b) at the points at which Director's contract with DC-SA was renewed or extended, to perform any updated independence review or conflicts check; and (c) at the points at which various DC-SA personnel, who knew of Director's consulting relationship with the Firm, received communications explicitly identifying Director as a member of Company A's Board, to recognize that the Firm's continued employment of Director while Director

simultaneously served on Company A's Board interfered with DT-SA's obligation to maintain its independence as Company A's auditor.

DT-SA's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the Commission staff.

IV.

Based on the foregoing, the Commission finds that Respondent DT-SA (a) violated Rule 2-02(b) of Regulation S-X; (b) caused Company A to violate Exchange Act Section 13(a) and Exchange Act Rule 13a-1; and (c) engaged in improper professional conduct pursuant to Exchange Act Section 4C and Rule 102(e) of the Commission's Rules of Practice.

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

Accordingly, it is hereby ORDERED, effective immediately, that Respondent DT-SA is hereby censured.

IT IS FURTHER ORDERED that Respondent DT-SA shall, within ten (10) days of the entry of this Order, pay disgorgement of $200,000 and prejudgment interest of $47,043.66 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to Commission Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the Commission website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying DT-SA as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order, or documentation of whatever other form of payment is used, must be simultaneously sent to Brian M. Privor, Senior

Counsel, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5546.

IT IS FURTHER ORDERED, effectively immediately, that Respondent DT-SA shall cease and desist from committing or causing any violations and any future violations of Rule 2-02(b) of Regulation S-X, and from causing any violations and any future violations of Exchange Act Section 13(a) and Rule 13a-1 thereunder.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

Commissioner Aguilar
Commissioner Gallagher
not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 68431 / December 13, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 3427 / December 13, 2012

Admin. Proc. File No. 3-13797

In the Matter of the Application of

WENDY MCNEELEY, CPA
c/o Robert L. Michels, Esq.
Winston & Strawn LLP
35 Wacker Dr.
Chicago, IL 60601

OPINION OF THE COMMISSION

102(e) PROCEEDING

Grounds for Remedial Action

Improper Professional Conduct

Certified public accountant acting as audit manager engaged in improper professional conduct in the audit of the financial statements of a private company and a related fund. *Held*, it is in the public interest to deny the accountant the privilege of appearing or practicing before the Commission for six months.

APPEARANCES:

Robert L. Michels, Scott P. Glauberman, and *J. Malcolm Cox*, of Winston & Strawn LLP, for Wendy McNeeley.

Andrea Wood and *Robert Moye*, for the Division of Enforcement.

Appeal filed: February 11, 2011
Last brief received: May 2, 2011
Oral Argument: November 2, 2011

I.

Wendy McNeeley, a licensed certified public accountant and former audit manager at Ernst & Young ("E&Y"), appeals from the decision of an administrative law judge. The law judge found that McNeeley engaged in improper professional conduct as defined in the Commission's Rule of Practice 102(e)[1] while serving as the audit manager during E&Y's audit of AA Capital Partners, Inc. ("AA Capital"), a registered investment adviser, and AA Capital Equity Fund, L.P. (the "Equity Fund") for the year ended December 31, 2004. The law judge found that McNeeley's improper professional conduct was the result of a single instance of highly unreasonable conduct that resulted in a violation of generally accepted auditing standards ("GAAS") in circumstances in which McNeeley knew, or should have known, that heightened scrutiny was warranted.[2] The law judge determined that, because of this conduct, McNeeley should be denied the privilege of appearing or practicing as an accountant before the Commission for one year. We base our findings on an independent review of the record, except for findings that the parties do not challenge on appeal.

II.

A. AA Capital and its Affiliates

This matter involves McNeeley's audit of a series of transactions through which AA Capital transferred approximately $1.9 million from client trust accounts to its president and co-founder, John Orecchio, purportedly to pay a tax assessment by the Internal Revenue Service. At the time of the audit, AA Capital was headquartered in Chicago, Illinois, and co-owned, equally, by Orecchio and his business partner, Paul Oliver, Jr. In addition to being president, Orecchio served as AA Capital's director and secretary and exercised day-to-day management and control over AA Capital. Oliver served as AA Capital's chairman and treasurer. AA Capital's chief financial officer and chief compliance officer was Mary Beth Stevens, who was responsible for AA Capital's entire accounting function.[3]

AA Capital had several affiliated private equity funds into which AA Capital's clients invested money. The largest of these funds was the Equity Fund, which had approximately $131 million in assets under management as of December 31, 2004. The Equity Fund was governed by an Amended and Restated Limited Partnership Agreement (the "Partnership Agreement"), which gave the Equity Fund's general partner, AA Private Equity Investors Management, LLC

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1 17 C.F.R. § 201.102(e)(1)(ii).

2 GAAS are standards of conduct relating to how auditors should perform an audit. *See SEC v. Arthur Young & Co.*, 590 F.2d 785, 788 n.2, 789 n.4 (9th Cir. 1979). GAAS are generally described in the American Institute of Certified Public Accountants ("AICPA") Codification of Statements of Auditing Standards, hereinafter cited as "AU § __."

3 None of AA Capital's employees testified at the hearing.

("AA Investors Management LLC"), control over the Equity Fund. Orecchio and Oliver each owned twenty percent of the general partner. The Equity Fund's limited partners were three pension funds, which had their investment commitments deposited into separate bank trust accounts ("Investor Trust Accounts") in the name of each investor. The Equity Fund could call capital from the Investor Trust Accounts for three primary purposes: (i) to make investments; (ii) to pay management fees; or (iii) to pay overhead expenses.

B. E&Y's Audits

E&Y became AA Capital's auditors in 2002, but in 2004, became concerned about whether it had the resources to staff those engagements. This concern caused some delay, but E&Y eventually agreed to audit AA Capital and its affiliated funds for the fiscal years ended December 31, 2003 and 2004. Because of the delay, however, E&Y had to conduct the 2003 and 2004 audits concurrently. AA Capital also requested a June 30, 2005 deadline so that investors would have the financial statements necessary to complete their tax filings. The deadline required E&Y to conduct ten audits simultaneously by June 30, 2005.

E&Y began the audits during the spring and early summer of 2005 and assigned McNeeley as audit manager. The audit team also included an independent review partner, John Kavanaugh; an engagement partner, Gerard Oprins; two audit seniors; and two audit staff. McNeeley was twenty-nine-years old at the time and had been licensed as a certified public accountant for approximately eight years. As audit manager, McNeeley reported to the engagement partner, Oprins, but McNeeley was responsible for overseeing day-to-day audit planning and executing audit strategy. McNeeley also supervised the audit staff and reviewed audit workpapers in significant risk areas.

As part of the planning process, E&Y's audit team determined not to rely on AA Capital's internal controls because E&Y determined those controls to be "ineffective" for purposes of E&Y's audit. McNeeley explained that this determination was primarily due "to the lack of sophistication with the client's accounting function and that they kept all their books and records in Excel format." This determination meant that E&Y's audit would need to test all account balances substantively and verify (or "vouch") all capital calls and distributions.

McNeeley also expressed concern early in the audit process about meeting the June 30 deadline because of staffing constraints, another audit engagement McNeeley was conducting by herself, and a two-week vacation McNeeley intended to take (and did take) starting May 20, 2005. McNeeley, for instance, wrote in an e-mail to Oprins in May 2005 that she was "very concerned about the wrap up of this engagement." In a subsequent email in June 2005, McNeeley again wrote "to convey that the June 30th deadline will be challenging to meet," but added that she believed "that we will be able to meet the June 30 deadline" and "just wanted to prepare Mary Beth [Stevens]" for the fact "that things may be pulled together at the last minute."

C. Discovery of Orecchio's Purported Tax Loans

Sometime during the audit, the E&Y team noticed that AA Capital's accounts receivable schedule (the "Receivable Schedule")[4] listed four cash transfers to Orecchio (collectively, the "Transfers"). The Receivable Schedule described the transfers as "John – tax payment" and totaled approximately $1.92 million. The Transfers were spread over approximately six months, at uneven intervals, in varying amounts, and with slightly different structures:

- On May 19, 2004, $987,000 was transferred from two Investor Trust Accounts to AA Capital's primary bank account. The same day, $602,150 was transferred from AA Capital's primary bank account to Orecchio's personal bank account.

- On August 2, 2004, $190,000 was transferred from three Investor Trust Accounts to AA Capital's primary bank account. The same day, $190,154 was transferred from AA Capital's primary bank account to Orecchio's personal bank account.

- On September 20, 2004, $600,000 was transferred from three Investor Trust Accounts to AA Capital's primary bank account. The same day, $579,000 was transferred from AA Capital's primary bank account to Orecchio's personal bank account.

- On November 5, 2004, $550,000 was transferred from three Investor Trust Accounts to the Equity Fund's bank account. The same day, $550,000 was transferred from the Equity Fund's bank account to Orecchio's personal bank account.[5]

On or around May 7, 2005, an E&Y audit staff member, Corina Rojas, had a conversation with Stevens about the Transfers. Rojas documented the conversation with a note on the Receivable Schedule:

> Per conversation w/ Mary Beth Stevens, CFO, all of the funds held under AA Capital Inc. had not finalized their audits, tax filings, and therefore John Orrechio [sic], (managing member) did not have a final tax return draft that included taxable income w/ set figures. Therefore he had to estimate his tax liability [and] made a payment to the IRS for 1,921,150 . . . . The 1,921,150 is essentially a loan made to John Orrechio [sic]. Mary Beth Stevens expects to receive payment from either Mr. Orrechio [sic] or the IRS after taxes are finalized.

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4 McNeeley explained that the Receivable Schedule was prepared by Stevens and contained a list "of disbursements from the entity and gives further detail and break out of what those amounts related to."

5 The parties stipulated to these details, although an e-mail dated June 16, 2005, from Stevens to McNeeley, described the Transfers in slightly different amounts: $596,129 (May 19, 2004); $188,100 (August 2, 2004); $573,210 (September 20, 2004); and $544,500 (November 5, 2004).

Rojas, who did not testify, further noted on the Receivable Schedule that Orecchio's co-owner, Oliver, had also received a tax advance – for $18,228.

D. McNeeley's Audit Steps Regarding the Transfers

McNeeley testified that, "at some point," she saw the Receivable Schedule listing the four transfers to Orecchio. She could not remember, however, precisely when she first learned of the Transfers, explaining that "it is hard for me to remember exactly when I learned things throughout the audit." McNeeley recalled meeting with Stevens to discuss the Receivable Schedule, but could not recall when that meeting occurred. McNeeley remembered asking Stevens during their meeting to provide "any and all documentation that she had regarding the tax advances." According to McNeeley, Stevens responded to the request for documents by directing McNeeley to the tax advance amounts listed in the Receivable Schedule. McNeeley added that she and the audit team "also had other documentation that we had previously been provided that also reflected and supported [the Transfers]."

The first document was a general ledger. McNeeley explained that the ledger was a document prepared by Stevens reflecting "all transactions going through the company for a set period of time." The ledger showed the detail of the individual purported tax payments, dollar amounts, and dates paid.

The second document was a management representation letter (which was actually two documents: one each for AA Capital and the Equity Fund). The letters were signed by Stevens and Orecchio and represented to E&Y that AA Capital's and the Equity Fund's accounting records were complete and accurately reflected all transactions. The management letter for the Equity Fund included a general representation that all related-party transactions were properly recorded or disclosed in the financial statements. Neither management representation letter, however, explicitly mentioned the Transfers.

The third document was the Partnership Agreement, which allowed tax-related transfers in certain situations. Section 7.3.1 of the agreement provided that "if net income of the [Equity Fund] is allocated to [its] Partners in any fiscal year," then the Equity Fund could make "tax distributions" to satisfy any tax liability such partner "would actually have incurred."[6] Here, however, the Equity Fund had a net investment loss in both 2003 and 2004, and neither of the other two parties involved in the Transfers (Orecchio and AA Capital) were partners in the Equity Fund.

McNeeley testified that she "read through" the Partnership Agreement at the beginning of the audit and "gained an understanding of all the significant provisions within the limited partnership agreement." She could not recall, however, whether she reviewed the Partnership Agreement when evaluating the Transfers. As she explained, "I don't have a specific recollection of looking at [the Partnership Agreement] while . . . looking at the accounts receivable schedule,

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6 The Partnership Agreement's Section 7.3.3, which was subject to Section 7.3.1, similarly provided for advances to partners to satisfy estimated taxes.

but I had previously looked at the [Partnership Agreement] at the beginning of field work and had an understanding of the provision allowed for in the agreement."

When asked during the hearing, McNeeley also testified that she and the audit team never sought nor received any third-party confirmation regarding the Transfers, such as documentation from the IRS evidencing a tax liability assessment. McNeeley also could not remember whether she ever asked about Orecchio's ability to repay the Transfers. As McNeeley explained, "we had no reason to question the collectibility of the receivable from John Orecchio to AA Capital Partners. We understand him to be a successful wealthy business man. He had capital in the [E]quity [F]und as well as investments and various other funds." McNeeley added, "Based on my recollection of the transaction, we understood it to be an erroneous tax liability that had been assessed to John Orecchio; and therefore, he anticipated settlement with the IRS and was going to use that to repay it."

McNeeley also could not recall contacting the E&Y tax department for any reason. E&Y's tax department prepared AA Capital's tax returns at the time of the audits and, therefore, likely could have confirmed whether AA Capital had reported income in 2003 or 2004 on which Orecchio would owe taxes. McNeeley testified, however, that she "d[id]n't know why I would go and inquire [of] the E&Y tax team . . . when the tax liability that John Orrechio [sic] received advances for related to his personal tax return . . . and our tax department wouldn't have all the information necessary to make the evaluation of his personal tax position."

McNeeley testified at various points during the hearing that she was comforted by her understanding that Oliver and Orecchio "would have full knowledge about each other's tax advances." McNeeley could not recall, however, ever confirming whether Oliver actually knew about the Transfers. In fact, McNeeley could not recall whether she or any other member of the audit team ever spoke with Orecchio or Oliver about any aspect of the Transfers. McNeeley instead testified that she "understood" that the two partners "would have full knowledge of each other's tax advances" and that she based this understanding "on Paul Oliver being the treasurer of the company and having full access to the records." McNeeley later added that Oliver "had the opportunity to become aware of such transaction and had a fiduciary . . . obligation as a co-owner of AA Capital Partners to be aware of all the transaction [sic] and ongoing of the business [sic]."

Near the end of the audit, McNeeley went on vacation for approximately two weeks, beginning May 20, 2005. After her return, McNeeley e-mailed Stevens "to get clarification as to exactly what the tax liability related to." In her initial email, sent June 7, 2011, McNeeley expressed confusion to Stevens about who owed the tax liability and whether any payment had been made. McNeeley, for example, asked Stevens to clarify that accruals "labeled as 'John's Tax Payment' . . . are accruals for the Corporation's tax payments and not personal tax liabilities of the Shareholders." McNeeley also asked "when are the actual payments expected to be made[?]"

Stevens responded that Orecchio had been "dinged by the IRS and incurred multiple fees and tax payments." Stevens added that most of the supposed tax assessment amounts were not correct, but could not be settled with the IRS until the audit and tax work were completed.

Stevens explained, "Payments for which [Orecchio] is truly liable for he will pay and a majority, if not all, will be refunded back to him which he will then repay the company."

McNeeley expressed continued confusion in a follow-up email about what she described as "these hefty tax assessments." McNeeley wrote to Stevens that "it's my understanding that no money has actually been paid from or received by AA Capital in relation to the payment of John [Orecchio]'s taxes," and asked "if it is proper to present a liability on the books of AA Capital for which AA Capital does not currently have obligation to pay." Stevens wrote back to clarify that AA Capital was owed an accounts receivable from Orecchio and, in turn, AA Capital owed an accounts payable to the Equity Fund.

On the same day as her email exchange with Stevens, McNeeley documented her understanding of the Transfers with a note in the workpapers:

> [T]he Equity fund made approx. [$]1,921,304 of tax payments for John Orrechio [sic] during 2004. [T]he Equity fund has set up a receivable from AA Capital Partners for reimbursement of this amt. E&Y verified that AA Cptl Ptnrs has a reciprocal payable balance to Equity. E&Y also noted that AA Cptl has an offsetting receivable balance from John Orrechio [sic]. Appears proper.

Oprins testified that he saw McNeeley's note, but he could not recall "one way or the other" whether McNeeley ever discussed the Transfers with him. Oprins could recall only that McNeeley kept him informed about what was happening during the audits, but not the specific audit steps taken regarding the Transfers or whether he had discussed the Transfers with the audit team.

E. E&Y's Subsequent Review Testing

As part of the 2004 audit, the E&Y audit team conducted "subsequent review testing" of transactions that occurred after the 2004 year end. E&Y's workpapers showed that the audit team looked at AA Capital's cash receipt and disbursement records for "significant" or "unusual" items that may have occurred between January 1, 2005 and March 31, 2005. McNeeley wrote in the workpapers that "no unusual items" were uncovered during this subsequent review.

AA Capital's 2005 accounts receivable schedule, however, showed that AA Capital made nine more disbursements to Orecchio in January and February 2005, totaling $482,000. The 2005 accounts receivable schedule described these transfers as "J.O. taxes," "JO Tax Distrib," or "JO Tax Dist." The record is not clear, however, whether McNeeley saw these subsequent transfers. The only document in the record that lists the subsequent transfers is the 2005 accounts receivable schedule. That document, however, includes entries dated as late as December 31, 2005 and therefore could not have existed at the time McNeeley was completing the audit in June 2005.

F. The 2004 Financial Statement

E&Y completed the audits by the end of June 2005 and issued unqualified audit opinions for AA Capital's and the Equity Fund's 2004 financial statements. E&Y's audit opinion represented that E&Y had conducted its audit in accordance with GAAS and that the audit provided a reasonable basis for E&Y's opinion that AA Capital's and the Equity Fund's financial statements fairly presented the firms' financial positions, results of operations, and cash flows.[7]

The audited financial statements provided no specifics about the $1.92 million tax advance to Orecchio. Instead, AA Capital's 2004 financial statements disclosed only that the company had $2.534 million in "[f]ee and accounts payable" and $2.251 million in "[a]ccounts receivable from affiliates." The notes to AA Capital's financial statements also provided no mention of transfers to Orecchio. The notes instead discussed only that the company had paid $264,176 in "certain reimbursable expenses" for several of AA Capital's related funds. The Equity Fund's financial statements similarly listed a $1.92 million "[a]ccounts receivable from AA Capital Partners, Inc.," with no other details such as the terms or manner of settlement.

E&Y's internal GAAP Disclosure Checklist stated that "[n]otes or accounts receivable from officers, employees or affiliated companies must be shown separately and not included under a general heading such as notes or accounts receivable." In response to this item, McNeeley checked a box indicating "not applicable." McNeeley explained that she checked "not applicable" because she believed the requirement was limited to making sure that "accounts receivable with related parties is not grouped in with other accounts receivables from trade creditors and that was not the case in either one of these financial statements."

G. Discovery of Orecchio's Fraud

AA Capital engaged E&Y to audit the company and its related funds again the following year, 2005. Jennifer Aquino replaced McNeeley as the audit manager because McNeeley was on maternity leave. Most of the 2005 E&Y audit team otherwise remained the same.

During the 2005 audit, Aquino asked Stevens for documentation supporting the tax transfers to Orecchio, but never received anything in return. Aquino testified that the E&Y audit team had several internal meetings regarding the transfers and sent Orecchio an e-mail, but the record provides no indication that Orecchio ever responded. Those steps, Aquino recalled, were

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[7] The audit opinion for AA Capital's financial statements included a disclaimer that AA Capital's policy was to prepare its financial statements on a tax basis of accounting. The financial statements, the audit opinion explained, were not intended to be presentations in conformity with generally accepted accounting principals ("GAAP"). Despite this disclaimer, Oprins and McNeeley both acknowledged that GAAP disclosure requirements for related-party transactions were the same no matter whether the financial statements were tax-based or GAAP-based. The audit opinion for the Equity Fund's financial statements did not include a tax basis disclaimer.

"the best that we felt we could do at that time." She explained that, because the audit team "didn't have anything to audit," they could only wait to receive something more from AA Capital. Aquino also learned during the audit that, by the end of 2005, the tax transfers to Orecchio had grown to $5.7 million. As McNeeley's expert witness testified, AA Capital's financial statements expressly identified the Transfers as "accounts receivables," which indicated that the Transfers were short-term advances repayable within one year. Aquino, therefore, found it significant that the 2004 transfers not only still existed on AA Capital's books in 2005, but had, in fact, increased.

The audit team eventually decided that they would not continue with the 2005 audit until Orecchio paid back the "tax loan" and E&Y had received enough documentation to audit the transfer balance. On June 30, 2006, Oprins informed Stevens and Orecchio that E&Y would not release its 2005 audit opinions until Orecchio repaid the transfers. The E&Y audit team also raised a "going concern" issue regarding AA Capital's ability to fund its operations. The audit team was unable to resolve these issues, and E&Y never issued its 2005 audit reports.

In August 2006, the Commission conducted a "for cause" on-site examination of AA Capital to investigate a tip from the U.S. Department of Labor about a kickback scheme. During the examination, Commission staff learned that Orecchio had misappropriated approximately $5 million through a fraudulent tax-loan mechanism. In September 2006, the Commission filed a complaint in U.S. District Court against AA Capital and Orecchio. The complaint alleged that AA Capital and Orecchio misappropriated at least $10.7 million from AA Capital's advisory clients, and the U.S. District Court placed a receiver over AA Capital.[8] The U.S. Department of Justice subsequently brought criminal charges against Orecchio in 2009 for wire fraud and theft of funds from an employee benefit plan. Orecchio pleaded guilty in February 2010, and a U.S. District Court sentenced Orecchio to more than nine years in prison.[9] The Commission also instituted administrative proceedings against Stevens and Oliver for their involvement in the fraud. Stevens and Oliver eventually consented to, among other things, a bar and twelve-month suspension, respectively; civil penalties; and a cease-and-desist order.[10]

H. Rule 102(e) Administrative Proceeding

In March 2010, the Commission issued an Order Instituting Proceedings ("OIP") against McNeeley and her supervisor, Gerard Oprins, in connection with their audit of AA Capital. The OIP charged McNeeley and Oprins with engaging in improper professional conduct as defined in Rule 102(e) "in that their conduct constituted (A) intentional or knowing conduct, including

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[8] *SEC v. AA Capital Partners, Inc.*, No. 06-C-4859 (N.D. Ill. Sept. 8, 2006).

[9] *United States v. Orecchio*, No. 09-CR-622 (N.D. Ill. 2010).

[10] *Mary Beth Stevens*, Investment Advisers Act Rel. No. 2973 (Jan. 5, 2010), 97 SEC Docket 24420; *Paul W. Oliver, Jr.*, Advisers Act Rel. No. 2903 (July 17, 2009), 96 SEC Docket 19124.

reckless conduct, that resulted in a violation of the applicable professional standards, or in the alternative, (B) negligent conduct, consisting of a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Respondents knew, or should have known, that heightened scrutiny was warranted." After an eight-day hearing, an administrative law judge issued an initial decision finding that McNeeley's actions did not constitute reckless conduct, but did constitute highly unreasonable conduct in circumstances warranting heightened scrutiny that resulted in a violation of the applicable professional standards. The law judge found that Oprins also violated the applicable professional standards, but that his actions were neither reckless nor highly unreasonable. McNeeley appeals the law judge's decision.[11]

III.

Rule of Practice 102(e) permits us to censure or deny (either permanently or temporarily) the privilege of appearing or practicing before the Commission to persons found to have engaged in improper professional conduct. The rule defines three classes of "improper professional conduct" for accountants, but this appeal concerns only one: whether McNeeley engaged in "a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted."[12] We find, for the reasons below, that McNeeley engaged in such improper professional conduct.

A. Heightened Scrutiny Was Warranted

Our Rule 102(e) analysis first considers whether the Transfers warranted heightened scrutiny. Under Rule 102(e), "heightened scrutiny" is warranted "when matters are important or material, or when warning signals or other factors should alert an accountant" to a heightened risk.[13] These factors were clearly present here.

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[11] Because the law judge's decision regarding Oprins was not appealed, the only issue before us on appeal is whether McNeeley engaged in improper professional conduct. *See Gerard A.M. Oprins, CPA*, Securities Exchange Act Rel. No. 63931 (Feb. 18, 2011) (giving notice, "pursuant to Rule 360(d) of the Commission's Rules of Practice, that the initial decision of the administrative law judge has become the final decision of the Commission with respect to Gerard A.M. Oprins").

[12] 17 C.F.R. § 201.102(e)(1)(iv)(B)(*1*). The other two classes of improper professional conduct are "intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards;" and "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." 17 C.F.R. § 201.102(e)(1)(iv)(A), (e)(1)(iv)(B)(*2*).

[13] *Amendment to Rule 102(e) of the Commission's Rules of Practice* ("*Amendment to Rule 102(e)*"), 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998).

First, the Transfers were related-party transactions, which we and the courts have repeatedly held require heightened scrutiny.[14] The reason for this, the D.C. Circuit has explained, "is apparent: Although in an ordinary arms-length transaction, one may assume that parties will act in their own economic self-interest, this assumption breaks down when the parties are related. A company that would perform a thorough credit-risk assessment before extending a loan might not do so if the loan were to one of its officers or directors."[15] That is the case here. AA Capital essentially extended a loan from clients' trust accounts to Orecchio, who was not only an officer and director of AA Capital, but also a founder and co-owner. Transactions involving such strong related-party relationships, the D.C. Circuit has explained, alert auditors that a firm may not have thoroughly vetted those transactions and that, as a result, heightened scrutiny is needed – exactly the case that faced McNeeley.[16]

Second, the Transfers were plainly material, which we have also stated triggers heightened scrutiny.[17] McNeeley counters that materiality "is irrelevant" because, she contends, auditors are concerned only with material transactions. She claims that to hold that materiality warrants heightened scrutiny would therefore mean that every transaction would warrant heightened scrutiny. She argues that multi-million dollar tax liabilities are not unusual for private equity firm partners and do not necessarily require heightened scrutiny. Even if we accepted this latter proposition regarding the absolute amount of the tax liabilities, the Transfers here were more than 100 times greater than a transfer to Orecchio's equal partner in a year in which the Equity Fund had no net income.[18] Even McNeeley described the $1.9 million transfers combination warrants heightened scrutiny.[19]

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[14] *McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005) (citing *Howard v. SEC*, 376 F.3d 1136, 1149 (D.C. Cir. 2004)) (noting that related-party transactions "are viewed with extreme skepticism in all areas of finance"), *aff'g James Thomas McCurdy, CPA*, 57 S.E.C. 277 (2004); *see also Gordon v. Comm'r*, 85 T.C. 309, 326-27 (1985) (explaining "heightened" skepticism for related-party transactions); AU § 334 (recognizing need for care in the examination of material related-party transactions).

[15] *McCurdy*, 396 F.3d at 1261.

[16] *McCurdy*, 396 F.3d at 1264 ("The related-party interest underlying the transaction was not minor: Bagwell was the founder and CEO of the fund, a trustee, and its investment advisor.").

[17] *Amendment to Rule 102(e)*, 63 Fed. Reg. at 57,168 (stating that heightened scrutiny is warranted "when matters are important or material").

[18] *Cf. McCurdy*, 396 F.3d at 1264 (affirming Commission's finding of recklessness where auditor failed to investigate adequately a related-party receivable that "was nearly ten times the amount of the GAAS-dictated materiality threshold").

[19] *See McCurdy*, 57 S.E.C. at 295 (finding heightened scrutiny to be warranted where, among other things, the receivable at issue "arose from a related party transaction" and

(continued...)

Finally, McNeeley argues that the material, related-party nature of the Transfers cannot provide a basis for finding that the Transfers warranted heightened scrutiny because, she claims, the Division failed to make such allegations in the OIP. To the contrary, however, the OIP expressly alleged that "McNeeley identified Orecchio's 'tax loan' as a related party transaction, [but] failed to apply heightened scrutiny or perform any additional audit steps to evaluate it." Moreover, the standard for determining whether notice is adequate is whether "the respondent 'understood the issue' and 'was afforded full opportunity' to justify [her] conduct during the course of the litigation."[20] We find that McNeeley, who has been represented by counsel throughout these proceedings, adequately understood the allegation that the Transfers warranted heightened scrutiny because of their material, related-party nature and that she had ample opportunity to defend herself against those allegations.

B. McNeeley Violated Applicable Professional Standards

Our analysis of whether McNeeley engaged in improper professional conduct next addresses whether McNeeley violated applicable professional standards. Here, we find that McNeeley violated three professional standards: (i) exercising due professional care, (ii) obtaining sufficient competent evidence, and (iii) rendering an accurate audit report.[21]

1. Failure to Exercise Due Professional Care

GAAS require auditors to exercise due professional care when conducting an audit and preparing a report.[22] Under this standard, auditors must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence."[23] Until an auditor obtains an understanding of the business purpose of material related-party

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19 (...continued)
was "clearly material"); AU § 334.07 ("The auditor should place emphasis on testing material transactions with parties he knows are related to the reporting entity."); *cf. McCurdy*, 396 F.3d at 1263-64 (finding that auditor's failure to investigate material, related-party transaction was reckless under Rule 102(e)).

20 *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979).

21 AU § 230.01 (professional care); AU § 326.22 (sufficient competent evidential matter); AU § 508.07 (accurate audit report).

22 AU § 230.01 ("Due professional care is to be exercised in the planning and performance of the audit and the preparation of the report.").

23 AU § 230.07; *see also* AU § 230.08 ("[P]rofessional skepticism should be exercised throughout the audit process."); AU § 330.15 (requiring auditors to exercise an appropriate level of professional skepticism in designing and conducting the confirmation process).

transactions, her audit is not complete.[24] Here, numerous red flags and other irregularities surrounded the Transfers – anomalies that should have triggered McNeeley's professional skepticism and led her to investigate further at that point. Instead, McNeeley did essentially nothing, and an unqualified audit opinion was eventually issued. As explained below, this failure to investigate fell well below the necessary level of professional care.

The first, and most glaring, red flag that McNeeley failed to investigate properly involved the Equity Fund's Partnership Agreement. That agreement contemplated tax-related transfers only for partners of the Equity Fund. Neither Orecchio nor AA Capital, however, was a partner in the fund. The Partnership Agreement also contemplated tax-related transfers only for years in which the fund allocated net income to such partners. The Equity Fund, however, had a net investment *loss* in both 2003 and 2004.

Even a relatively casual understanding of the Partnership Agreement, therefore, should have, at a minimum, alerted McNeeley that the agreement's terms did not accord with what she knew about the Transfers. As an auditor, McNeeley was responsible for reconciling these discrepancies, and verifying that the Equity Fund's governing documents allowed the Transfers was perhaps the most basic auditing step McNeeley could have taken. The workpapers, however, contain no indication that she made any effort to square the Partnership Agreement with the Transfers, and McNeeley herself testified that she could not remember whether she reviewed the Partnership Agreement subsequent to learning of the Transfers. Instead, McNeeley claims only that "she was familiar with private equity partnership agreements and the typical provisions within such agreements, and based on her review of the Partnership Agreement at the outset of the audit, she understood its provisions." Given the centrality of the Partnership Agreement in determining the permissibility and appropriate reporting of the Transfers, it was incumbent upon McNeeley to have a better understanding of the Partnership Agreement than she did. The lack of evidence that McNeeley performed any follow-up regarding the Partnership Agreement leads us to one of two conclusions: either McNeeley did not review the agreement sufficiently to notice and understand the obvious red flags or she noticed the red flags, but did nothing about them. Either is a failure to exercise due care.

In her appeal, McNeeley disputes that the Partnership Agreement contained any red flags, because, she claims, the agreement in fact allowed for tax distributions and advances. McNeeley does not explain, however, how the agreement actually allowed for the Transfers, other than to point to what she calls the "common sense" argument that the "very reason that Mr. Orecchio chose to disguise his misappropriations as a tax advance was that the Partnership Agreement clearly allows for tax advances under the circumstances here. If it had not, he would not have used the Partnership Agreement to justify withdrawing the money." McNeeley's generic, unsupported, after-the-fact assertion that the Partnership Agreement allowed for tax distributions and advances in certain situations – situations that, on their face, did not apply here – is not a foundation on which one may properly base an audit. Moreover, McNeeley's contention that it is "common sense" that a fraudster's cover-up would conform to the governing documents is contradicted here by the audit evidence of the Partnership Agreement's provisions, and underscores how little attention she paid to that evidence.

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24 AU § 334.09(a).

The inconsistencies between the Transfers and the Partnership Agreement were not the only red flags that McNeeley failed to investigate. Stevens gave McNeeley and her audit team inconsistent explanations for why Orecchio needed the Transfers. The first explanation Stevens gave was that Orecchio needed the Transfers because he "did not have a final tax return draft [and] [t]herefore he had to estimate his tax liability and make a payment to the IRS." This explanation suggests that Orecchio's alleged tax liability was based on his own estimate. Later, however, Stevens told McNeeley that Orecchio had been "dinged by the IRS and incurred multiple fees and tax payments." This explanation suggests that Orecchio's alleged tax liability was based on an IRS calculation (which Orecchio believed was incorrect).[25] The record again contains no evidence that McNeeley exercised appropriate care by attempting to reconcile these inconsistencies.

McNeeley defends her failure to investigate by arguing that Stevens's explanations were not, in fact, inconsistent. As McNeeley testified, she understood the Transfers to be "a tax assessment that was assessed to Mr. Orrechio [sic] based on his estimated taxes[, which] he believed . . . was erroneous in nature because it was not based on final numbers." McNeeley, however, points to no evidence supporting this after-the-fact rationalization that Orecchio had incurred some sort of estimated, erroneous taxes. To the contrary, McNeeley's convoluted explanation of the situation raises its own set of questions.[26] How, for example, did Orecchio estimate a nearly $2 million tax liability for a year in which the Equity Fund had no net investment income? How did Orecchio's erroneous tax estimate, which the workpapers indicated was related to a failure by "all of the funds held under AA Capital" to finalize their audits and tax filings, explain why Orecchio withdrew money from only the Equity Fund? How does an erroneous tax assessment explain why the Transfers, even when taken out of the Equity Fund, were not always drawn from the same client trust accounts? How does an erroneous tax assessment explain why the Transfers took place on multiple dates, at uneven intervals, and in varying amounts? Again, the record contains no indication that McNeeley explored these questions. Instead, McNeeley simply accepted management's explanations at face value.

An additional, obvious question would have been how not having "final numbers" led Orecchio to estimate taxes that were more than 100 times larger than what his equal partner Oliver paid. McNeeley argues that Orecchio's disproportionately large tax liability was not suspicious because she was told that his tax liability was the result of an erroneous assessment that McNeeley contends "would not bear any relation to the amount of a correct tax liability or the amount of someone else's correct tax liability." In support, McNeeley points to an E&Y tax partner's testimony in which he theorized that the IRS could make any variety of mistakes that could result in large tax discrepancies, such as entering incorrect numbers on one's tax files. This

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25 In yet a third explanation, a managing director at AA Capital told Oprins that AA Capital's partners "were incurring substantial interest and penalties as a result of late filings of tax returns." The record does not indicate that McNeeley was aware of this explanation.

26 *Cf. Michael J. Marrie, CPA*, 56 S.E.C. 760, 784 (2003) (rejecting "an after-the-fact justification for [respondents'] failure to exercise the required degree of professional care"), *rev'd on other grounds*, 374 F.3d 1196 (D.C. Cir. 2004).

hypothetical example, however, is inconsistent with the reason for the Transfers that McNeeley was initially given: that someone erroneously estimated Orecchio's taxes because of not having final tax information. McNeeley's explanation for her lack of suspicion about Orecchio's disproportionate tax liability thus highlights the difference between the two explanations she was given. The record contains no evidence that McNeeley ever investigated the reasons for these differing explanations.

The record also contains no evidence that McNeeley ever attempted to verify Orecchio's ability to repay the tax advance. McNeeley testified only that she could not recall whether she inquired into Orecchio's ability to pay, and added that "we had no reason to question the collectibility [because] [w]e understood him to be a successful wealthy businessman who had capital in AA Capital Partners, Inc. plus investments in various other funds." McNeeley's assumption about Orecchio, however, again lacked support. The workpapers contained no evidence that McNeeley inquired into Orecchio's overall financial condition. What were these "various other funds" worth? Were these investments liquid enough to satisfy the amount of the short-term loans? What were his liabilities? Were his assets encumbered by any debt? Did Orecchio have sufficient liquid assets to repay the loan in a time period consistent with the loan being classified as a short-term receivable? The workpapers contain no evidence that McNeeley ever investigated these questions.[27] Stevens also told McNeeley that the IRS was likely to reimburse Orecchio for the supposedly erroneous tax payments, but the workpapers contain no evidence supporting that claim either.

Ultimately, because McNeeley never investigated, let alone reconciled, these various inconsistencies, McNeeley's various hypothetical explanations for the Transfers remained just that: hypotheticals. Pursuant to GAAS, however, "[i]f a representation made by management is contradicted by other audit evidence," an auditor may not simply hypothesize, but "should investigate the circumstances, and consider the reliability of the representation made."[28] That was repeatedly the case here. But instead of investigating, McNeeley did essentially nothing.[29]

McNeeley contends that any follow-up regarding the Transfers would have been futile because, she claims, individuals at AA Capital were engaged in collusive fraud. In support, she notes that Orecchio had forged two IRS notices that she claims show that "AA Capital's

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[27] *Cf. Gregory M. Dearlove, CPA*, Exchange Act Rel. No. 57244 (Jan. 31, 2008), 92 SEC Docket 1867, 1887 (rejecting auditor's reliance on family's ability to repay loan where auditor did not determine whether family's assets were encumbered by other debts and auditor "saw no financial statements or other proof of the family's financial condition other than local media reports that the [family members] 'were billionaires'"), *petition denied*, 573 F.3d 801 (D.C. Cir. 2009).

[28] AU § 333.04.

[29] Our identification of examples of steps that McNeeley could have taken, but did not, is not intended to imply that she necessarily was required to take all of these steps to fulfill her professional duties. Rather, faced with multiple red flags, McNeeley had an obligation to investigate more than she did.

management had plainly prepared a series of false documents to dole out to the auditors as necessary." She acknowledges that the record contains no evidence that the audit team ever saw the notices, but hypothesizes that "[m]ore demands [from McNeeley] would have been met with more false documents." Individuals at AA Capital were indisputably engaged in fraud, and E&Y's auditors were plainly not receiving accurate information about the Transfers. It is thus possible that, no matter the steps McNeeley took, individuals at AA Capital would have continued to hide the Transfers' true nature. The gravamen of the charge against McNeeley, however, is not her failure to uncover the fraud itself, but her failure to adhere to GAAS during the audit. An auditor, we have explained, "is not a guarantor of the accuracy of financial statements of public companies, but the Commission and the investing public rely heavily on auditors to perform their tasks in auditing public companies 'diligently and with a reasonable degree of competence.'"[30] Therefore, although "[w]e do not know whether [the] fraud would have been uncovered had [McNeeley] fulfilled [her] professional duties in conducting the audit, . . . that is not relevant to our inquiry."[31]

McNeeley also defends her conduct by challenging whether the Division met its burden of proving that McNeeley, in fact, failed to take the various follow-up auditing steps described above (such as reviewing the Partnership Agreement a second time in connection with the Transfers or verifying Orecchio's tax liability). McNeeley asserts that the only evidence against her is her own failure to remember whether she took the steps described above and the workpapers' failure to mention whether she took such steps. She claims that the Division, by relying on such evidence, is essentially faulting her for not memorializing "every fact gathered, conversation held, or procedure performed in the course of an audit."[32] McNeeley's argument, however, misconstrues her auditing responsibilities and the Division's case against her. Understanding the red flags described above was crucial to understanding, and approving the accounting treatment of, the underlying Transfers. As we have stated before, "[w]e consider the absence of work papers to be evidence that the audit team did not devote substantial, if any,

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30 *See Marrie*, 56 S.E.C. at 795 (quoting *Touche Ross & Co. v. SEC*, 609 F.2d 570, 581 (2d Cir. 1979)).

31 *See Marrie*, 56 S.E.C. at 794-95; *see also Michael S. Hope, CPA*, 49 S.E.C. 568, 606 (1986) (noting that the Commission has repeatedly held that "being lied to" is not an automatic defense to charges of improper professional conduct); *Touche Ross & Co.*, 45 S.E.C. 469, 469 (1974) (finding that "deception . . . did not relieve Touche of its responsibility to perform its audits in conformity with generally accepted auditing standards").

32 McNeeley frames this argument as an error by the law judge to apply the proper burden of proof. McNeeley, in fact, frames much of her appeal in terms of errors by the law judge. Our *de novo* review, however, cures any error that the law judge may have made. *See Robert M. Fuller*, 56 S.E.C. 976, 989 n.30 (2003), *petition denied*, 95 F. App'x 361 (D.C. Cir. 2004). The law judge's opinion thus ceased to have any force or effect once McNeeley filed her petition for review. *See Fundamental Portfolio Advisers, Inc.*, 56 S.E.C. 651, 679 n.44 (2003); 17 C.F.R. § 201.360(d), (e).

effort to review the areas in question."[33] And here, McNeeley does not dispute that the workpapers do not explain, or even mention, the red flags described above or that the workpapers fail to document any steps she may have taken toward understanding or reconciling the red flags.

In the end, despite a variety of significant red flags surrounding the Transfers, McNeeley and the E&Y team verified only the amount of those Transfers ($1.9 million). On almost every other aspect, McNeeley had only vague, unsupported, and often contradictory management representations, which raised more questions than they answered. McNeeley's failure to follow up on such obvious, outstanding issues was a clear failure to exercise due care.

2. Failure to Obtain Sufficient Competent Evidential Matter

McNeeley's lack of due care also led to the related auditing failure of not obtaining sufficient competent evidential matter. GAAS require auditors to obtain evidence sufficient to afford a reasonable basis for an opinion with respect to the financial statements under review.[34] GAAS explain that "[t]he amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his or her professional judgment after a careful study of the circumstance in the particular case."[35] GAAS also warn that management representations "are not a substitute for the application of th[e] auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit," and auditors may not become satisfied with less than persuasive evidence merely because they believe that management is honest.[36] These warnings were all the more urgent in the context of auditing a transaction requiring heightened scrutiny because it was a material, related-party transaction involving a member of management. McNeeley's audit did not conform to these standards.

If the Transfers were, as Stevens represented them to be, related to a tax liability, then a variety of obvious evidential material about the Transfers should have been readily obtainable, such as IRS-related correspondence, filings, or checks. But McNeeley did not require Stevens to produce any of this material. Nor did McNeeley question Stevens's failure to produce such documents when McNeeley asked Stevens to provide all documents related to the Transfers – a non-response that should have raised its own set of questions. McNeeley relied only on a receivable schedule, a general ledger, and management representation letters.[37] These documents told McNeeley little about the Transfers other than the amount that was transferred to Orecchio. In fact, McNeeley's June 7 emails to Stevens showed that McNeeley could not tell from those

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33 *Dearlove*, 92 SEC Docket at 1883 n.39 (noting that "workpapers are ordinarily the foundation on which support for audit conclusions is demonstrated").

34 AU § 326.22.

35 *Id.*

36 AU §§ 333.02, 230.09.

37 McNeeley also claims to have relied on the Partnership Agreement, but, as discussed, that document did not support the validity of the Transfers.

documents such basic information as whether the Transfers related to a personal or corporate tax liability, whether any payment had yet been made, or who, if anyone, made such payment. Nor did the materials on which McNeeley relied answer the various questions discussed above, such as why the Transfers came only from the Equity Fund or how an erroneously estimated tax liability could be nearly $2 million, which was more than 100 times more than his equal partner Oliver's liability, in a year in which the Equity Fund had no net investment income. McNeeley's correspondence with Stevens was a good starting point for answering these questions, but Stevens's responses about Orecchio's being "dinged by the IRS" were still only unsubstantiated management representations, lacked detail, and arguably contradicted Stevens's earlier explanation about the Transfers' being related to estimated taxes.

In fact, other than the Partnership Agreement, the evidential materials McNeeley obtained were all representations or internal accounting documents generated by management. As GAAS expressly warn, evidential matter regarding related-party transactions, such as the Transfers, "should extend beyond inquiry of management."[38] GAAS are even more specific concerning the audit of related-party transactions involving an uncollected balance (the case here). GAAS identify certain sources an auditor should consider when testing an uncollected balance from a related party, including "audited financial statements, unaudited financial statements, income tax returns, and reports issued by regulatory agencies, taxing authorities, financial publications, or credit agencies."[39] Other than looking at AA Capital's past financial statements, however, the record does not show that McNeeley consulted any of these materials.

To the contrary, McNeeley effectively admits to not seeking certain evidential material (such as tax documents or cancelled checks) when she argues that it was not her job to investigate the legitimacy of Orecchio's ultimate use of the Transfers. McNeeley acknowledged during her testimony, however, that it was "a typical procedure" for an audit team to seek confirmation of a transaction from third parties. McNeeley testified that she did not do that in this case because she "essentially already got" such confirmation by obtaining the management representation letters signed by Orecchio. She explained that "the only party related to the transaction from AA Capital to John Orrechio [sic] would be John Orrechio [sic]. And so we did obtain a confirmation from him in the form of the management representation letter." This confusing explanation, however, concedes that the letters McNeeley obtained were from management (a related party), and not a third party. Furthermore, these management representation letters did not expressly address the Transfers and thus did not support the legitimacy of the Transfers.[40]

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38 AU § 334.09.

39 AU § 334.10e.

40 *Cf. Kevin Hall, CPA*, Exchange Act Rel. No. 61162 (Dec. 14, 2009), 97 SEC Docket 23679, 23692 (finding insufficient evidence to conclude that auditors engaged in unreasonable conduct where auditors questioned management about the problematic transactions and included a representation about the problematic transactions in the management representation letter).

3. Failure to Ensure Issuance of an Accurate Audit Report

McNeeley also failed to ensure that E&Y issued accurate audit reports. GAAS require that the financial statements subject to an audit be presented in accordance with GAAP.[41] GAAP, as compared to GAAS, focus "not upon an auditor's judgment but upon how specific accounting tasks should be performed."[42] GAAP include FAS 57, which requires that disclosure of related-party transactions must indicate (i) the nature of the relationship involved; (ii) a description of the transaction; (iii) the dollar amount of the transaction; and (iv) amounts due from or to related parties and, if not otherwise apparent, the terms and manner of settlement.[43] Here, McNeeley failed to ensure that AA Capital's and the Equity Fund's financial statements disclosed the Transfers in compliance with GAAP.

McNeeley claims that AA Capital's and the Equity Fund's financial statements complied with GAAP, but we fail to see how. The financial statements included the Transfers only vaguely as part of an "account receivable" and provided no information about the parties involved, terms, or manner of settlement. In fact, McNeeley had no real means of ensuring that the financial statements complied with FAS 57, as she saw essentially no evidential material providing the information required by FAS 57 nor did she make any other real attempt to understand the Transfers.

The Transfers also do not fall within an exception to FAS 57, which states that "[i]n some cases, aggregation of similar transactions by type of related party may be appropriate."[44] As the exception explains, "[s]ometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient."[45] That is not the case here. The Transfers were purportedly tax-related transfers to an officer. The only similar transaction

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41 *See* AU § 410.01 ("The first standard of reporting is: The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.").

42 *Dearlove v. SEC*, 573 F.3d 801, 804 (D.C. Cir. 2009). GAAP include a hierarchy of statements published by the Financial Accounting Standards Board ("FASB") and by the AICPA. The highest level of GAAP hierarchy consists of the FASB Statements of Financial Accounting Standards ("FAS"). On June 30, 2009, FASB issued the FASB Accounting Standards Codification® ("FASB ASC") and established the FASB ASC as the source of authoritative U.S. GAAP. FASB ASC is effective for interim and annual periods ending after September 15, 2009. *See* Commission Guidance Regarding the Financial Accounting Standards Board's Accounting Standards Codification, Exchange Act Rel. No. 60519A (Aug. 19, 2009), 96 SEC Docket 19829. FAS 57 is currently codified in FASB ASC Topic 850, Related Party Disclosures. Because the conduct at issue took place before the codification, this opinion uses the FAS designations.

43 FAS No. 57 ¶2.

44 FAS No. 57 n.3.

45 *Id.*

was AA Capital's transfer to Oliver. AA Capital's other related-party transactions involved reimbursable expenses to AA Capital's related funds – transactions that the financial statements fully disclosed and that did not relate to the Transfers.

C. McNeeley Acted Highly Unreasonably

Our Rule 102(e) analysis finally examines whether McNeeley's auditing failures were highly unreasonable. Highly unreasonable conduct "is an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness."[46] Whether conduct is highly unreasonable is measured objectively by the degree of the departure from professional standards rather than by the intent of the accountant.[47] McNeeley violated that standard here.

As noted earlier, verifying that the Partnership Agreement allowed the Transfers was perhaps the most basic auditing step McNeeley could have taken during the audit, but did not. The record establishes, however, that McNeeley either (i) never discovered the obvious inconsistencies between the Partnership Agreement and the Transfers' terms, or (ii) she discovered those inconsistencies but took no steps to reconcile them. Either conclusion constitutes an egregious auditing failure.

McNeeley also faced a variety of other red flags that she should have investigated further. Such investigation could have involved any number of simple, obvious follow-up steps, such as requiring AA Capital to produce copies of IRS correspondence or cancelled checks to validate the Transfers. Instead, McNeeley relied only on management representations, knew only what information Stevens provided to her – information that was vague and contradictory – and confirmed only how much money flowed from the Equity Fund to Orecchio.[48]

McNeeley's reliance on Stevens's unsupported representations was made worse by the fact that McNeeley had previously determined that AA Capital's internal controls were "ineffective." McNeeley downplays the significance of that determination by arguing that AA Capital's internal controls were ineffective "only in the sense that the audit team could not rely on such controls as a substitute for conducting substantive audit procedures; and . . . this was completely ordinary for a relatively small and new private equity company." This, however, is exactly the point. A determination that AA Capital had weak internal controls did not mean the company was necessarily doing anything wrong. It did, however, alert McNeeley that she should rely on more than management representations.

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46 *Amendment to Rule 102(e)*, 63 Fed. Reg. at 57,167.

47 *Id.*

48 *Cf., e.g., McCurdy*, 57 S.E.C. at 295 ("McCurdy failed to undertake such simple, obvious steps as contacting [the fund investment adviser] or the [fund's] Trustees for more information, or reviewing copies of [the investment adviser]'s tax returns or credit reports. Under these circumstances, McCurdy's failure to obtain additional competent evidence regarding the collectibility of the Receivable was highly unreasonable.").

McNeeley further exacerbated the unreasonableness of her auditing conduct by denying readers of the financial statements any chance to make their own determination about the Transfers. The financial statements gave readers no way to know that AA Capital had lent $1.9 million to Orecchio or what the terms of that loan were. Even E&Y's own internal disclosure checklist, which McNeeley went through when conducting the audit, reminded its auditors of FAS 57's requirements and stated that accounts receivable from officers or employees "must be shown separately and not included under a general heading such as notes or accounts receivable." Although a firm's own internal guidance may not be a professional standard on which we can base a finding of improper professional conduct under Rule 102(e), E&Y's internal guidance was such an obvious reminder of GAAP's requirements that the guidance made McNeeley's failure to comply all the more glaring.[49]

Any one of McNeeley's auditing failures would have been highly problematic. But taken together, the failures are especially egregious. McNeeley was faced with multiple red flags surrounding a material, related-party transaction. She had any number of avenues for investigating those red flags, but pursued none of them. She then compounded those failures by not ensuring that, at a minimum, readers of the financial statements would be aware of the Transfers and could thus make their own determination about the Transfers' importance. This failure to comply with auditing standards with respect to the Transfers constituted highly unreasonable conduct as defined in Rule 102(e).

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McNeeley presents several broad, generalized, arguments about why we should not find her conduct to have been highly unreasonable. She argues, for instance, that it is inconsistent to find that she acted highly unreasonably when the law judge found that her supervisor, Oprins, had not acted highly unreasonably during the same audit. The law judge's finding regarding Oprins, however, is not before us on appeal. And while the law judge ultimately found that Oprins had not acted highly unreasonably for purposes of Rule 102(e), the law judge also found that Oprins had failed to comply with auditing standards.

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49 *Cf. Dormu v. District of Columbia*, 795 F. Supp. 2d. 7, 29 (D.D.C. 2011) (noting that the D.C. Court of Appeals has "held that internal guidelines and policies do not establish a standard of care, but 'may properly be received in evidence as bearing on the standard of care'" (citations omitted)); *Sabratek Liquidating LLC. v. KPMG LLP*, No. 01-C-9582, 2003 WL 22715820, at *6 (N.D. Ill. 2003) (unpublished) (noting that KPMG's internal standards and procedures "could shed light on KPMG's knowledge of applicable accounting standards and whether the result of its conduct was foreseeable"); *Gregory O. Trautman*, Exchange Act Rel. No. 61167 (Dec. 15, 2009), 98 SEC Docket 26534, 26563 (finding recklessness where petitioner did not know that late trading was illegal despite internal instruction manual that mandated that orders be placed before 4:00 p.m.).

Of more significance, however, is that GAAS establish different roles and responsibilities for different audit team members. GAAS explain that "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining."[50] Here, as engagement partner, Oprins was responsible for, among other things, overseeing the audit manager (*i.e.*, McNeeley), reviewing the workpapers, and signing the audit report. McNeeley, by comparison, was responsible for overseeing day-to-day audit planning, executing audit strategy, supervising audit staff, and reviewing audit workpapers in significant risk areas. Significantly, she was also responsible for reporting to Oprins any significant questions concerning the audit.[51] Any failure by McNeeley to bring such red flags to Oprins's attention, therefore, could explain how Oprins could have performed his duties in a manner commensurate with his knowledge, skill, or ability, even where McNeeley did not.

We recognize that Oprins was told about the loans, but the record is unclear whether McNeeley brought the red flags to his attention. Given the uncertainty in the record, we cannot say whether Oprins knew or should have known about the problems surrounding the Transfers. McNeeley, however, had the red flags in front of her. Given her role in the audit, we therefore conclude it is appropriate to find that she engaged in improper professional conduct.[52]

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50 AU § 230.06.

51 *Cf.* AU § 311.14 ("The auditor with final responsibility for the audit should direct assistants to bring to his attention significant accounting and auditing questions raised during the audit so that he may assess their significance.").

52 McNeeley filed a letter with the Commission on November 9, 2011, repeating an assertion made during oral argument that the law judge erred when concluding that "the record does not establish that Oprins was ever made aware that the Transfers were purportedly made to satisfy an erroneous tax liability." McNeeley argues that the law judge's conclusion was wrong because Oprins, in his Amended and Restated Answer to the OIP, "admit[ed] that he was told that Orecchio borrowed the [$1.92 million] as a loan to pay an erroneous tax assessment." In her letter, McNeeley attached Oprins's Answer "for the Convenience of the Commissioners because it was discussed during oral argument on November 2, but was not attached to any of the briefs."

On November 16, 2011, the Division moved to strike McNeeley's letter, arguing that "the Answer was already part of the record submitted to the Commission pursuant to Commission Rule of Practice 460." The Division added that "the content of the letter shows that its true purpose is to argue again certain factual findings in the Initial Decision." We grant the Division's motion. As discussed in the text, the issue is not whether Oprins was told about the loans, but whether McNeeley alerted Oprins to the various red flags surrounding those loans. McNeeley's letter adds nothing that was not already argued or part of the record, and our Rule of Practice 450(a) provides that, "[n]o briefs in addition to those specified in the briefing schedule order may be filed except with leave of the Commission." 17 C.F.R. § 201.450(a).

McNeeley also disputes the sufficiency of the Division's evidence by pointing to the fact that a majority of witnesses at the hearing testified that her conduct was reasonable. The majority of witnesses, however, were McNeeley's own witnesses. It is not surprising that those witnesses testified in McNeeley's favor. We find, however, that the Division's expert's testimony and conclusion that McNeeley's conduct was "an extreme departure from GAAS" was more persuasive.

McNeeley challenges the persuasiveness of the Division's expert by asserting that the expert "conceded" that McNeeley did not engage in highly unreasonable conduct. We disagree with that characterization of the testimony. The expert's supposed concession occurred during cross-examination, during which the expert acknowledged that reasonable auditors could disagree with his conclusion that McNeeley's conduct was an extreme departure from GAAS, *i.e.*, that her conduct was reckless. The expert then added that it was "certainly possible" that reasonable auditors could disagree about whether McNeeley's conduct was reasonable.

Because GAAS "were established by consensus among members of the accounting profession," accounting professionals can, by GAAS's very nature, disagree about their provisions.[53] Thus, read in context, the Division's expert's statements were no more than a reflection of the process by which GAAS were established. The expert was otherwise unequivocal about his conclusion that McNeeley's conduct was an extreme departure from GAAS, and our findings that McNeeley's conduct was highly unreasonable are consistent with that testimony. Moreover, even if, as McNeeley claims, the Division's expert had conceded that McNeeley's conduct was not highly unreasonable, the Commission has its own expertise and is not bound by expert testimony regarding auditing standards. In fact, determining whether McNeeley's conduct was highly unreasonable is the reason for this proceeding. As we have explained, "while the opinions of qualified expert accountants may be helpful, this Commission must in the last analysis weigh the value of expert testimony against its own judgment of what is sound accounting practice."[54]

IV.

When determining an appropriate sanction, "we are mindful of the remedial nature of Rule 102(e) and our purpose in promulgating the rule to ensure that the Commission's 'processes continue to be protected, and that the investing public continues to have confidence in the

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53 PCAOB Release 2003-025 (Dec. 17, 2003), PCAOB Rulemaking Docket Matter No. 010 (noting that "generally accepted" auditing and accounting standards were established by consensus).

54 *Haskins & Sells*, Accounting Series Release No. 73 (Oct. 30, 1952), 1952 SEC LEXIS 1062, at *28; *see also Dearlove*, 92 SEC Docket at 1897-98 (noting that "[t]he Commission may consider expert testimony, but it is not bound by such testimony even where it is available").

integrity of the financial reporting process.'"[55] As we recognized in our release adopting the 1998 amendments to Rule 102(e), "the Commission has limited resources" and therefore "must rely on the competence and independence of the auditors who certify, and the accountants who prepare, financial statements."[56] Because of this, the Commission and the investing public must "rely heavily on accountants to assure corporate compliance with federal securities law and disclosure of accurate and reliable financial information."[57]

McNeeley failed to meet these obligations. McNeeley was responsible for auditing a material, related-party transaction that raised obvious concerns. She had ample opportunity to investigate these red flags, yet did essentially nothing. McNeeley instead deferred to her client's unsupported representations about the Transfers during the audit and to her client's subsequent, limited disclosure preferences in the financial statements. Such an egregious failure to comply with auditing standards "jeopardize[s] the achievement of the objectives of the securities laws and can inflict great damage on public investors."[58]

McNeeley's conduct also indicates a risk that she will commit future violations. As the D.C. Circuit has recognized, "the existence of a violation raises an inference that it will be repeated,"[59] and McNeeley has made clear that she intends to remain an auditor if permitted. Our concern that McNeeley will commit future violations is exacerbated by McNeeley's subsequent failure to recognize the wrongfulness of her conduct. McNeeley has consistently asserted that she conducted the audit appropriately. While a respondent has the right to present a vigorous defense, McNeeley's testimony and subsequent arguments on appeal reflect a continuing failure to grasp the role of an auditor. McNeeley argues, for example, that she had no duty to verify the legitimacy of the reasons for the Transfers (*e.g.*, verifying that Orecchio owed the taxes that he claimed). This assertion ignores the importance of obtaining third-party evidence, especially when auditing related-party transactions and, more generally, displays a failure to appreciate the overarching obligation to exercise due care and professional skepticism. McNeeley also testified, and now argues on appeal, that the evidential matter she obtained from AA Capital was sufficient to understand the Transfers. That evidential matter, however, consisted almost exclusively of management representations that were often vague and contradictory. Perhaps most troubling, McNeeley not only fails to recognize her failures, but she also argues that "[t]his case arose only because a criminal audit client, who now resides in a federal prison, successfully led an effort to defraud her and the rest of the audit team." Orecchio's fraud, however, did not cause her auditing

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55 *Dearlove*, 92 SEC Docket at 1912 (quoting *Amendment to Rule 102(e)*, 63 Fed. Reg. at 57,164).

56 *Amendment to Rule 102(e)*, 63 Fed. Reg. at 57,165.

57 *Id.*

58 *Touche Ross & Co.*, 609 F.2d at 581.

59 *Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004) (affirming violation of Securities Act Section 5 and related cease-and-desist order).

failures. Her highly unreasonable conduct caused her auditing failures. Orecchio's fraud served only to expose those failures. Such an inability to recognize the wrongfulness of her conduct gives us concern that McNeeley will repeat her misconduct in the future.

McNeeley disputes that a likelihood of her committing a future violation exists because of her "perfect record in the nearly six years since the [a]udits." An otherwise clean disciplinary history, however, is not determinative for purposes of our sanctions analysis.[60] We also find little assurance in McNeeley's performance history given that McNeeley would have known that, once the Commission instituted these proceedings, her conduct would be more highly scrutinized, which reduced the likelihood of her committing additional misconduct during this time.

We recognize that imposing a sanction on McNeeley could have collateral consequences, such as tarnishing her reputation, but such consequences are outweighed by our concern that "[a]n incompetent or unethical practitioner has the ability to inflict substantial damage to the Commission's processes, and thus the investing public, and to the level of trust and confidence in our capital markets."[61] We have accordingly warned that "'where such individuals engage in professional misconduct which impairs the integrity of the Commission's processes, the Commission has an obligation to respond through the application of' Rule 102(e)."[62]

On appeal, McNeeley argues that any suspension at this stage of the proceedings would be punitive because the Division did not issue the OIP until "nearly five years after the Audits ended." McNeeley claims that, "[i]f there were a legitimate need to protect the public, Ms. McNeeley would not have been allowed to continue practicing before the Commission year after year after year." We disagree. Bringing a 102(e) case against an accountant involves various complexities, not the least of which is that problems with an audit, which can be complex, are not typically brought to light until the problems with the underlying financial statements are understood. The Commission is also entitled to prioritize its resources toward disciplining fraudsters. Although auditors and the underlying fraudsters both pose a threat to the public, they present the Commission with differing priorities, which are reflected in the different sanctions

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60 *Cf., e.g.*, *Steven Altman, Esq.*, Exchange Act Rel. No. 63306 (Nov. 10, 2010), 99 SEC Docket 34405, 34437 n.81 (imposing bar against attorney for engaging in improper profession conduct under Rule 102(e) despite attorney's previously clean disciplinary record), *petition denied*, 666 F.3d 1322 (D.C. Cir. 2011); *James C. Dawson*, Advisers Act Rel. No. 3057 (July 23, 2010), 98 SEC Docket 30697, 30704 (imposing bar despite respondent's previously clean record in a nearly thirty-year career and respondent's claim that such a record established a "marked unlikelihood" of future violations); *Gary M. Kornman*, Exchange Act Rel. No. 59403 (Feb. 13, 2009), 95 SEC Docket 14246, 14259 (imposing bar despite respondent's lack of disciplinary history), *petition denied*, 55 F.3d 173 (D.C. Cir. 2010).

61 *Altman*, 99 SEC Docket at 34437 (quoting *Keating, Muething, & Klekamp*, 47 S.E.C. 95, 120 (1979) (concurring opinion)) (imposing bar while noting the "potential collateral consequences that may result from our decision in this case").

62 *Id.* (quoting *Keating*, 47 S.E.C. at 120).

ultimately leveled against the various actors involved with fraudulent financial statements (*e.g.*, jail for Orecchio; a professional bar for Stevens; and a six-month suspension for McNeeley). Our rules, in fact, reflect these differing priorities by expressly contemplating that government resources will be focused first toward the fraudsters. Rule 210(c)(3), in particular, allows criminal prosecutorial authorities, such as the U.S. Department of Justice, to seek a stay of a Commission enforcement or disciplinary hearing "during the pendency of a criminal investigation or prosecution arising out of the same or similar facts that are at issue"[63] – a rule the Department of Justice has used in the past to stay Commission Rule 102(e) proceedings against auditors.[64]

Here, the delay in instituting the proceedings obviated the need for a stay by the Department of Justice, and the OIP was issued less than a month after Orecchio pleaded guilty in his criminal proceedings and within three and one half years of the Division discovering the fraud. This timing is consistent both with the considerations described above and with other administrative proceedings in which we have imposed sanctions against auditors under Rule 102(e).[65] We therefore see nothing unusual or punitive about imposing a sanction at this stage of the proceedings.

McNeeley challenges the appropriateness of imposing a suspension by arguing that the record contains no evidence that her misconduct was intentional.[66] We have explained, however, that "a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive."[67] A disciplinary matter involving highly unreasonable conduct is

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63 17 C.F.R. § 201.210(c)(3).

64 *See Hall*, 97 SEC Docket at 23689 (noting that "[l]argely because the administrative proceeding was stayed at the request of the Department of Justice, pending resolution of criminal proceedings arising out of the fraud, the hearing did not begin until July 2007," which was approximately seventeen months after the order instituting proceedings was filed).

65 *See, e.g.*, *Marrie*, 374 F.3d at 1199 (involving OIP that was issued "just shy of five years" after audit at issue); *Dearlove*, 92 SEC Docket at 1873, 1919 (involving OIP that was issued more than four years after audit at issue).

66 McNeeley also argues that the law judge erred by failing to conduct the multi-factor public interest analysis outlined in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). The D.C. Circuit, however, has recognized that "the Commission is not required to follow any mechanistic formula in determining an appropriate sanction." *Kornman v. SEC*, 592 F.3d 173, 186 (D.C. Cir. 2010).

67 *Amendment to Rule 102(e)*, 63 Fed. Reg. at 57,167.

therefore not necessarily less egregious than one involving intentional or reckless conduct, and, for all the reasons described in this opinion, we believe that this is such a case.[68]

Nevertheless, we believe that certain factors weigh in favor of a more measured sanction than the three-year suspension that the Division believes is appropriate. McNeeley, for example, was a relatively young auditor at the time of the audits and had not been in the industry as long as some others against whom we have imposed sanctions under Rule 102(e).[69] McNeeley was also overseen by a supervisor, Oprins, who the law judge found had not fully complied with his own auditing duties. Although the law judge ultimately concluded that Oprins's auditing failures did not amount to highly unreasonable conduct under Rule 102(e), Oprins's conduct during the audit raised sufficient questions about the adequacy of Oprins's supervision to suggest that a sanction less severe than what the Division requests is appropriate.

In weighing all of the considerations, we therefore believe that a six-month suspension from appearing or practicing before the Commission is appropriate. This time spent out of auditing will impress upon McNeeley the severity of her auditing failures, thus providing specific deterrence to her and providing more general deterrence to the auditing profession.

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68 *See Dearlove*, 92 SEC Docket at 1912 (recognizing "that, under some circumstances, unreasonable conduct is not necessarily a less egregious disciplinary matter than either intentional or reckless conduct, or highly unreasonable conduct in circumstances warranting heightened scrutiny").

69 *See, e.g.*, *Dearlove*, 92 SEC Docket at 1913 (imposing four-year suspension for auditor who had been an accountant for approximately twenty-five years at time of audit by noting, in part, that "Dearlove's lengthy audit experience makes his failure to conduct the . . . audit in accordance with applicable professional standards all the more troubling"); *McCurdy*, 57 S.E.C. at 295-96 (imposing one-year suspension for auditor who had been a CPA for nearly twenty years at time of audit by noting, in part, that "[t]his lengthy experience makes his failure to conduct the audit in accordance with applicable professional standards particularly troublesome").

For the reasons above, we find that McNeeley engaged in improper professional conduct as defined in the Commission's Rule of Practice 102(e) and that, as a result, McNeeley should be denied the privilege of appearing or practicing as an accountant before the Commission for six months. An appropriate order will issue.[70]

By the Commission (Chairman SCHAPIRO and Commissioner WALTER); Commissioner PAREDES, concurring in part and dissenting only with respect to the sanction imposed, Commissioners AGUILAR and GALLAGHER not participating.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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70 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.

Commissioner PAREDES, dissenting with respect to the sanction imposed:

The Commission has found that Wendy McNeeley, a certified public accountant and audit manager, violated the Commission's Rule of Practice 102(e) ("Rule 102(e)"). Although I concur, on the basis of the record before us, that McNeeley's conduct violated Rule 102(e), I cannot support the sanction imposed by the majority of the Commission. In light of the facts of this matter, a six-month suspension from appearing or practicing before the Commission is more severe than is appropriate to achieve its purpose.[1]

The conduct of McNeeley that gave rise to this matter occurred over seven years ago while McNeeley served as audit manager for an audit of a client's 2004 financial statements. Over the course of the past several years, McNeeley has had ample time to reflect on her failure to perform an audit according to applicable standards – an audit that, as the Commission's opinion notes, occurred when McNeeley "was a relatively young auditor."[2]

Furthermore, after the deficient audit and throughout the course of the Commission's action against McNeeley, McNeeley has been employed by a national accounting firm and has continued to appear and practice before the Commission.[3] That McNeeley has continued practicing without any other disciplinary action being brought against her indicates her comportment with professional standards of conduct and, perhaps more tellingly, belies the majority's concern that she poses such a risk that a six-month suspension is warranted at this point in her career after so much time has elapsed since the conduct underlying her Rule 102(e) violation. Simply put, the majority of the Commission too readily concludes that there is a risk that McNeeley will commit future violations.[4]

There is no evidence in the record that McNeeley has engaged in any subsequent improper professional conduct since the occurrence of the conduct that is the basis of this matter. To the contrary, McNeeley has shown over a meaningful number of years – after the violation – that she is capable of performing her responsibilities in accordance with applicable standards.[5]

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1 *See* Commission Opinion, text accompanying *supra* note 55.

2 Commission Opinion, text accompanying *supra* note 69.

3 *Wendy McNeeley, CPA*, Initial Decision Rel. No. 411 (Dec. 28, 2010), 100 SEC Docket 36461, 36464-65.

4 *See* Commission Opinion, *supra* pp. 24-25.

5 The OIP against McNeeley was filed nearly five years after completion of the audit of the 2004 financials, and the Commission heard oral argument more than one and a half years later. No stay of proceedings against McNeeley was requested by the Department of

(continued...)

To the extent that McNeeley's clean record since the Rule 102(e) violative conduct is a result of her taking extra care, that is precisely the intended effect of a remedial sanction.

I am not persuaded that there is a justifiable remedial purpose to be served by subjecting McNeeley to a six-month suspension at this time. Therefore, I am troubled that the six-month suspension will have an unnecessarily punitive effect. The Commission's interests would be appropriately served with a less severe sanction, perhaps a censure. Accordingly, I dissent with respect to the sanction imposed by the majority of the Commission.

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[5] (...continued)
Justice, and there is nothing in the record to indicate that the length of time that passed was the result of any obstruction, cover-up, or delaying tactics on McNeeley's part.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 68431 / December 13, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 3427 / December 13, 2012

Admin. Proc. File No. 3-13797

In the Matter of the Application of

WENDY MCNEELEY, CPA
c/o Robert L. Michels, Esq.
Winston & Strawn LLP
35 Wacker Dr.
Chicago, IL 60601

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Wendy McNeeley be, and hereby is, denied the privilege of appearing or practicing before the Commission as an accountant for six months from the date of this order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 68433; File No. S7-13-12)

December 14, 2012

ORDER GRANTING CONDITIONAL EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH PORTFOLIO MARGINING OF SWAPS AND SECURITY-BASED SWAPS

AGENCY: Securities and Exchange Commission.

ACTION: Exemptive order; request for comment.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is issuing an order granting conditional exemptive relief from compliance with certain provisions of the Securities Exchange Act of 1934 ("Exchange Act") in connection with a program to commingle and portfolio margin customer positions in cleared credit default swaps ("CDS"), which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the Commodity Exchange Act ("CEA").

DATES: Effective Date: This exemptive order is effective on [Insert date of publication in the Federal Register].

Comments Due Date: Comments must be received on or before [Insert date 60 days after the date of publication in the Federal Register].

ADDRESSES: Comments may be submitted, identified by File Number S7-13-12, by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-13-12 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions

for submitting comments.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number S7-13-12. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec/gov/rules/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without charge; the Commission does not edit personal identifying information from submissions. You should only submit information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Emily Westerberg Russell, Senior Special Counsel, Catherine Moore, Senior Special Counsel, and Natasha Vij Greiner, Special Counsel, at 202-551-5550, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

I. Introduction

On July 21, 2010, President Barack Obama signed the Dodd-Frank Act into law.[1] Title VII of the Dodd-Frank Act ("Title VII") establishes a regulatory regime applicable to the over-the-counter ("OTC") derivatives markets. Title VII provides the Commission and the

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

Commodity Futures Trading Commission ("CFTC") with tools to oversee these markets.[2] Under the comprehensive framework established in Title VII, the SEC is given regulatory authority over security-based swaps, and the CFTC is given regulatory authority over swaps.[3] The Dodd-Frank Act amended the Exchange Act to require, among other things, that transactions in security-based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration, if the security-based swaps are of a type that the Commission determines must be cleared, unless an exception or exemption from mandatory clearing applies.[4] The Dodd-Frank Act similarly amended the CEA.[5] In addition, the Dodd-Frank Act provided the SEC and CFTC with explicit authority to facilitate portfolio margining by allowing cash and securities to be held in a futures account, and futures and options on futures and related collateral to be held in a securities account, subject to certain conditions.[6]

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2 Generally, Subtitle A of Title VII creates and relates to the regulatory regime for swaps, while Subtitle B of Title VII creates and relates to the regulatory regime for security-based swaps.

3 See Section 3(a)(68) of the Exchange Act, 15 U.S.C.78c(a)(68) (as added by Section 761(a)(6) of the Dodd-Frank Act) and Section 1a(47) of the CEA, 7 U.S.C. 1a(47) (as added by Section 721(a) of the Dodd-Frank Act) for the definitions of security-based swap and swap, respectively. See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (Jul. 18, 2012), 77 FR 48207 (Aug. 13, 2012) (Joint Final Rule with the CFTC) ("Product Definitions Adopting Release"), further defining the terms swap and security-based swap.

4 See Section 763(a) of the Dodd-Frank Act (adding new Section 3C(a)(1) to the Exchange Act). 15 U.S.C. 78c-2.

5 See Section 723(a)(3) of the Dodd-Frank Act (adding new Section 2(h)(1)(A) to the CEA).

6 See Section 713 of the Dodd-Frank Act. Under Section 713 of the Dodd-Frank Act, dually-registered broker-dealers and futures commission merchants may portfolio margin pursuant to an approved portfolio margin program, subject to certain requirements,

On December 16, 2011, the Commission approved a request by a clearing agency for portfolio margining of clearing members' proprietary security-based swaps and swap positions consisting of single-name CDS and CDS indices, respectively.[7] Under such a portfolio margining arrangement, clearing members are able to maintain reduced levels of margin that are commensurate with the risks of the portfolio based on correlations in a member's cleared CDS positions consisting of both swaps and security-based swaps.

Market participants have also sought the use of similar portfolio margining arrangements in the context of customer positions in CDS. On November 7, 2011, ICE Clear Credit, LLC ("ICE Clear Credit") filed with the Commission a petition for rulemaking, regulation or order to provide exemptive relief from certain Exchange Act provisions to allow portfolio margining treatment for customer-related positions in anticipation of ICE Clear Credit offering clearing of security-based swaps for customer-related transactions.[8] ICE Clear Credit requested exemptive relief from the application of certain provisions of the Exchange Act to allow ICE Clear Credit, and any ICE Clear Credit member that is a dually-registered broker-dealer and futures commission merchant ("BD/FCM"), to, among other things: (1) hold customer assets used to margin, secure, or guarantee customer positions consisting of cleared CDS, which include both

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including regulatory action by the SEC and CFTC (pursuant to an exemption, or by rule or regulation). See Exchange Act Section 15(c)(3)C and CEA Section 4d(h). See also infra note 23.

7 See Order Approving Proposed Rule Change to Adopt ICC's Enhanced Margin Methodology, Exchange Act Release No. 66001 (Dec. 16, 2011).

8 ICE Clear Credit formally petitioned the Commission to grant exemptive relief from the application of Section 15(c)(3), Rule 15c3-3 and related rules under the Exchange Act. See Letter from Michael M. Phillip, Partner, Winston & Strawn LLP (Nov. 7, 2011) (the petition and comments received on the petition are on file at the Commission's website at http://www.sec.gov/rules/petitions.shtml).

swaps and security-based swaps, in a commingled customer omnibus account subject to Section 4d(f) of the CEA; and (2) calculate margin for this commingled customer account on a portfolio margin basis.[9] ICE Clear Europe Limited ("ICE Clear Europe") also requested substantially similar relief for itself and its members.[10]

The Commission has received four comment letters, one of which was provided by ICE Clear Credit. All of these letters supported ICE Clear Credit's request for relief.[11] Commenters generally argued that portfolio margining of customer positions in CDS removes economic barriers to customer clearing and would encourage greater clearing, thereby reducing systemic risk.[12] One commenter stated that a portfolio margining program for customer accounts could also improve competitiveness between market participants who are not clearing members and those that are clearing members who are already permitted to portfolio margin in their proprietary accounts.[13] Certain commenters addressed additional issues associated with the approval of ICE Clear Credit's request for relief, including concerns relating to a potential requirement to provide customers the ability to choose an account type and a request for certainty about the applicable bankruptcy regime, which are more specifically addressed, where

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9 Id.

10 See Letter from Paul Swann, President and Chief Operating Office, ICE Clear Europe Limited (May 31, 2012) (on file as a comment to the ICE Clear Credit petition at http://www.sec.gov/comments/4-641/4641-5.pdf).

11 See letter from Managed Funds Association dated June, 13, 2012 ("MFA Letter"); letter from Investment Company Institute ("ICI Letter") dated April 9, 2012; letter from ICE Clear Credit LLC dated December 22, 2011 ("ICE Letter"); and letter from Association of Institutional Investors dated December 22, 2011.

12 Id.

13 See, e.g., MFA Letter.

appropriate, below.[14] Additionally, one commenter argued that the Commission should provide equivalent relief to all clearing agencies seeking exemptive relief, stating that different approaches could lead to inefficiencies in the market because market participants may choose to clear at a particular clearinghouse based on the applicable regulatory standards rather than market efficiencies.[15]

II. Discussion

Portfolio margining of index CDS (subject to CFTC regulations)[16] and single-name CDS (subject to SEC regulations) can offer many benefits to investors and the markets, including promoting greater efficiencies in clearing with respect to off-setting positions and thereby aligning costs more closely with overall risks presented by an investor's portfolio. Further, portfolio margining may help to alleviate excessive margin calls, improve cash flows and liquidity, and reduce volatility.

At the same time, facilitating portfolio margining for customer-owned swaps requires careful consideration to ensure that customer protection concerns are appropriately addressed, as well as to promote appropriate risk management and disclosure. The Commission is mindful of the need to address these issues.

Accordingly, after careful consideration of the requests before the Commission, comments received, and the relevant statutory provisions, the Commission is acting to provide

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14 See ICE Letter, MFA Letter, and ICI Letter.

15 See ICI Letter.

16 Index CDS that are currently cleared are generally swaps subject to CFTC regulation. The definition of "narrow-based security index" is used to help in distinguishing between certain swaps, such as index CDS, and security-based swaps. See Product Definitions Adopting Release.

conditional exemptive relief to facilitate portfolio margining treatment for customer-related positions in CDS that are cleared pursuant to the terms of this Order.

A. Relevant Provisions

Section 3E of the Exchange Act, as established pursuant to Section 763 of the Dodd-Frank Act, sets forth the framework for the segregation of assets held as collateral in security-based swap transactions. Section 3E(b)(1) of the Exchange Act provides that a broker, dealer, or security-based swap dealer shall treat and deal with all money, securities, and property of any security-based swap customer received to margin, guarantee, or secure a cleared security-based swap transaction as belonging to the customer.[17] Section 3E(b)(2) of the Exchange Act provides that the money, securities, and property shall be separately accounted for and shall not be commingled with the funds of the broker, dealer, or security-based swap dealer or used to margin, secure, or guarantee any trades or contracts of any security-based swap customer or person other than the person for whom the money, securities, or property are held.[18] Section 3E(c)(1) of the Exchange Act provides that, notwithstanding Section 3E(b) of the Exchange Act, money, securities, and property of cleared security-based swap customers of a broker, dealer, or security-based swap dealer may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency.[19] Section 3E(c)(2) of the Exchange Act further provides that the Commission may, notwithstanding Section 3E(b) of the

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17 See Section 3E(b)(1) of the Exchange Act (15 U.S.C. 78c-5(b)(1)) (as added by Section 763(d) of the Dodd-Frank Act).

18 See Section 3E(b)(2) of the Exchange Act (15 U.S.C. 78c-5(b)(2)) (as added by Section 763(d) of the Dodd-Frank Act).

19 See Section 3E(c)(1) of the Exchange Act (15 U.S.C. 78c-5(c)(1)) (as added by Section 763(d) of the Dodd-Frank Act).

Exchange Act, by rule, regulation, or order prescribe terms and conditions under which any money, securities, or property of a customer with respect to cleared security-based swaps may be commingled and deposited with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swap customer of the broker, dealer, or security-based swap dealer.[20] Section 3E(d) of the Exchange Act restricts the ability to invest such money, securities, and property of the security-based swap customer,[21] and Section 3E(e) of the Exchange Act places certain prohibitions on the disposition and use of customer money, securities, and property of a security-based swap customer by any person, including any clearing agency and any depository institution that has received any money, securities, or property for deposit in a separate account or accounts, as provided in Section 3E(b) of the Exchange Act.[22] Finally, Section 3E(g) of the Exchange Act provides that an account holding a security-based swap, other than a portfolio margining account referred to in Section 15(c)(3)(C) of the Exchange Act, shall be considered to be a securities account, as defined in 11 U.S.C. 741.[23]

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20 See Section 3E(c)(2) of the Exchange Act (15 U.S.C. 78c-5(c)(2) (as added by Section 763(d) of the Dodd-Frank Act).

21 15 U.S.C. 78c-5(d) (as added by Section 763(c) of the Dodd-Frank Act).

22 15 U.S.C. 78c-5(e) (as added by Section 763(c) of the Dodd-Frank Act).

23 Solely for purposes of Section 3E(g) of the Exchange Act, the Commission interprets "a portfolio margining account referred to in section 15(c)(3)(C)" to include a portfolio margining account that is maintained in accordance with the terms of this Order.

Section 15(c)(3) of the Exchange Act and Rule 15c3-3[24] also provide for the protection of customer securities and funds. Specifically, under Section 15(c)(3) of the Exchange Act, the SEC may prescribe rules and regulations "to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers, including, but not limited to, the acceptance of custody and use of customers' securities and the carrying and use of customers' deposits or credit balances."[25] Under Exchange Act Rule 15c3-3, a broker-dealer must, in essence, segregate customer funds and fully paid and excess margin securities held by the firm for the accounts of customers. The intent of the rule is, among other things, to "facilitate the liquidations of insolvent broker-dealers and to protect customer assets in the event of a SIPC liquidation through a clear delineation in Exchange Act Rule 15c3-3 of specifically identifiable property of customers."[26] Absent an exemption, a broker-dealer would be required to comply with applicable provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder as they relate to all securities, including security-based swaps.[27]

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24 17 CFR 240.15c3-3.

25 15 U.S.C. 78o(c)(3).

26 See Broker-Dealers; Maintenance of Certain Basic Reserves, Exchange Act Release No. 9856 (Nov. 10 1972), 37 FR 25224 (Nov. 29, 1972).

27 In addition to the Exchange Act provisions specific to security-based swaps, there are Exchange Act provisions applicable to "securities", which would apply to security-based swaps. Section 761 of the Dodd-Frank Act amended the definition of "security" under the Exchange Act to include security-based swaps. See Exchange Act Section 3(a)(10), 15 U.S.C. 78c(a)(10) (as revised by Section 761 of the Dodd-Frank Act). The Commission approved an order granting temporary relief and providing interpretive guidance to make it clear that a substantial number of the requirements of the Exchange Act would not apply to security-based swaps when the revised definition of "security" went into effect on July 16, 2011. Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment,

Section 724 of the Dodd-Frank Act added provisions to Section 4d of CEA that perform functions similar to those in Section 3E of the Exchange Act in creating a segregation framework for swap customers.[28] Accordingly, in order to permit collateral related to cleared security-based swaps to be commingled with that related to cleared swaps for purposes of portfolio margining and to operate under the segregation framework for swaps, a broker-dealer would need relief from the applicable provisions of Section 3E and Section 15(c)(3) of the Exchange Act as well as Rule 15c3-3 thereunder. Similarly, a clearing agency would need relief from applicable provisions of Section 3E of the Exchange Act.[29]

Moreover, Exchange Act Rules 8c-1 and 15c2-1 ("hypothecation rules") prohibit, among other things, a broker-dealer from commingling customer securities (the term "customer" for this

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Exchange Act Release No. 64795 (July 1, 2011) ("Exchange Act Exemptive Order"). While the Exchange Act Exemptive Order provided registered broker-dealers a limited exemption from Section 15(c)(3) of the Exchange Act and rules thereunder in connection with security based-swaps (to the extent that these provisions do not apply to security-based swap activities or positions as of July 15, 2011), the exemption from Exchange Act Rule 15c3-3 is not available for the broker-dealer's activities and positions related to cleared security-based swaps, to the extent that the broker-dealer is a member of a clearing agency that functions as a central counterparty for security-based swaps, and holds customer funds or securities in connection with cleared security-based swaps, because at the time the exemption was granted no clearing agencies were clearing security-based swaps. Id. Accordingly, relief separate from Section 15(c)(3) of the Exchange Act and Rule 15c3-3, and certain other Exchange Act provisions applicable to "securities" discussed herein, is necessary to permit the commingling and portfolio margining of customer positions in cleared CDS.

28 See 7 U.S.C. 6d(f) (as added by Section 724 of the Dodd-Frank Act).

29 The CFTC would also need to provide relief to allow security-based swaps to be commingled with swaps in an account maintained in accordance with Section 4d(f) of the CEA. The Commission notes that the CFTC has also received similar requests for relief. See Letter from Michael M. Phillip, Partner, Winston & Strawn LLP (Oct. 4, 2011) (the petition and comments received on the petition are on file at the CFTC's website at http://sirt.cftc.gov/sirt/sirt.aspx?Topic=CommissionOrdersandOtherActionsAD&Key=22685).

purpose generally includes affiliates of the broker-dealer) with its own proprietary securities under a lien for a loan made to such broker-dealer.[30] However, pursuant to the CFTC Part 22 Rules, the money, securities, and property of an affiliate (as defined in association with the definition of "Cleared Swaps Proprietary Account" pursuant to CFTC Rule 22.1)[31] of an intermediary (i.e., BD/FCM) must be held in a Cleared Swaps Proprietary Account in accordance with the CFTC regime in order to permit such affiliates to use portfolio margining for CDS.[32] Absent an exemption, affiliates of a broker-dealer that are not excluded from the definition of customer in the hypothecation rules are customers whose securities positions cannot be commingled with the broker-dealer's proprietary securities and therefore could not be held in a Cleared Swap Proprietary Account, as required by the CFTC's Part 22 Rules.[33]

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[30] 17 CFR 240.8c-1 and 17 CFR 240.15c2-1. The term "'customer" is defined in paragraph (b)(1) of the hypothecation rules and excludes any general or special partner or any director or officer of such broker-dealer, or any participant, as such, in any joint, group or syndicate account with such broker-dealer or with any partner, officer, or director thereof.

[31] Cleared Swaps Proprietary Account means an account for cleared swaps and associated collateral that is carried on the books and records of a FCM for persons with certain relationships with that FCM, including applicable affiliates. In association with the definition of a Cleared Swaps Proprietary Account, an "affiliate" is defined to include a person, directly or indirectly, controls such individual, partnership, corporation or association or, directly or indirectly, is controlled by or is under common control with, such individual, partnership, corporation or association. See CFTC Rule 22.1, 17 CFR 22.1.

[32] Under CFTC Rule 22.1, a firm that is an affiliate of a FCM would not be a cleared swaps customer, which is defined as any person entering into a cleared swap, excluding any owner or holder of a Cleared Swaps Proprietary Account with respect to the cleared swaps in such account and a clearing member of a DCO with respect to cleared swaps cleared on that DCO. See CFTC Rule 22.1, 17 CFR 22.1. Thus, such an affiliate would not be a customer for purposes of a customer portfolio margining program with respect to swaps and security-based swaps.

[33] The Exchange Act Exemptive Order provided registered broker-dealers a temporary exemption from these rules, which expires on February 11, 2013. While the Commission

B. Exemptive Relief

Given the above requirements for the segregation of assets held as collateral under the Exchange Act, absent relief by the Commission, participants would not be able to operate in accordance with both the Exchange Act and the CEA and establish a program to commingle and portfolio margin cleared customer positions in CDS, which include both swaps and security-based swaps. The Commission has received requests to provide certain exemptive relief[34] to facilitate the establishment of a program providing for portfolio margining of cleared customer positions in CDS. Such a program has the potential to reduce clearing costs through the integration of clearing functions and the potential reduction of margin requirements by taking into account offsetting positions. As discussed above, Section 3E(c)(2) of the Exchange Act provides that, notwithstanding Section 3E(b) of the Exchange Act, in accordance with any terms and conditions the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or security-based swap dealer described in Section 3E(b) of the Exchange Act may be commingled and deposited as provided in Section 3E of the Exchange Act with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swaps customer of the broker, dealer, or security-based swap dealer.

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will consider the appropriate treatment of security-based swaps under the provisions of the Exchange Act not amended by the Dodd-Frank Act before expiration of the exemptions set forth in the Exchange Act Exemptive Order, including Exchange Act Rules 8c-1 and 15c2-1, the Commission believes that it is appropriate to provide relief from these rules in the context of this order. See Product Definitions Adopting Release.

34 See supra notes 8 and 10.

In addition, Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from certain provisions of the Exchange Act or certain rules or regulations thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[35]

After careful consideration, the Commission believes that providing certain conditional exemptive relief to facilitate portfolio margining, as outlined below, is necessary or appropriate in the public interest, and is consistent with the protection of investors, because it would promote a more accurate measure of the risk of the total position of the customer based on off-setting positions. Portfolio margining would also increase efficiency and reduce costs by closely aligning the costs of maintaining a portfolio of cleared CDS to the risks presented by such a portfolio. Moreover, the conditions to the exemption will provide restrictions designed to protect money, securities, and property of a security-based swap customer, to address certain differences in the statutory requirements of the Exchange Act and CEA, and to promote appropriate risk management and disclosure.

Specifically, consistent with the discussion on the need for relief to facilitate portfolio margining outlined above under the heading "Relevant Provisions," pursuant to Section 3E(c)(2) and Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant the following conditional exemptions:[36]

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35 15 U.S.C. 78mm(a)(1).

36 The following conditional exemptions do not in any way limit the Commission's authority to oversee or regulate security-based swaps under the Exchange Act with

(1) An exemption from Sections 3E(b), (d), and (e) of the Exchange Act and any rules thereunder for a clearing agency registered pursuant to Section 17A of the Exchange Act and registered as a derivatives clearing organization pursuant to Section 5b of the CEA ("clearing agency/DCO"),[37] solely to perform the functions of a clearing agency for CDS under a program to commingle and portfolio margin CDS for customer positions; and

(2) An exemption from Sections 3E(b), (d), and (e) of the Exchange Act and Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder,[38] and from any requirement to treat an affiliate (as defined in association with the definition of "Cleared Swaps Proprietary Account" pursuant to CFTC Rule 22.1) as a customer for purposes of Exchange Act Rules 8c-1 and 15c2-1, for BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and the rules thereunder.

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respect to provisions that are not subject to the exemptions, including, among others, the antifraud and anti-manipulation provisions and the Commission's examination authority provisions.

37 An entity that clears both security-based swaps and swaps is required to be dually registered as a clearing agency/DCO. See Section 17A(g) of the Exchange Act, (requiring that clearing agencies that clear security-based swaps be registered with the Commission) and Section (h) of the CEA (requiring that DCOs that clear swaps be registered with the CFTC).

38 ICE Clear Credit and ICE Clear Europe also requested exemptive relief from Rules 15c3-1, 17a-3, 17a-4, 17a-5 and 17a-11(c)(2) of the Exchange Act for their members engaged in the portfolio margining program. However, compliance with these rules depends upon the application of Exchange Act Rule 15c3-3 to CDS covered by the portfolio margining program contemplated under this Order. Therefore, because the Commission is already providing conditional exemptive relief from Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder, the Commission does not need to provide separate exemptive relief from these provisions with respect to the portfolio margining program contemplated under this Order.

As discussed in more detail below, this relief is subject to certain conditions that are designed to help ensure the protection of money, securities, and property received from a security-based swap customer, as well as to address certain differences in the statutory requirements of the Exchange Act and CEA and promote appropriate risk management and disclosure. In particular, the conditions seek to preserve customers' ability to select between the segregation requirements and customer protections afforded a securities account subject to the Exchange Act and the requirements and protections afforded a swap account subject to the CEA, help ensure that BD/FCMs collect sufficient margin from customers to address the risk presented by this business, and help ensure that customers receive relevant disclosures about the legal framework that will apply to their CDS transactions.

C. Conditional Exemptions for Clearing Agencies/DCOs from Sections 3E(b), (d) and (e) of the Exchange Act

As summarized above, pursuant to Section 3E(c)(2) and Section 36 of the Exchange Act from Sections 3E(b), (d), and (e) of the Exchange Act and any rules thereunder, the Commission is issuing an exemption to a clearing agency/DCO. This exemption is available to a clearing agency/DCO solely to perform the functions of a clearing agency for CDS under a program to commingle and portfolio margin cleared CDS for customer positions. This exemption is subject to five conditions that are designed to help safeguard customer money, securities, and property and promote the ability of customers to select an appropriate framework for the segregation of assets.

The first two conditions are intended to provide for portfolio margining within a securities account as an alternative for customers that may desire to conduct portfolio margining under a securities account structure as opposed to in a swaps account, once the Commission adopts final rules setting forth margin and segregation requirements applicable to security-based swaps consistent with Section 3E of the Exchange Act ("final margin and segregation rules for security-based swaps").[39]

Specifically, the first condition requires that the clearing agency/DCO, by the later of (i) six months after the adoption date of the final margin and segregation rules for security-based swaps or (ii) the compliance date of such rules, take all necessary action within its control to obtain any relief needed to permit its BD/FCM clearing members to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in CDS in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Under this condition, a clearing agency/DCO would be required to have taken steps, by the later of six months after the adoption date of final rules or the compliance date of such rules, that are within its control to obtain relief from all appropriate regulatory agencies, including submitting any applicable request for relief and working diligently to address any questions or issues raised by regulators.[40]

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39 The Commission has proposed margin, and segregation requirements for security-based swap dealers and major security-based swap participants. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers ("Capital, Margin, and Segregation Requirements Adopting Release"), Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012), at http://www.gpo.gov/fdsys/pkg/FR-2012-11-23/pdf/2012-26164.pdf. Once adopted, the Commission's rules would help establish a more permanent framework for the availability of a securities account as an alternative for customer accounts holding both security-based swaps and swaps. As a result, the Commission may provide further guidance on the application of the exemptive relief provided in this Order after the final rules related to margin and the segregation requirements of security-based swaps are adopted by the Commission.

40 The Commission anticipates that the CFTC will consider appropriate regulatory action to

The second condition requires that the clearing agency/DCO, by the later of (i) six months after the adoption date of final margin and segregation rules for security-based swaps or (ii) the compliance date of such rules, take all necessary action within its control to establish rules and operational practices to permit a BD/FCM (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Until the clearing agency/DCO has developed such rules and operational practices, the clearing agency/DCO must have in place rules requiring BD/FCM clearing members to maintain customer money, securities, and property received to margin, guarantee, or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. This condition would ensure that all customer assets are segregated and subject to appropriate regulatory oversight.

Some commenters raised certain issues associated with a requirement that market participants be provided a choice in account structure. Specifically, ICE Clear Credit stated that offering customers a choice would require changes at ICE Clear Credit and each of its participant

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facilitate portfolio margining.

BD/FCMs and result in needless additional costs.[41] ICE Clear Credit stated that few, if any, customers would choose an account established in accordance with Section 3E of the Exchange Act instead of an account established in accordance with Section 4d(f) of the CEA.[42] Another commenter also stated that granting the petition now would not prohibit customers from later choosing a different portfolio margining option under a Section 3E account structure, if made available.[43]

The Commission appreciates the benefits of providing relief to facilitate portfolio margining now while maintaining discretion for customers to later choose a different portfolio margining option under a Section 3E account structure when it becomes available. The Commission believes that it is important to ultimately provide market participants with the ability to select an account structure to manage their individual risks by taking into account the different regulatory provisions that may apply to different accounts types and that any costs incurred in providing such an option would be based on existing obligations that clearing agencies and markets participants have under Section 3E of the Exchange Act in connection with the clearing of security-based swaps in accordance with Section 3E of the Exchange Act. Accordingly, the Commission is imposing these two conditions in order to facilitate the ability of customers to choose an alternative account option in the future, once the Commission adopts final margin and segregation rules for security-based swaps.[44]

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41 See ICE Letter.

42 Id.

43 See MFA Letter.

44 The choice of the type of portfolio margining account structure (i.e., security account or swap account) would be made by each intermediary (i.e., BD/FCM) for the benefit of its

The third condition requires the clearing agency/DCO to have obtained any other relief needed to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. The conditional exemptions from the requirements under the Exchange Act are based in part on the applicability of the regulatory regime under the CEA. This condition is designed to help ensure the exemption from the Exchange Act regulatory framework would apply only in circumstances where the regulatory regime under the CEA is applicable.

The fourth condition requires the clearing agency/DCO to have appropriate rules and operational practices to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Similar to the prior condition, this condition is designed to help ensure the

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customers, while the clearing agency would be expected to maintain the capacity to allow the intermediary, acting as a clearing member, to select either option. This optionality also will further efforts to achieve more fully the benefits of risk-based portfolio margining, by giving to customers the choice of portfolio margining in a single futures or securities account at a dually-registered BD/FCM. See A Joint Report of the SEC and the CFTC on Harmonization of Regulation (Oct. 19, 2009) "Joint Report".

exemption from the Exchange Act regulatory framework would apply only in circumstances where the regulatory regime under the CEA is applicable.

The fifth condition requires the clearing agency/DCO to have rules mandating that each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS shall be an "eligible contract participant" as defined in Section 1a(18) of the CEA. Persons that are not eligible contract participants may lack the expertise or resources to effectively determine the risks associated with engaging in these types of transactions.[45] Accordingly, the Commission believes it is appropriate to provide conditions that would limit the applicability of the exemptions to customers that are eligible contract participants.

D. Conditional exemption for BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder.

As summarized above, the Commission is issuing an exemption to BD/FCMs from Exchange Act Sections 3E(b), (d), and (e), and Section 15(c)(3) and Rule 15c3-3 thereunder, as well as an exemption from any requirement to treat an affiliate (as defined in association with the

45 The Dodd-Frank Act limits the swaps and security-based swap transactions that may be entered into by parties that are not eligible contract participants. For example, under the Dodd-Frank Act, only an eligible contract participant may enter into security-based swaps that are not on a national securities exchange. See Exchange Act Section 6(l), 15 U.S.C. 78f(l) (added by Section 763(e) of the Dodd-Frank Act). In addition, security-based swaps that are not registered pursuant to the Securities Act of 1933 ("Securities Act") can only be sold to eligible contract participants. See Securities Act Section 5(d), 15 U.S.C. 77e(d) (added by Section 768(b) of the Dodd-Frank Act). Securities Act Section 5(d) specifically provides that it is unlawful to offer to buy, purchase, or sell a security-based swap to any person that is not an eligible contract participant, unless the transaction is registered under the Securities Act. Id. Given that Congress determined it is appropriate to include these limitations in the Dodd-Frank Act with respect to eligible contract participants, we believe it is appropriate to limit the exemptions in this Order to CDS entered into with eligible contract participants.

definition of "Cleared Swaps Proprietary Account" pursuant to CFTC Rule 22.1)[46] as a customer for purposes of Exchange Act Rules 8c-1 and 15c2-1, provided that the BD/FCM complies with the conditions to the exemption discussed below. This exemption is available to BD/FCMs solely to perform the functions of a BD/FCM for CDS with respect to any customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure cleared customer positions in security-based swaps included in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and the rules thereunder under a program to commingle and portfolio margin customer positions in cleared CDS.

The exemption is subject to six conditions that are designed to permit such BD/FCMs to participate in a program to commingle and portfolio margin customer positions in cleared CDS while helping to ensure the protection of customer securities and funds. The first two conditions of this exemption relate to the segregation of customer positions in CDS and impose separate requirements for customers that are not affiliates of the BD/FCM and customers that are affiliates of the BD/FCM.[47] The remaining conditions apply generally to all BD/FCMs participating in the program – regardless of whether they deal with customers that are affiliates of the BD/FCM – and relate to the risk management and other safeguards the BD/FCM must have in place in order to rely on the exemption. Among other things, these conditions establish minimum margin levels and disclosure requirements.

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46 17 CFR 22.1. The definition of "Cleared Swaps Proprietary Account" was recently adopted by the CFTC and is substantially similar to the definition of "Proprietary Account" for futures contracts in regulation 1.3. See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012).

47 "Customer" for purposes of this exemption has the same meaning as in Exchange Act Rules 15c2-1 and 8c2-1.

The first condition consists of two requirements and applies with respect to transactions involving customers that are not affiliates[48] of the BD/FCM.

First, the BD/FCM must maintain customer money, securities, and property received to margin, guarantee or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member or through a clearing member of a clearing agency/DCO operating pursuant to the exemption in this Order) such customer positions under a program to commingle and portfolio margin CDS. This condition is designed to help ensure that the exemption under this Order would apply only in circumstances where customer money, securities, and property are maintained in a segregated account pursuant to the regulatory regime under the CEA.

Second, the BD/FCM must enter into a non-conforming subordination agreement[49] with each customer that is not an affiliate regarding all customer money, securities, or property held in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder under a program to commingle and portfolio margin CDS. The non-

48 See supra notes 31 and 32 and accompanying text.

49 The term "non-conforming subordination agreement" is used broadly to refer to a subordination agreement between a broker-dealer and its client where the client agrees to subordinate its claims to the claims of all customers and other creditors of the broker-dealer. Non-conforming subordination agreements have previously been used in limited circumstances to permit broker-dealer affiliates to be treated as non-customers for purposes of Exchange Act Rule 15c3-3 to allow the positions of the affiliate to be commingled with the positions of the clearing member. See, e.g., Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000). See also Statement of the SEC Division of Trading and Markets Regarding the Protection of Customer Assets, Sept. 20, 2008 (available at http://www.sec.gov/news/press/2008/2008-216.htm).

conforming subordination agreement must contain: (i) a specific acknowledgment by the customer that such money, securities or property will not receive customer treatment under the Exchange Act or Securities Investor Protection Act of 1970 ("SIPA") or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the customer that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swaps customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order. The Commission believes that this condition, along with the disclosure conditions discussed below, should help to ensure that customers clearly understand that any customer protection treatment otherwise available with respect to securities transactions under the Exchange Act, SIPA or the stockbroker liquidation provisions will not be available for CDS held in an account maintained in accordance with Section 4d(f) of the CEA.

One commenter similarly requested clarity about how CDS commingled in a Section 4d(f) account would be treated in the event of the bankruptcy of a BD/FCM.[50] The commenter requested that the Commission and the CFTC clarify and confirm in any approval of ICE Clear Credit's request for relief that commingled accounts held in accordance with the segregation requirements of Section 4d(f) of the CEA would be a cleared swaps customer account for customers trading swaps and would be treated as such under the Bankruptcy Code (rather than a

50 See ICI Letter.

securities account subject to SIPA).[51] The Commission believes it is critical for the protection of customer's assets to clarify at the outset the rights of customers, generally, in the event of a bankruptcy of the BD/FCM, and believes that the subordination agreement condition discussed herein, in conjunction with disclosure condition described below, should help provide customers with clarity that the segregation requirements of the Exchange Act and any protections of SIPA and the stockbroker liquidation provisions will not apply to customer positions in CDS that are security-based swaps and are held in a Section 4d(f) account.[52]

The second condition applies with respect to transactions involving customers that are affiliates of the BD/FCM and consists of three requirements.

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51 Id.

52 In response to statements in the ICE Letter regarding what occurs when there is a shortfall in customer property in a broker-dealer bankruptcy or SIPA liquidation versus an FCM bankruptcy, the Commission notes that SIPA provides protections to customers that give them priority over general creditors. See Joint Report, supra, note 44, at 39-40. First, in the case of a shortfall in customer property held by a broker-dealer, SIPA and the stockbroker liquidation provisions of the Bankruptcy Code provides that customer property may be supplemented with other property in certain circumstances. See 15 U.S.C. 78lll(4)(E); 15 U.S.C. 78fff-2(c)(3); 11 U.S.C. 741(4)(A)(iv); and 11 U.S.C. 749. In a SIPA liquidation, to the extent customer property and SIPC advances (up to $500,000 per customer, including a maximum of $250,000 for cash claims) are not sufficient to pay or otherwise satisfy in full the net equity claims of customers, such customers are entitled, to the extent only of their respective unsatisfied net equities, to participate in the general estate as unsecured creditors.

In response to statements in the ICE Letter that the SIPA insolvency rules do not appear to provide assurances for a prompt liquidation, the Commission notes that SIPA and Commission regulations contemplate expeditious transfer of customer accounts through self-liquidation or a proceeding under SIPA. In general, if the books and records of the broker-dealer are in order and customer accounts are properly margined, customer accounts may be transferred to another broker-dealer in a process known as a bulk transfer. See Joint Report, supra, note 44, at 40.

First, the BD/FCM must maintain affiliate money, securities, and property received to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, in a Cleared Swaps Proprietary Account for the purpose of clearing (as a clearing member of a clearing agency/DCO operating pursuant to the exemption in this Order) such positions under a program to commingle and portfolio margin CDS. The purpose of this requirement is to ensure that a program to commingle and portfolio margin CDS will conform to the regulatory regime of the CFTC, under which certain affiliates are not treated as customers.[53] Specifically, the money, securities, and property of a customer that is an affiliate of the BD/FCM must be held in a Cleared Swaps Proprietary Account in accordance with the CFTC regime.[54]

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53 Under CFTC regulations, an account in which Cleared Swaps and associated collateral of applicable affiliates of an FCM are held is classified as a proprietary account. See 17 CFR 22.1. As previously noted, the Commission believes the relief being provided with respect to affiliates of a BD/FCM is appropriate because absent an exemption, affiliates of a BD/FCM that are not otherwise excluded from the definition of customer in the hypothecation rules (i.e., Exchange Act Rules 8c-1 and 15c2-1) are customers whose securities positions cannot be commingled with the broker-dealer's own proprietary securities positions and therefore could not be held in Cleared Swap Proprietary Account as required under the CFTC regime.

54 The Commission has previously granted similar relief to non-broker-dealer affiliates of members of a registered clearing agency. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000). The no-action relief included terms that required each non-broker-dealer member affiliate whose securities positions would be hypothecated to consent to being treated as a non-customer and to execute a non-conforming subordination agreement meeting certain criteria accompanied by an opinion of counsel regarding the legal authority of the member affiliate to so subordinate its claims. In connection with the no action relief, the Commission approved a proposed rule change filed by OCC to allow an affiliate of an OCC clearing member to designate itself as a non-customer under the Commission's hypothecation rules and OCC's By-Laws and Rules in order for the affiliate's transactions and positions to be commingled in its clearing member's firm and/or proprietary cross-margin account. See Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of Proposed Rule Change Relating to Clearing Member

Second, the BD/FCM must enter into a non-conforming subordination agreement[55] with each affiliate regarding all customer money, securities, or property held in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder under a program to commingle and portfolio margin CDS. The non-conforming subordination agreement must contain: (i) a specific acknowledgment by the affiliate that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be held in a proprietary account in accordance with the CFTC requirements and will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the affiliate that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order. The Commission believes that this requirement should help to ensure that affiliates clearly understand that any customer protection treatment otherwise available with respect to securities transactions under the Exchange Act, SIPA or the stockbroker

Affiliates, Exchange Act Release No. 43668 (Dec. 4, 2000), 65 FR 77413 (Dec. 11, 2000).

55 Under Exchange Act Rule 15c3-1, a broker-dealer can exclude from its liabilities a subordinated loan that has been approved by its designated examining authority ("DEA") for purposes determining its net capital. See 17 CFR 240.15c3-1(c)(2)(ii) and 15c3-1d. A non-conforming subordinated loan is one that the DEA has not approved and, therefore, cannot be used to exclude the liability arising from the loan agreement. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000).

liquidation provisions will not be available and the account would be treated as a proprietary account (and not a customer account) under the CEA.

Third, the BD/FCM must obtain from the affiliate an opinion of counsel that the affiliate is legally authorized to subordinate all of its claims against the BD/FCM to those of other customers. The Commission believes that this condition is appropriate to help ensure that affiliates of the BD/FCM do not place in a proprietary account any assets that the affiliate is not legally authorized to subordinate.

The remaining conditions are applicable generally to all BD/FCMs operating pursuant to the exemption in this Order, regardless of whether they deal with customers that are affiliates of the BD/FCM.

The third condition to this exemption states that the BD/FCM must set minimum margin levels, with respect to any customer transaction in a program to commingle and portfolio margin CDS, at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved in writing by the Commission or the Commission staff. In conducting this review function, the Commission intends that the Commission staff will consult with the CFTC staff and take into consideration the margin methodology used by the clearing agency/DCO in setting customer margin levels under the CFTC risk management regulations.[56] This condition is designed to help assure that consistent customer margin requirements apply to the BD/FCM, regardless of the type of account in which a security (including security-based swap) is held, and that the BD/FCM is requiring minimum

56 See 17 CFR 39.13 (CFTC risk management regulations applicable to DCOs). In appropriate circumstances, the Commission or the Commission staff may provide temporary approval of a BD/FCM's margin methodology while the methodology is still being evaluated prior to granting final approval.

margin that adequately measures the risk in the customer's CDS portfolio in a manner consistent with its appropriate internal risk management procedures.[57] This approach will promote the establishment of consistent margin levels for securities across account types, which in turn will mitigate the risk that clearing agency/DCOs will compete by implementing lower margin levels and help ensure that margin levels are set at sufficiently prudent levels to reduce systemic risk. Finally, the Commission intends that the Commission staff will work with the CFTC staff to see that trading under the program will facilitate both capital efficiency and prudent risk management.

A BD/FCM seeking approval for a margin methodology would be expected to submit sufficient information for the Commission or Commission staff[58] to be able to make a determination regarding the performance of the firm's margin methodology.[59] In reviewing this information, the Commission or the Commission staff will be guided by the standards prescribed in Appendix E of Exchange Act Rule 15c3-1, to the extent relevant to the portfolio margining of

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57 Nothing in this Order will preclude an FCM from setting a higher margin level for some or all of its customers. See 17 CFR 39.13(g)(8).

58 The Commission expects and intends that the Financial Industry Regulatory Authority ("FINRA") will be actively involved in reviewing risk management systems and procedures, including margin methodologies, used by BD/FCMs seeking to participate in the program. FINRA has a defined and vital interest in seeing that its members use portfolio margining arrangements involving securities, including security-based swaps, in a manner that is prudent and fully accounts for all the risks that they incur in connection with such arrangements.

59 If a BD/FCM's margin methodology is approved for purposes of this exemption, the performance of the methodology would be subject to ongoing regulatory supervision, and the BD/FCM would be expected to submit for approval any material changes to its margin methodology.

cleared CDS that are swaps and security-based swaps.[60] In reviewing the BD/FCM's submitted margin methodology, we expect that the Commission or Commission staff would consider, among other things, whether the type and amount of securities permitted to be held for margin purposes are restricted to those which would facilitate the portfolio margining program and whether the BD/FCM's VaR model meets the standards set forth in Appendix E to Exchange Act Rule 15c3-1, as applicable.[61] In cases where a BD/FCM proposes to use a standardized, rather than model-based, methodology, the Commission or Commission staff would consider whether the methodology could be expected to be at least as conservative in setting margin amounts as a model meeting the requirements just described.

By conducting this review, the Commission will be approving margin methodologies for customer positions in securities as well as non-securities held in a portfolio margin account. Due to the nature of portfolio margining, in which the margin methodology is applied to all positions in an account as a single portfolio, security-based swaps cannot be singled out for margin treatment that differs from the treatment applied to swaps. This order by its terms does not apply to, and the Commission is not seeking to establish margin requirements with respect to, accounts that hold no positions in security-based swaps.

The fourth condition requires that the BD/FCM be in compliance with applicable laws and regulations relating to risk management, capital, and liquidity, and be in compliance with

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60 See generally 17 CFR 240.15c3-1e(a). Information submitted as part of such application shall be accorded confidential treatment, subject to provisions of applicable law.

61 The amount and type of securities held for margin purposes should be commensurate with the risk and activity contained in the portfolio margining program and must not be designed to evade the requirements generally applicable to securities pursuant to Exchange Act Rule 15c3-3.

applicable clearing agency/DCO rules and CFTC requirements (including segregation and related books and records provisions) for accounts established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder and subject to a program to commingle and portfolio margin CDS. The purpose of this condition is to help assure that the exemption under this Order is available only where the applicable regulatory requirements are appropriately followed.

The fifth condition requires that each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS be an "eligible contract participant" as defined in Section 1a(18) of the CEA. Similar to the condition under the exemption for clearing agencies/DCOs, the Commission believes that it is appropriate to limit the availability of this exemption to eligible contract participants, as persons that are not eligible contract participants may lack the expertise or resources to effectively determine the risks associated with engaging in these types of transactions.

The sixth and final condition requires that, before receiving any money, securities, or property of a customer to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS, the BD/FCM must furnish to the customer a disclosure document containing (i) a statement indicating that the customer's money, securities, and property will be held in an account maintained in accordance with the segregation requirements of Section 4d(f) of the CEA and that the customer has elected to seek protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and the rules and regulations thereunder with respect to such money, securities, and property, and (ii) a statement that the broker-dealer segregation requirements of Section 15(c)(3) and Section 3E of the Exchange Act and the rules thereunder, and any customer protections under SIPA and the stockbroker liquidation provisions, will not apply to such customer money, securities, and property. The disclosure document may be provided to a customer at or prior to the time that the customer opens an account to commingle and portfolio margin CDS positions in accordance with Section 4d(f) of the CEA, but must be provided prior to the BD/FCM receiving any money, securities or property to margin, guarantee or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS. The Commission believes that this condition will help to provide market participants that elect to participate in a portfolio margining arrangement, as contemplated under this Order, with important disclosures regarding the legal framework that will govern their transactions. As noted above, the Commission views the disclosure requirements as essential to highlight to customers who elect to commingle and portfolio margin their positions in CDS in accounts maintained in accordance with Section 4d(f) of the CEA that the account will be governed by the segregation requirements under the CFTC's regulatory regime and that any protections under the SIPA will not be available to the account in the event of insolvency.[62]

III. Solicitation of Comments

The Commission requests comment on this exemption for clearing agencies/DCOs and BD/FCMs. The Commission is soliciting public comment on all aspects of this exemption, including whether other conditions should apply. If so, what conditions and why?

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 3E(c)(2) and Section 36(a) of the Exchange Act, the following exemptions from Exchange Act requirements will apply:

62 See supra note 52 and associated text.

(a) Exemption for dually registered clearing agencies/derivatives clearing organizations.

A clearing agency registered pursuant to Section 17A of the Exchange Act and registered as a derivatives clearing organization pursuant to Section 5b of the CEA (a "clearing agency/DCO") shall be exempt from Sections 3E(b), (d), and (e) of the Exchange Act and any rules thereunder, solely to perform the functions of a clearing agency for CDS under a program to commingle and portfolio margin cleared CDS for customer positions, subject to the following conditions:

(1) The clearing agency/DCO, by the later of (i) six months after the adoption date of final rules setting forth margin and segregation requirements applicable to security-based swaps consistent with Section 3E of the Exchange Act or (ii) the compliance date of such rules, takes all necessary action within its control to obtain any relief needed to permit its clearing members that are registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) and also registered as a futures commission merchant pursuant to Section 4f(a)(1) of the CEA (a "BD/FCM") (at the BD/FCM's election), to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps (as defined in Section 1(a)(47) of the CEA and the rules thereunder) and security-based swaps (as defined in Section 3(g)(68) of the Exchange Act and the rules thereunder), in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

(2) The clearing agency/DCO, by the later of (i) six months after the adoption date of final rules setting forth margin and segregation requirements applicable to security-based

swaps consistent with Section 3E of the Exchange Act or (ii) the compliance date of such rules, takes all necessary action within its control to establish rules and operational practices to permit a BD/FCM (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. Until such rules and operational practices have been developed, pursuant to the clearing agency/DCO's rules, clearing members that are BD/FCMs must maintain customer money, securities, and property received to margin, guarantee, or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

(3) The clearing agency/DCO has obtained any other relief needed to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing

agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

(4) The clearing agency/DCO has appropriate rules and operational practices to permit a BD/FCM that is a clearing member (at the BD/FCM's election) to maintain customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

(5) The rules of the clearing agency/DCO require that each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS shall be an "eligible contract participant" as defined in Section 1a(18) of the CEA.

(b) Exemption for certain BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section <u>4d(f) of the CEA and rules thereunder</u>.

Solely to perform the functions of a BD/FCM for cleared CDS, with respect to any customer money, securities, and property received by the BD/FCM to margin, guarantee, or secure customer positions in security-based-swaps included in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder under a program to commingle and portfolio margin customer positions in CDS, a BD/FCM shall be exempt from Exchange Act Sections 3E(b), (d), and (e), and Section 15(c)(3) and Rule 15c3-3 thereunder and any requirement to treat an affiliate (as defined in association with the definition of "Cleared

Swaps Proprietary Account" pursuant to CFTC Rule 22.1) as a customer for purposes of Exchange Act Rules 8c-1 and 15c2-1, subject to the following conditions:

(1) With respect to customers that are not affiliates of the BD/FCM,

(i) the BD/FCM shall maintain customer money, securities, and property received to margin, guarantee or secure customer positions consisting of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder for the purpose of clearing (as a clearing member or through a clearing member of a clearing agency/DCO operating pursuant to the exemption in paragraph (a) above) such customer positions under a program to commingle and portfolio margin CDS; and

(ii) the BD/FCM shall enter into a non-conforming subordination agreement with each customer. The agreement must contain a specific acknowledgment by the customer that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM and that such money, securities or property will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; as well as an affirmation by the customer that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order.

(2) With respect to customers that are affiliates of the BD/FCM,

(i) the BD/FCM maintains money, securities, and property of affiliates received to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, in a Cleared Swaps Proprietary Account for the purpose of clearing (as a clearing member of a clearing agency/DCO operating pursuant to the exemption in paragraph (a) above) such positions under a program to commingle and portfolio margin CDS;

(ii) the BD/FCM enters into a non-conforming subordination agreement with each affiliate. The agreement must contain a specific acknowledgment by the affiliate that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be held in a proprietary account in accordance with the CFTC requirements and will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; as well as an affirmation by the affiliate that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order; and

(iii) the BD/FCM obtains from the affiliate an opinion of counsel that the affiliate is legally authorized to subordinate all of its claims against the BD/FCM to those of customers.

(3) The BD/FCM requires minimum margin levels with respect to any customer transaction in a program to commingle and portfolio margin CDS at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved by the Commission or the Commission staff.

(4) The BD/FCM must be in compliance with applicable laws and regulations relating to risk management, capital, and liquidity, and shall be in compliance with applicable clearing agency/DCO rules and CFTC requirements (including segregation and related books and records provisions) for accounts established and maintained in accordance with Section 4d(f) of the CEA and rules thereunder and subject to a program to commingle and portfolio margin CDS.

(5) Each customer of the BD/FCM participating in a program to commingle and portfolio margin CDS is an "eligible contract participant" as defined in Section 1a(18) of the CEA.

(6) Before receiving any money, securities, or property of a customer to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS, the BD/FCM must furnish to the customer a disclosure document containing the following information:

(i) a statement indicating that the customer's money, securities, and property will be held in an account maintained in accordance with the segregation requirements of Section 4d(f) of the CEA and that the customer has elected to seek protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and the rules and regulations thereunder with respect to such money, securities, and property; and

(ii) a statement that the broker-dealer segregation requirements of Section 15(c)(3) and Section 3E of the Exchange Act and the rules thereunder, and any customer protections under SIPA and the stockbroker liquidation provisions, will not apply to such customer money, securities, and property.

V. Paperwork Reduction Act

Certain provisions of this Order contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995.[63] The Commission has submitted this Order to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Collection of Information

The Commission found it necessary or appropriate in the public interest and consistent with the protection of investors to grant the conditional exemptions discussed in this Order. Among other things, the Order would require BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder, to obtain certain agreements and opinions from its customers regarding the applicable regulatory regime, and to make certain disclosures to its customers before receiving any money, securities, or property of a customer to margin, guarantee, or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS. The Order

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63 44 U.S.C. 3501 et. seq.

would also require BD/FCMs that elect to offer a program to commingle and portfolio margin CDS positions in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder, to maintain minimum margin levels using a margin methodology approved by the Commission or the Commission staff.

B. Proposed Use of Information

The collection of information requirements are designed, among other things, to provide appropriate agreements, disclosures, and opinions to BD/FCM customers to clarify key aspects of the regulatory framework that will govern their participation in a program to commingle and portfolio margin CDS positions and to ensure that appropriate levels of margin are collected.

C. Respondents

The collections of information as required by this Order would apply to those BD/FCMs that are seeking to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA. Based on conversations with industry participants and the Commission's market oversight experience, the Commission estimates that approximately 57 firms would be likely to participate in the CDS market in the future.[64] Consequently, the Commission estimates that approximately 57 firms may seek to avail themselves of the conditional exemptive relief provided in this Order.

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64 Based on a review of FOCUS reports filed with the Commission there are approximately 57 broker-dealers that also completed the Commodity Futures Account segregation page on the FOCUS report and therefore would be BD/FCMs. The Commission is assuming that all 57 BD/FCMs would be likely to participate in the CDS market. In addition, the Commission notes it had previously estimated that approximately 50 entities may fit within the definition of security-based swap dealer ("SBSD") and up to 5 entities may fit within the definition of major security-based swap participant ("MSBSP"). <u>See</u> <u>Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants,</u> Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784 (Oct. 24, 2011), at 65808. The Commission believes that the number of BD/FCMs likely to

D. Total Annual Reporting and Recordkeeping Burden

Paragraph IV(b)(1)(ii) of this Order applies with respect to customers that are not affiliates of the BD/FCM and requires BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder to enter into a non-conforming subordination agreement with the non-affiliate customer. The non-conforming subordination agreement must contain: (i) a specific acknowledgment by the customer that such money, securities or property will not receive customer treatment under the Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM and that such money, securities or property will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the customer that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order.

The Commission estimates that the average number of non-affiliate CDS customers of a BD/FCM to be approximately 1,000[65] and the average number of hours to develop a

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engage in the CDS business would be approximately equal to the previously estimated number of security-based swap dealers and major security-based swap participants given that CDS make up a significant portion of the current security-based swap market.

65 This estimate is based on a previous estimate in the Capital Margin and Segregation Release that each of SBSD and MSBSP has 1,000 counterparties at any given time. See Capital, Margin, and Segregation Requirements Adopting Release. Commission staff believes that the number of counterparties of a SBSD or MSBSP may likely be equivalent to the number of customers of a BD/FCM that may participate in a portfolio margining program for customer positions in cleared CDS offered by the BD/FCM. However, as

subordination agreement for each non-affiliate CDS customer to be approximately 20 hours. In addition, based on a consultation with industry representatives, the Commission estimates that each non-affiliate customer will do business with more than one BD/FCM, averaging out to 2.5 BD/FCMs per customer. Consequently, the Commission estimates the total one-time burden associated with this requirement to be 2,850,000 hours.[66] In addition, because the BD/FCM would enter into these agreements with CDS customers, the Commission staff estimates that a BD/FCM would have outside counsel review a standard non-conforming subordination agreement and that the review would take approximately 100 hours at a cost of approximately $400 per hour.[67] As a result, the Commission staff estimates that each BD/FCM would incur one-time costs of approximately $40,000, resulting in an industry-wide one-time cost of approximately $2,280,000.[68]

Paragraph IV(b)(2)(ii) of this Order applies with respect to customers that are affiliates of the BD/FCM and requires BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder to enter into a non-conforming subordination agreement. The non-conforming subordination agreement must contain: (i) a specific acknowledgment by the affiliate that such money, securities or property will not receive customer treatment under the

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portfolio margining programs are not yet being offered for CDS customers, it is difficult to estimate with precision the number of customers that may participate in customer clearing of CDS. Furthermore, the number of customers that seek to clear CDS through a portfolio margining program may change after final mandatory clearing determinations are made with respect to various product types within CDS.

66 57 BD/FCMs x 1,000 non-affiliate customers per dealer x 2.5 BD/FCMs used by each customer x 20 hours for each agreement.

67 See PRA Analysis in Capital, Margin, and Segregation Requirements Adopting Release (providing an estimate of $400 an hour to engage an outside attorney).

68 57 BD/FCMs x 100 hours to review x $400 per hour.

Exchange Act or SIPA or be treated as customer property as defined in 11 U.S.C. 741 in a liquidation of the BD/FCM, and that such money, securities or property will be held in a proprietary account in accordance with the CFTC requirements and will be subject to any applicable protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and rules and regulations thereunder; and (ii) an affirmation by the affiliate that all of its claims with respect to such money, securities, or property against the BD/FCM will be subordinated to the claims of other securities customers and security-based swap customers not operating under a program to commingle and portfolio margin CDS pursuant to this Order. The Commission estimates that the average number of customers that are affiliates of the BD/FCM to be approximately 11[69] and the average number of hours to develop a subordination agreement for a non-affiliate CDS customer to be approximately 20 hours based on the Commission's prior experiences with the development of subordination agreements.[70] Consequently, the Commission estimates that the total one-time burden associated with this requirement to be 12,540 hours.[71]

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69 FINRA CRD data indicate that the 17 largest broker-dealers (i.e., those with total assets of $50 billion or more) reported a total of 188 affiliates that are themselves registered with the SEC (i.e., they have their own CRD numbers), representing approximately 11 affiliates per broker-dealer. The Commission believes that this would be a useful approximation of the average number of customers that are affiliates of the BD/FCM, as many affiliates of a BD/FCM that would seek to use portfolio margining are likely to be subject to some form of a registration requirement with the SEC. Furthermore, the assumption that all such registered affiliates would seek to engage in portfolio margining (when some may not) should help to offset any discrepancy associated with customers that are affiliates but would not be subject to an SEC registration requirement.

70 The Commission has previously considered the development of subordination agreements in other contexts. See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, to William H. Navin, EVP and General Counsel, The Options Clearing Corporation (June 15, 2000).

71 57 BD/FCMs x 11 affiliate customers x 20 hours.

As stated previously, the Commission staff believes that a BD/FCM would have outside counsel review a standard non-conforming subordination agreement and that review would result in a one-time industry cost of $2,280,000. Because the same requirements and acknowledgements in the non-conforming subordination agreements with non-affiliate customers must be included in the non-conforming subordination agreements with affiliate customers (with an additional acknowledgement by the affiliate that its money, securities, or property will be held in a proprietary account in accordance with CFTC requirements), we believe that a BD/FCM would not need to engage an outside counsel to perform a review of a separate review of a standard non-conforming subordination agreement for affiliate customers.

Paragraph IV(b)(2)(iii) of this Order applies with respect to customers that are affiliates of the BD/FCM and requires BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder to obtain from its affiliates an opinion of counsel that the affiliate is legally authorized to subordinate all of its claims against the BD/FCM to those of customers. Again, the Commission estimates that the average number of customers that are affiliates of the BD/FCM to be approximately 11 and the average number of hours to develop the required opinion for an affiliate CDS customer to be approximately 2 hours.[72] Consequently, the Commission estimates that the total one-time burden associated with this requirement to be 1,254

72 This estimate is based on the Commission's currently approved Collection of Information Supporting Statement for Rule 15c3-1 of the Exchange Act, which discusses obtaining an opinion of counsel as required by Appendix C to Rule 15c3-1 of the Exchange Act (available at http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201006-3235-004). The Commission believes that obtaining an opinion of counsel as required by this order will require additional time to adequately research the issue to provide an opinion of counsel and, therefore, has provided additional time in its estimation.

hours.[73] The Commission staff also estimates that the BD/FCM will engage outside counsel to review a standard opinion of counsel and that the outside counsel would need approximately 20 hours at a cost of approximately $400 per hour. As a result, the Commission staff estimates that the BD/FCM would incur a one-time cost of approximately $8,000, resulting in an industry-wide one-time cost of approximately $456,000.[74]

Paragraph IV(b)(5) of this Order requires that BD/FCMs that elect to offer a program to commingle and portfolio margin customer positions in CDS in customer accounts maintained in accordance with Section 4d(f) of the CEA and rules thereunder, to maintain minimum margin levels with respect to any customer transaction in a program to comingle and portfolio margin CDS at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved by the Commission or its staff. As part of the approval process, a BD/FCM would be expected to submit certain information in order to make a determination regarding the performance of the margin methodology. The Commission anticipates that information would be substantially similar to information required in Appendix E to Exchange Act Rule 15c3-1 to the extent relevant to portfolio margining CDS that are swaps and security-based swaps. Based on similar estimates, the Commission estimates that each BD/FCM that that seeks approval from the Commission would spend approximately 1,000 hours to create and compile the various documents to provide to Commission staff and to work with Commission staff through the approval process.[75] This includes approximately 100 hours for an

73 57 BD/FCMs x 11 affiliate customers x 2 hours.

74 57 BD/FCMs x 20 hours for outside counsel to review x $400 per hour.

75 This estimate is based on the Commission's currently approved Collection of Information Supporting Statement for Rule 15c3-1 of the Exchange Act, which discusses the reporting burden for broker-dealers to apply and receive approval from the Commission

in-house attorney to complete a review of the information and documentation provided to the Commission staff. Consequently, the Commission estimates the total one-time burden associated with this requirement to be 57,000 hours.[76]

Paragraph IV(b)(6) of this Order requires each BD/FCM receiving any money, securities, or property of a customer to margin, guarantee or secure positions consisting of cleared CDS, which include both swaps and security-based swaps, under a program to commingle and portfolio margin CDS in an account maintained in accordance with Section 4d(f) of the CEA and the rules thereunder to disclose to its customers that (i) the customer's money, securities, and property with be held in an account maintained in accordance with the segregation requirements of Section 4(d)f of the CEA and that the customer has elected to seek protections under Subchapter IV of Chapter 7 of Title 11 of the United States Code and the rules and regulations thereunder with respect to such money, securities, and property and (ii) that the broker-dealer segregation requirements of Section 15(c)(3) and Section 3E of the Exchange Act, and any customer protections under SIPA and the stockbroker liquidation provisions, will not apply to such customer money, securities, and property. These disclosures provide customers important disclosures regarding the legal framework that will govern their transactions if a liquidation were to occur. The Commission believes that the BD/FCM could use the language in the Order that describes the disclosure that must be made as a template to draft the disclosure statement. Consequently, the Commission estimates that it would take a BD/FCM clearing member

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to use Appendix E to Rule 15c3-1 of the Exchange Act (available at http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201006-3235-004).

76 1,000 hours x 57 BD/FCMs.

approximately 8 hours to draft the disclosure statement.[77] Further, the Commission believes the BD/FCM will include this disclosure statement with other documents or agreements provided to cleared CDS customers and as a result the BD/FCM should not be subject to any additional burden associated with relaying this information to the customer. Therefore, the Commission estimates that aggregate burden from this requirement will be 456 hours[78] to comply with this requirement.

E. Collection of Information is Mandatory

The collections of information contained in the conditions to this Order are mandatory for any entity wishing to rely on the conditional exemptions granted by this Order.

F. Confidentiality

The Commission expects to receive confidential information in connection with the proposed collections of information. To the extent that the Commission receives confidential information pursuant to these collections of information, the Commission is committed to protecting the confidentiality of such information, subject to the provisions of applicable law.[79]

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77 This estimate is based on the Commission's currently approved Collection of Information Supporting Statement for Rule 15c3-3 of the Exchange Act, which discusses the reporting burden to prepare a disclosure statement pursuant to Rule 15c3-3 of the Exchange Act (http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201103-3235-025).

78 57 BD/FCMs x 8 hours.

79 See, e.g., Exchange Act Section 24, 15 U.S.C. 78x (governing the public availability of information obtained by the Commission) and 5 U.S.C. 552 et. seq. (Freedom of Information Act – "FOIA"). FOIA Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. 552(b)(4). FOIA Exemption 8 provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared

G. Request for Comment on Paperwork Reduction Act

The Commission requests, pursuant to 44 U.S.C. 3506(c)(2)(B), comment on the collections of information contained in this Order to:

(i) evaluate whether the collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) evaluate the accuracy of the Commission's estimates of the burden of the collections of information;

(iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

(iv) evaluate whether there are ways to minimize the burden of the collections of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. S7-13-12. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the Federal Register; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of

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by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. 552(b)(8).

this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-13-12, and be submitted to the Securities and Exchange Commission, Records Management Office, 100 F Street, NE, Washington, DC 20549.

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. 68436 / December 14, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3430 / December 14, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15078

In the Matter of RAJNISH K. DAS	ORDER DENYING MOTION TO LIFT TEMPORARY SUSPENSION AND DIRECT HEARING

On October 24, 2012, we issued an order instituting proceedings against Rajnish K. Das pursuant to Commission Rule of Practice 102(e)(3)[1] that temporarily suspended him from appearing or practicing before the Commission.[2]

The OIP alleges that Das was the chief financial officer of infoUSA, Inc. from approximately September 2003 through January 2006, and in that position certified infoUSA's Forms 10-K that were filed with the Commission.[3] On March 15, 2010, the Commission filed a

1 Rule of Practice 102(e)(3)(i), 17 C.F.R. § 201.102(e)(3)(i), provides:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney, accountant, engineer, or other professional or expert who has been by name:
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> (A) Permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or
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> (B) Found by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party or found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

2 *Rajnish K. Das*, Exchange Act Release No. 68096, 2012 WL 5246492 (Oct. 24, 2012).

3 *Id.* at *1. The OIP also alleges that Das "has not passed the certified public accountant ('CPA') exam and has not been a licensed CPA." *Id.* at *1.

complaint in the United States District Court for the District of Nebraska alleging that Das engaged in securities fraud and other violations of the securities laws by preparing and reviewing infoUSA's Forms 10-K and proxy statements that materially understated and failed to properly disclose perquisite compensation to Vinod Gupta, infoUSA's former chief executive officer and Chairman of the Board of Directors, and failed to properly disclose related party transactions involving Gupta.[4] The complaint also alleged that Das aided and abetted the filing of infoUSA's false Forms 10-K.

A jury found that Das violated the antifraud, false proxy statements, false certifications, false statements and omissions to accountants and auditors, and books-and-records provisions of the federal securities laws. It also found that Das aided and abetted infoUSA's violations of the reporting and record-keeping provisions of the Securities Exchange Act of 1934.[5] On May 29, 2012, the district court entered a judgment permanently enjoining Das from future violations, directly or indirectly, of §§ 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5), and 14(a) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13a-14, 13b2-1, 13b2-2, 14a-3, and 14a-9 promulgated thereunder.[6] The judgment also barred Das from serving as a director or officer of a publicly traded company for a period of three years, and ordered Das to pay a civil monetary penalty of $50,000.[7]

In issuing the OIP, we found it "appropriate and in the public interest" that Das be temporarily suspended from appearing or practicing before the Commission based on the district court's final judgment. We stated that the temporary suspension would become permanent unless Das filed a petition challenging it within thirty days of service of the order, pursuant to Rule of Practice 102(e)(3)(ii). We further advised that, pursuant to Rule of Practice 102(e)(3)(iii), upon receipt of such a petition, we would either lift the temporary suspension, set the matter down for hearing, or both.

In his petition, Das requests that the temporary suspension be lifted, arguing that (i) he is outside the reach of the suspension provision of Rule of Practice 102(e)(3)(i) because he has never been an accountant or "other professional," (ii) the OIP was filed more than ninety days after the final judgment and was therefore untimely under Rule 102(e)(3), (iii) the doctrine of collateral estoppel prevents the Commission from imposing a permanent suspension based on

4 *SEC v. Rajnish K. Das, et al.*, No. 10-CV-00102 LSC (FG3), *available at* http://www.sec.gov/litigation/complaints/2010/comp21451-dasanddean.pdf.

5 The jury found that Das violated (i) the antifraud provisions in Exchange Act § 10(b), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; (ii) the false proxy statements provisions of Exchange Act § 14(a), 15 U.S.C. § 78n(a), and Rules 14a-3 and 14a-9 thereunder, 17 C.F.R. §§ 240.14a-3 and 14a-9; (iii) the false certifications provisions of Exchange Act Rule 13a-14, 17 C.F.R. § 240.13a-14; (iv) the false statements and omissions to accountants and auditors provisions of Exchange Act Rule 13b2-2, 17 C.F.R. § 240.13b2-2; and (v) the books-and-records provisions of Exchange Act § 13(b)(5), 15 U.S.C. § 78m(b)(5), and Rule 13b2-1 thereunder, 17 C.F.R. § 240.13b2-1. The jury further found that Das aided and abetted infoUSA's violations of (i) the issuer reporting requirements in Exchange Act § 13(a), 15 U.S.C. § 78m(a), and Exchange Act Rules 12b-20, 13a-1, 13a-13 thereunder, 17 C.F.R. §§ 240.12b-20, 240.13a-1 and 240.13a-13; and (ii) the books-and-records provisions of Exchange Act § 13(b)(2), 15 U.S.C. § 78m(b)(2).

6 *SEC v. Rajnish K. Das, et al.*, Civil Action No. 8:10-cv-00102.

7 *Id.*

findings made by the district court, and (iv) the suspension is not in the public interest. The Division of Enforcement has not filed an opposition to Das's petition.

Rule 102(e)(3)(i)(a) permits the Commission to suspend any accountant or other professional or expert who has been "[p]ermanently enjoined . . . from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder."[8] At this stage it appears that the findings made in the injunctive proceeding and the injunction issued against Das "justify the continuance of his suspension until it can be determined what, if any, action may be appropriate to protect the Commission's processes."[9] As provided in Rule 102(e)(3)(iii),[10] therefore, we will set the matter down for public hearing.

Accordingly, IT IS ORDERED that this proceeding be set down for public hearing before an administrative law judge in accordance with Rule of Practice 110. As specified in Rule of Practice 102(e)(3)(iii), the hearing in this matter shall be expedited in accordance with Rule of Practice 500; it is further

ORDERED that the administrative law judge shall issue an initial decision no later than 210 days from the date of service of this order; and it is further

ORDERED that the temporary suspension of Rajnish K. Das, entered on October 24, 2012, remain in effect pending a hearing and decision in this matter.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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8 17 C.F.R. § 201.102(e)(3)(i)(a).

9 *Williams D. Shovers*, Exchange Act Release No. 59874, 2009 WL 1271170, at *2 (May 6, 2009).

10 17 C.F.R. § 201.102(e)(3)(iii).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68439; File No. TP 11-10)

December 14, 2012

Order Granting Limited Exemptions from Exchange Act Rules 101 and 102 of Regulation M to Shares of JPM XF Physical Copper Trust Pursuant to Exchange Act Rules 101(d) and 102(e)

By letter dated December 14, 2012 (the "Letter"),[1] as supplemented by conversations with the staff of the Division of Trading and Markets, counsel for J.P. Morgan Commodity ETF Services LLC ("Sponsor") on behalf of the Sponsor, JPM XF Physical Copper Trust ("Trust"), and persons or entities engaging in transaction in the shares of the Trust requested that the Securities and Exchange Commission ("Commission") issue an exemption from Rules 101 and 102 of Regulation M in connection with secondary market transactions in the shares of the Trust, and the creation or redemption of shares of the Trust.[2]

According to the Trust's registration statement, the Trust was formed as a Delaware statutory trust on October 15, 2010. The Trust, based on representations in the Letter, is a passive, unmanaged investment vehicle and will have no directors, officers, or employees. Additionally, the Letter represents that the Trust is an exchange-traded investment vehicle that will hold only Grade A Copper in physical form. The Letter also states that each share of the Trust represents a fractional undivided interest in the net assets of the Trust ("Share"). The Trust's investment objective, according to the Letter, is for the value of the Shares to reflect, at

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1 See Letter from John Crowley to Josephine Tao (December 14, 2012), re: Request of J.P. Morgan Commodity ETF Services LLC for Relief from Certain Provisions of Regulation M, available at: http://www.sec.gov/divisions/marketreg/mr-noaction.shtml.

2 For additional information regarding the Trust please see the Order Approving a Proposed Rule Change to List and Trade Shares of the JPM XF Physical Copper Trust Pursuant to NYSE Arca Equities Rule 8.201, Securities Exchange Act Release No. 68440; __ FR __ ("Approval Order").

any given time, the value of copper owned by the Trust less the Trust's expenses and liabilities at that time.

The Letter contains the following representations:

- Shares of the Trust will trade on a national securities exchange.[3]
- Shares will be issued and redeemed in basket-size aggregations ("Creation Units") to registered broker-dealers or certain other persons that have entered into a participation agreement with the Trust and the Sponsor ("Authorized Participants").
- Creation Units will be issued and redeemed daily in exchange for a specified amount of physical metal that represents a pro rata share of the metal then held in the Trust.
- The Sponsor does not expect the difference in price based on the locational premia to be significant.[4]
- The Sponsor believes that the copper selection protocol,[5] the independent third-party valuation agent,[6] and information transparency measures[7] will cause the

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3 See also Approval Order, supra, note 1.

4 According to the Letter, the copper will be held in one or more warehouses in locations throughout the world. The value of copper depends in part on its location, i.e., copper stored in a location that is low in supply and high in demand carries a higher premium than copper that is stored in a location where supply is high and demand is low. To assist in valuing the Trust's copper, by 9:00 am EST, an independent valuation agent will provide the administrative agent (the administrative agent, which initially will by J.P. Morgan Treasury Securities Services, will administer various daily functions of the Trust ("Administrative Agent")) the locational premia for the locations at which the Trust is permitted to hold copper. The locational premium for a warehouse location for a business day will be calculated as an amount expressed in U.S. dollars that is equal to the average value of copper per metric ton in such location minus the LME Settlement Price of copper on such business day. See Securities Exchange Act Release No. 66816 (April 16, 2012); 77 FR 23772, 23779 ("Notice").

price of Shares in the secondary market to closely track the net asset value per Share of the Trust.

- The Trust will continuously redeem baskets of Shares at net asset value expressed as a pro rata portion of the weight of copper held by the Trust.
- The Sponsor states that it believes that, because Authorized Participants have full, transparent information about the Trust's copper, including the locational premium and the brand for each lot of copper held by the Trust and whether the

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5 According to the Letter, the selection protocol is intended to provide a consistent and transparent method of selecting lots to satisfy redemption orders and calculating and paying expenses, by requiring the Administrative Agent to select lots in the following manner: (1) lots will be selected first from the warehouse where it holds available copper that has the lowest locational premium at a particular time (i.e., the "cheapest-to-deliver location"), and then from other warehouse locations successively based on a ranking of their respective locational premia from lowest to highest; (2) if there are multiple lots in the same warehouse location specified by the first step, lots in such warehouse location will be selected based on the date such lots were first delivered to the relevant account, with the earliest delivered lot being selected first; and (3) if there are multiple lots in the same warehouse location that were first delivered to the relevant account on the same date, lots will be selected based on the actual weight of the lot, with the lot having the lowest actual weight being selected first. For additional information, see Notice, supra, note 3, 77 FR at 23781–82.

6 According to the Letter, the valuation agent, which is independent from and unaffiliated with the Sponsor, is responsible for providing the locational premium for each permitted warehouse location, which is used to calculate the Trust's net asset value, determine the cheapest-to-deliver location, and make other determinations for the Trust.

7 According to the Letter, the Administrative Agent will provide full transparency on its website of the Trust's assets. The Sponsor anticipates that, through a combination of the use of the selection protocol and transparency of information, each Authorized Participant will be able to assess which lots of copper are likely to be delivered in connection with a redemption order by the Authorized Participant. Additionally, the Exchange will publish two intraday indicative values throughout the course of the day. These two intraday indicative values, discussed in subsequent bullets below, will provide Authorized Participants with an indication of the underlying value of the Trust's Shares during the trading day, on any day the Exchange is open for business.

brand of any such lot is or has ceased to be an Acceptable Delivery Brand,[8] factors such as locational premia and de-registering of copper will not impair the price alignment process or the arbitrage mechanism.[9]

- NYSE Arca will calculate and disseminate, approximately every 15 seconds during the Exchange's core trading session, two different intraday indicative values for the Shares: the First-Out IIV and the Liquidation IIV.[10]
- Authorized Participants can generally expect to receive copper from the cheapest-to-deliver location whenever they redeem Creation Units of Shares and are expected to seek to create Creation Units of Shares by transferring copper from the cheapest-to-deliver location at which they have copper available.[11]

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8 According to the Letter, the LME oversees the registration process for each refinery seeking to register its brand of copper as an acceptable delivery brand for LME registered transactions ("Acceptable Delivery Brand"). Any copper that is delivered to the Trust by an Authorized Participant must, at the time of delivery, be of an Acceptable Delivery Brand. If the LME de-registers a brand of copper that is held by the Trust, the Trust will use the de-branded copper to satisfy redemptions before using any other lots of copper, even if the de-branded copper is not held in the cheapest-to-deliver location.

9 See supra notes 4 and 9.

10 The "First-Out IIV" is designed to facilitate arbitrage activity by authorized participants by indicating whether the Shares are trading at a discount or premium during the trading day. See Notice, supra, note 3, 77 FR at 23785. It represents, as of the time of such calculation, the hypothetical U.S. dollar value per Share of the copper that would need to be transferred to or from the Trust to create or redeem one Share included in a Creation Unit, assuming that copper in the cheapest-to-deliver location was used for such creation or redemption. See id. at 23783. The "Liquidation IIV" is an intraday indicative value that represents, as of the time of the calculation, the hypothetical U.S. dollar value per Share of all of the copper owned by the Trust divided by the number of Shares then outstanding. See id. at 23783. For a description of how the Exchange will calculate the First-Out IIV and the Liquidation IIV, see id. at 23784–86.

11 See Notice, supra, note 3, 77 FR at 23784.

- Arbitrage activity by Authorized Participants is expected to result in the Shares trading within a limited range, with the lower end of that range approximating the first-out intraday indicative value and the higher end of that range approximating the value of copper in the cheapest-to-deliver location at which the Authorized Participants have copper available.[12]

Rule 101 of Regulation M

Generally, Rule 101 of Regulation M is an anti-manipulation regulation that, subject to certain exemptions, prohibits any "distribution participant" and its "affiliated purchasers" from bidding for, purchasing, or attempting to induce any person to bid for or purchase, any security which is the subject of a distribution until after the applicable restricted period, except as specifically permitted in the rule. Rule 100 of Regulation M defines "distribution" to mean any offering of securities that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods. The provisions of Rule 101 of Regulation M apply to underwriters, prospective underwriters, brokers, dealers, or other persons who have agreed to participate or are participating in a distribution of securities, and affiliated purchasers of such persons. Shares of the Trust are in a continuous distribution and, as such, the restricted period in which distribution participants and their affiliated purchasers are prohibited from bidding for, purchasing, or attempting to induce others to bid for or purchase extends indefinitely. As a result, absent an exemption from Rule 101 of Regulation M, the distribution participants would be prohibited from bidding for or purchasing Shares during the distribution without violating Rule 101 of Regulation M.

On the basis of the representations and the facts presented in the Letter, particularly that the Trust will continuously redeem baskets of Shares at net asset value expressed as a pro rata

[12] Id. at 23785.

portion of the weight of copper held by the Trust and that the secondary market price of Shares is expected to trade within a limited range with the lower end of that range approximating the first-out intraday indicative value and the higher end of that range approximating the value of copper in the cheapest-to-deliver location at which the Authorized Participants have copper available, the Commission finds that it is appropriate in the public interest, and is consistent with the protection of investors, to grant the Shares of the Trust a limited exemption from Rule 101 of Regulation M pursuant to paragraph (d) thereof,[13] to permit persons participating in the distribution of Shares and their affiliated purchasers to bid for or purchase Shares during their participation in such distribution.[14] In particular, the price alignment process and arbitrage mechanism, which are expected to align the price of the Shares in the secondary market to the copper held by the Trust, should mitigate the potential manipulation concerns that Rule 101 of Regulation M is designed to prevent. Accordingly, granting such relief to the Shares to permit persons participating in the distribution of Shares and their affiliated purchasers to bid for or purchase Shares during their participation in such distribution is appropriate in the public interest, and is consistent with the protection of investors.

Rule 102 of Regulation M

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13 Rule 101(d) of Regulation M specifies the Commission may grant an exemption from the provision of Rule 101, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities.

14 The Commission, pursuant to delegated authority, has granted similar exemptive relief from Rule 101 to other exchange-traded vehicles that hold only physical metal. See, e.g., Letters from James A. Brigagliano, Assistant Director, Division of Market Regulation, (i) to Kathleen Moriarty, Esq., Carter Ledyard & Milburn, dated November 17, 2004, with respect to the trading of StreetTRACKS Gold Trust, (ii) to David Yeres, dated January 27, 2005, with respect to the trading of the iShares COMEX Gold Trust, and (iii) to David Yeres, dated April 27, 2006, with respect to the trading of iShares Silver Trust.

Rule 102 of Regulation M prohibits issuers, selling security holders, or any affiliated purchaser of such persons from bidding for, purchasing, or attempting to induce any person to bid for or purchase a covered security[15] during the applicable restricted period in connection with a distribution of securities effected by or on behalf of an issuer or selling security holder, except as specifically permitted in the rule. As a result, absent an exemption from Rule 102 of Regulation M, the Shares could not be redeemed by the Trust without violating Rule 102 of Regulation M.

On the basis of the representations and the facts presented in the Letter, particularly that the Trust will continuously redeem baskets of Shares at net asset value expressed as a pro rata portion of the weight of copper held by the Trust and that the secondary market price of Shares is expected to be within a limited range with the lower end of that range approximating the first-out intraday indicative value and the higher end of that range approximating the value of copper in the cheapest-to-deliver location at which the Authorized Participants have copper available, the Commission finds that it is appropriate in the public interest, and is consistent with the protection of investors, to grant the Shares of the Trust a limited exemption from Rule 102 of Regulation M, pursuant to paragraph (e) thereof,[16] to permit the Trust and any of its affiliated purchasers to redeem Shares during the distribution of the Shares.[17] In particular, the price alignment process

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15 Covered security is defined as any security that is the subject of a distribution, or any reference security. Rule 100(b), 17 CFR 242.100(b).

16 Rule 102(e) specifies the Commission may grant an exemption from the provision of Rule 102, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities.

17 The Commission, pursuant to delegated authority, has granted similar exemptive relief from Rule 102 to other exchange-traded vehicles that hold only physical metal. See, e.g., Letters from James A. Brigagliano, Assistant Director, Division of Market Regulation, (i) to Kathleen Moriarty, Esq., Carter Ledyard & Milburn, dated November 17, 2004, with respect to the trading of StreetTRACKS Gold Trust, (ii) to David Yeres, dated January

and arbitrage mechanism, which are expected to align the price of the Shares in the secondary market to the copper held by the Trust, should mitigate the potential manipulation concerns that Rule 102 of Regulation M is designed to prevent. Accordingly, granting such relief to the Shares to permit the Trust and any of its affiliated purchasers to redeem Shares during the distribution of the Shares is appropriate in the public interest, and is consistent with the protection of investors.

Conclusion

IT IS HEREBY ORDERED, pursuant to Rule 101(d) of Regulation M, that, based on the representations and facts presented in the Letter, the Shares of the Trust are exempt from the requirements of Rule 101 to permit persons participating in the distribution of Shares of the Trust and their affiliated purchasers to bid for or purchase such Shares during their participation in such distribution.

IT IS FURTHER ORDERED, pursuant to Rule 102(e) of Regulation M, that, based on the representations and facts presented in the Letter, the Shares of the Trust are exempt from the requirements of Rule 102 to permit the Trust and any of its affiliated purchasers to redeem Shares of the Trust during the distribution of such Shares.

This exemptive relief is subject to modification or revocation at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. Persons participating in the distribution of Shares of the Trust shall discontinue creations and redemptions involving the Shares of the Trust, in the event that any material change occurs with respect to any of the facts or representations made by the Trust, the Sponsor, or its counsel. In addition, persons relying on this exemption are directed to the anti-fraud and anti-manipulation provisions of the Exchange Act, particularly Sections 9(a), 10(b), and Rule

27, 2005, with respect to the trading of the iShares COMEX Gold Trust, and (iii) to David Yeres, dated April 27, 2006, with respect to the trading of iShares Silver Trust.

10b-5 thereunder. Responsibility for compliance with these and any other applicable provisions of the federal securities laws and rules must rest with the persons relying on this exemption. This order does not represent the Commission views with respect to any other question that the proposed transactions may raise, including, but not limited to the adequacy of the disclosure concerning, and the applicability of other federal or state laws and rules to, the proposed transactions.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Commissioner [illegible] not participating

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68440; File No. SR-NYSEArca-2012-28)

December 14, 2012

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change as Modified by Amendment No. 1 to List and Trade Shares of the JPM XF Physical Copper Trust Pursuant to NYSE Arca Equities Rule 8.201

I. Introduction

On April 2, 2012, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to list and trade shares ("Shares") of JPM XF Physical Copper Trust ("Trust") pursuant to NYSE Arca Equities Rule 8.201. J.P. Morgan Commodity ETF Services LLC is the sponsor of the Trust ("Sponsor"). The proposed rule change was published for comment in the Federal Register on April 20, 2012.[3]

The Commission initially received one comment letter, which opposed the proposed rule change.[4] On May 30, 2012, the Commission extended the time period for Commission action to July 19, 2012.[5] On June 19, 2012, NYSE Arca submitted a letter in support of its proposal.[6] On

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

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 66816 (April 16, 2012), 77 FR 23772 ("Notice").

4 See letter from Vandenberg & Feliu, LLP ("V&F"), received May 9, 2012 ("V&F May 9 Letter"). Comment letters are available at http://www.sec.gov/comments/sr-nysearca-2012-28/nysearca201228.shtml.

5 See Securities Exchange Act Release No. 67075, 77 FR 33258 (June 5, 2012).

6 See letter from Janet McGinness, General Counsel, NYSE Markets, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated June 19, 2012 ("Arca June 19 Letter").

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July 13, 2012, V&F submitted a second comment letter opposing the proposed rule change.[7] On July 16, 2012, United States Senator Carl Levin submitted a comment letter opposing the proposed rule change.[8] Additionally, on July 19, 2012, the Commission received a comment letter from another party opposing the proposed rule change.[9]

On July 19, 2012, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change.[10] The initial comments for the proceeding were due on August 24, 2012, and the Commission received four comment letters (another letter from V&F, another letter from the Exchange, a letter on behalf of the Sponsor, and a letter from several copper fabricators).[11] Rebuttal comments to submissions made during the initial

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7 See letter from Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated July 13, 2012 ("V&F July 13 Letter").

8 See letter from U.S. Senator Carl Levin, to Elizabeth M. Murphy, Secretary, Commission, dated July 16, 2012 ("Levin Letter").

9 See web comment from Suzanne H. Shatto ("Shatto Letter").

10 See Securities Exchange Act Release No. 67470, 77 FR 43620 (July 25, 2012) ("Order Instituting Proceedings").

11 See letters from Janet McGinness, General Counsel, NYSE Markets, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated August 23, 2012 ("Arca August 23 Letter"); Joe Williamson, Senior Vice President, Strategic Sourcing, Southwire Company; Janet Sander, Vice President, Director of Purchasing, Encore Wire Corporation; Ron Beal, Executive Vice President, Tubes Division, Luvata; and Mark Woehnklar, President, Amrod Corp., to Elizabeth M. Murphy, Secretary, Commission, dated August 23, 2012 ("Copper Fabricators Letter"); Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated August 24, 2012 ("V&F August 24 Letter"); and John G. Crowley, Davis Polk & Wardwell LLP ("DP"), on behalf of the Sponsor, to Elizabeth M. Murphy, Secretary, Commission, dated August 24, 2012 ("DP August 24 Letter"). In its August 24 Letter, V&F requested to make an oral presentation in the proceeding. See V&F August 24 Letter at 1. The Commission denied V&F's request. See letter from Kevin M. O'Neill, Deputy Secretary, Commission, to Robert B. Bernstein, Eaton & Van Winkle LLP ("EVW"), dated December 5, 2012, available at http://www.sec.gov/comments/sr-nysearca-2012-28/nysearca201228.shtml. By letter dated November 29, 2012, Mr. Bernstein informed the Commission that he had left V&F and would continue to represent Southwire Company, Encore Wire Corporation, Luvata,

comment period were due on September 10, 2012. The Commission received three more comment letters (another letter from V&F and two more on behalf of the Sponsor).[12] On October 2, 2012, the Commission issued a notice of designation of longer period for Commission action on proceedings to determine whether to approve or disapprove the proposed rule change.[13] The Commission subsequently received six more comment letters (two more letters from V&F, two letters from Americans for Financial Reform, and two letters from Robert E. Rutkowski).[14] On November 30, 2012, the Exchange filed Amendment No. 1 to the proposed rule change.[15]

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and Amrod Corp. (collectively, the "Copper Fabricators") and RK Capital LLC in this proceeding.

12 See letters from Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated September 10, 2012 ("V&F September 10 Letter"); John G. Crowley, DP, on behalf of the Sponsor, to Elizabeth M. Murphy, Secretary, Commission, dated September 10, 2012 ("DP September 10 Letter"); and John G. Crowley, DP, on behalf of the Sponsor, to Elizabeth M. Murphy, Secretary, Commission, dated September 12, 2012 ("DP September 12 Letter").

13 See Securities Exchange Act Release No. 67965, 77 FR 61457 (October 9, 2012).

14 See letters from Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated October 23, 2012 ("V&F October 23 Letter"); Americans for Financial Reform ("AFR"), to Elizabeth M. Murray [sic], Secretary, Commission, dated October 23, 2012 ("AFR October 23 Letter"); e-mail from Robert E. Rutkowski, to Mary Schapiro, Chair, Commission, dated October 24, 2012 ("Rutkowski October 24 Letter"); Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated November 16, 2012 ("V&F November 16 Letter"); AFR, to Elizabeth M. Murray [sic], Secretary, Commission, dated November 16, 2012 ("AFR November 16 Letter"); and e-mail from Robert E. Rutkowski, to Mary Schapiro, Chair, Commission, dated November 17, 2012 ("Rutkowski November 17 Letter").

15 In Amendment No. 1, the Exchange represented that: (1) it has obtained a representation from the Sponsor that the Sponsor is affiliated with one or more broker-dealers and other entities, and the Sponsor will implement a firewall with respect to such affiliate(s) regarding access to material non-public information of the Trust concerning the Trust and the Shares, and will be subject to procedures designed to prevent the use and dissemination of material non-public information of the Trust regarding the Trust and the Shares; (2) it will obtain a representation from the Trust prior to commencement of trading of the Shares that the net asset value ("NAV") of the Trust and the NAV per Share will be calculated daily and made available to all market participants at the same time; (3) if the First-Out IIV or the Liquidation IIV (terms defined infra in note 42) is not

On December 7, 2012, the Commission received another comment letter opposing the proposed rule change.[16] The Commission is publishing this notice to solicit comments on Amendment No. 1 to the proposed rule change from interested persons, and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.[17]

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being disseminated as required, the Exchange may halt trading during the day in which the disruption occurs; if the interruption persists past the day in which it occurred, the Exchange will halt trading no later than the beginning of the trading day following the interruption; (4) its comprehensive surveillance sharing agreement with the London Metal Exchange ("LME") applies to trading in copper derivatives (as well as copper); (5) it will require that a minimum of 100,000 Shares be outstanding at the start of trading of the Shares; and (6) it can obtain information regarding the activities of the Sponsor and its affiliates under the Exchange's listing rules. Additionally, the Exchange supplemented its description of surveillance applicable to the Shares contained in the proposed rule change as originally filed. Specifically, the Exchange represents that trading in the Shares would be subject to the existing trading surveillances, administered by the Financial Industry Regulatory Authority ("FINRA") on behalf of the Exchange, and that, in addition, FINRA would augment those existing surveillances with a review specific to the Shares that is designed to identify potential manipulative trading activity through use of the creation and redemption process. The Exchange represented that all those procedures would be operational at the commencement of trading in the Shares on the Exchange and that, on an ongoing basis, NYSE Regulation, Inc. (on behalf of the Exchange) and FINRA would regularly monitor the continued operation of those procedures. In addition, the Exchange has represented that it will communicate as needed regarding trading in the Shares with other markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

16 See letter from Robert B. Bernstein, EVW, to Elizabeth M. Murphy, Secretary, Commission, dated December 7, 2012 ("EVW December 7 Letter").

17 Similar to other exchange traded products that hold physical metals, the Sponsor, the Trust, and persons or entities engaging in transactions in Shares need to seek exemptions from, or interpretative or no-action advice regarding, Rules 101 and 102 of Regulation M under the Act to create or redeem Shares. See, e.g., letters from James A. Brigagliano, Assistant Director, Division of Market Regulation, (i) to Kathleen Moriarty, Esq., Carter Ledyard & Milburn, dated November 17, 2004, with respect to the trading of StreetTRACKS Gold Trust, (ii) to David Yeres, dated January 27, 2005, with respect to the trading of the iShares COMEX Gold Trust, and (iii) to David Yeres, dated April 27, 2006, with respect to the trading of iShares Silver Trust. The Sponsor, on behalf of itself, the Trust, and persons or entities engaging in transactions in Shares, submitted a request to the Commission requesting that the Commission grant exemptions from, or interpretative or no-action guidance regarding, Rules 101 and 102 of Regulation M. Simultaneous with the approval of the proposed rule change, the Commission, by

II. Description of the Proposal

The Exchange proposes to list and trade the Shares under NYSE Arca Equities Rule 8.201, which governs the listing and trading of "Commodity-Based Trust Shares."[18] The Trust's investment objective is for the value of the Shares to reflect, at any given time, the value of its copper, less the Trust's expenses and liabilities. The Trust will invest in Grade A copper[19] in physical form from a source refinery that has had its brand registered with the LME (an "Acceptable Delivery Brand").[20] The Exchange states that, although the Shares are not the exact equivalent of an investment in copper, they are designed to provide investors with an alternative that allows a participation in the copper market through the securities market.[21]

A. Description of the Copper Market[22]

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separate order, is granting the Trust, based on the representations and facts presented in its letter and subject to the conditions contained in that order, an exemption from the requirements of Rules 101 and 102 of Regulation M under the Act with respect to the Trust. See Securities Exchange Act Release No. 68439 (December 14, 2012).

18 Commodity-Based Trust Shares are securities issued by a trust that represent investors' discrete identifiable and undivided interest in and ownership of the net assets of the trust.

19 According to the Exchange, the LME trades, promotes, and maintains the standards of quality, shape, and weight of Grade A Copper, a commonly accepted standardized form of copper cathode. Grade A Copper currently must conform to the standard BS EN 1978:1998 (Cu-CATH-1), which specifies the allowed source, shape, and chemical composition of the cathode. Most copper cathodes are 99.95% to 99.99% pure copper. The chemical composition, and impurities, in the cathode depend largely on the source of the copper and whether the metal has been processed from copper sulfide ore or copper oxide ore. Copper oxide ore has a smaller number of residual chemical elements in the cathode. See Notice, supra note 3, 77 FR at 23777.

20 Currently, there are 79 brands that are Acceptable Delivery Brands. The LME may deregister brands from time to time. According to the Exchange, generally, copper that is not of an Acceptable Delivery Brand is worth less than copper that is of an Acceptable Delivery Brand because of the perceived lower liquidity associated with that brand of copper. See Notice, supra note 3, 77 FR at 23777–78.

21 See id.

22 See Notice, supra note 3, for a more detailed description of the copper market.

The following is a summary of the description of the copper market that the Exchange included in its filing. The market participants in the copper market include primary and secondary producers; fabricators, manufacturers, and end-use consumers; physical traders and merchants, who generally facilitate the domestic and international trade of copper supplies along the value chain and support the distribution of supplies to consumers; and the banking sector. Copper supply generally comes from the extraction and processing of ore ("primary production") and the recovery of copper from existing stock ("secondary production"). Primary production accounts for the majority of new global copper supply.

Copper's physical, chemical, and aesthetic properties make it a material of choice in a wide range of electrical, electronics and communication, construction, transportation, industrial machinery and equipment, and general consumer applications. From copper derived from primary and secondary production, fabricators produce semi-fabricated products, such as copper wire, copper alloys, tube products, rods, bars, section, plate, sheets and strips, for various applications. The location of copper relative to consumption demand is important given the bulk and cost of transportation. The source of copper also is important to fabricators and consumers and affects buying behavior. Copper end-users will pay an additional locational premium to obtain copper of a specific brand that is stored in a specific location.[23]

The global market in copper consists of: (i) trading within the physical copper market; and (ii) financial trading, through either (a) the exchange-traded futures and options market or (b) the over-the-counter ("OTC") market. Each of these is described below in further detail.

1. Physical Copper Market

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[23] See infra note 35.

The physical copper market is comprised of sales directly by producers and refiners to end-users, and by sales transacted by merchants, dealers, and trading banks. A major portion of annual copper production and use is effected through transactions in the physical copper market, often through renewable annual supply contracts.

2. Futures Exchanges

A majority of copper derivatives trading occurs on three exchanges: the LME, the Commodity Exchange, Inc. ("COMEX") (a division of CME Group, Inc.), and the Shanghai Futures Exchange ("SHFE"). LME members are regulated by the Financial Services Authority ("FSA"), the regulator of the financial services industry in the United Kingdom. COMEX is regulated by the U.S. Commodity Futures Trading Commission ("CFTC") under the Commodity Exchange Act ("CEA"). The SHFE is regulated by the Chinese Securities Regulatory Commission ("CSRC"). At present, Chinese regulations stipulate that only companies or organizations organized and registered in China or Chinese citizens are allowed to participate in trading on the SHFE.

Futures exchanges provide for the trading of futures and options on futures contracts, which producers and consumers use to fix a price in the future as a hedge against price variations. Producers and consumers take long or short positions to manage price risk, which activity is facilitated by investors who buy the price risk.

Only eligible organizations or members are able to participate directly in trading on the LME. The LME publishes prices discovered as a result of daily trading of exchange contracts on the LME. The LME Settlement Price[24] and forward prices serve as the global benchmark prices

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24 See infra note 34 and accompanying text.

of Grade A copper.[25] The copper industry uses these prices as the basis of price negotiations for the physical purchase and sale of copper. All contracts registered with the LME are executed on the basis of physical settlement: LME members deliver base metal against LME futures contracts in the form of LME warrants.[26] The seller has the right to select the LME warrant delivered to the buyer. Pertinent information about LME warrants is recorded in the LMEsword system. The LME publishes the number of LME warrants and associated tonnage (including canceled LME warrants for which copper has yet to be delivered out of the relevant LME warehouse).

3. OTC Market

Physical traders, merchants, and banks participate in OTC spot, forward, option, and other derivative transactions for copper.[27] The terms of OTC contracts are not standardized and market participants have the flexibility to negotiate all terms of the transaction, including delivery specifications and settlement terms. The OTC market facilitates long-term transactions, such as life-of-mine off-take arrangements,[28] which otherwise could be constrained by contract terms on a futures exchange. Participants in OTC transactions are subject to counter-party risk, including credit risk and contractual obligations to perform. The OTC derivative market for

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25 See infra note 34.

26 An "LME warrant" is a bearer document evidencing the right of the holder to possession of a specified lot of metal at a specified LME warehouse location. LME warrants are traded in the OTC market. The holder of an LME warrant is responsible for rental payments for storage of the underlying copper in an LME-approved warehouse as well as any changes to the price of the underlying copper and locational premium.

27 OTC contracts are principal-to-principal agreements traded and negotiated privately between two principal parties, without going through an exchange or other intermediary.

28 A life-of-mine off-take arrangement is an agreement between a producer and a buyer to purchase/sell portions of the producer's future production over the life of the operation. These agreements are commonly negotiated prior to the construction of a project as they can assist in obtaining financing by showing future revenue streams.

copper remains largely unregulated with respect to public disclosure of information by the parties, thus providing confidentiality among principals.

4. Copper Market Regulation

The CFTC is authorized under the CEA to monitor, investigate, and take actions with respect to activities that may have a material impact on the markets for physical commodities, commodity futures, commodity options, and swaps in the United States. Specifically, the CFTC has jurisdiction over manipulation and attempted manipulation of the cash commodity markets.[29] The CFTC also has broad authority over commodity derivatives markets and participants in those markets, including the COMEX.[30] Commodity futures and options traded on the COMEX also are subject to regulation by its parent, CME Group's Market Regulation Oversight Committee ("MROC"), under CFTC rules. The MROC is a self-regulatory body created in 2004 to ensure competitive and financially sound trading activity on the Chicago Mercantile Exchange, Inc. and its subsidiary exchanges.

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29 Section 9(a)(2) of the CEA, 7 U.S.C. 13(a)(2), provides that it is a felony punishable by up to ten years' imprisonment or up to a $1 million fine for "[a]ny person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, . . . or to corner or attempt to corner any such commodity." Section 6(c) of the CEA, 7 U.S.C. 9, authorizes the CFTC to assess treble damage penalties for manipulation or attempted manipulation of the price of any commodity in interstate commerce and to adopt rules to prevent manipulative practices. CFTC Rule 180.1 prohibits fraud and fraud-based manipulations, including any such attempts; CFTC Rule 180.2 addresses the elements of price-based manipulation and attempted manipulation.

30 For example, 17 CFR 18.05 requires all traders that hold or control a reportable futures or options positions to: (1) "keep books and records showing all details concerning all positions and transactions in the commodity" on all reporting markets, OTC transactions, exempt boards of trade, and foreign boards of trade; (2) "keep books and records showing all details concerning all positions and transactions in the cash commodity, its products and byproducts, and all commercial activities that the trader hedges in the futures or option contract in which the trader is reportable"; and (3) provide to the CFTC upon request "pertinent information concerning such positions, transactions, or activities."

The FSA is responsible for supervising the LME and regulating the financial soundness and conduct of the business conducted by LME members. The LME, a Recognised Investment Exchange by the FSA, is required by statute to ensure that business on its markets is conducted in an orderly and transparent manner, providing proper protection to investors and persons looking to manage risk. Regulation of the market is largely carried out by the LME. In addition to FSA oversight, the LME and its members also are subject to regulatory controls and input from various U.K. government bodies and offices, as well as directives from the European Union Commission. In international trading, rules applied by overseas regulatory bodies, such as the CFTC, are also taken into account.

The SHFE is a self-regulatory body under the supervision and governance of the CSRC. The SHFE is a day-to-day overseer of exchange activity, and is expected to carry out regulation as per the laws established by the CSRC. The CSRC serves as the final authority on exchange regulation and policy development, and ultimately determines the effectiveness of the SHFE as a regulatory entity. The CSRC has the right to overturn or revoke the SHFE's regulatory privileges at any time.

B. Description of the Proposed Rule Change and the Trust[31]

The Exchange proposes to list and trade the Shares under NYSE Arca Equities Rule 8.201. J.P. Morgan Treasury Securities Services, a division of JPMorgan Chase Bank, National Association, is the administrative agent of the Trust ("Administrative Agent"). Wilmington Trust Company is the trustee of the Trust ("Trustee"). The Henry Bath Group is the warehouse-

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31 See Notice, supra note 3, for a more detailed description. Additional details regarding the Trust also are set forth in the registration statement for the Trust, most recently amended on July 12, 2011 (No. 333-170085) ("Registration Statement").

keeper of the Trust ("Warehouse-keeper").[32] Metal Bulletin Ltd., which is not affiliated with the Sponsor, is the valuation agent of the Trust ("Valuation Agent").

As mentioned above, the Trust will hold Grade A copper in physical form, and the Trust's investment objective is for the value of the Shares to reflect, at any given time, the value of the copper owned by the Trust at that time, less the Trust's expenses and liabilities at that time. The Trust will hold only copper and will not trade in copper futures. The Trust will not be actively managed and will not engage in any activities designed to obtain a profit from, or to prevent losses caused by, changes in the price of copper.

The Administrative Agent will calculate the NAV of the Trust as promptly as practicable after 4:00 pm EST on each Business Day.[33] As part of this calculation, the Administrative Agent will determine the value of the trust's copper using the LME Settlement Price[34] and locational premia/discount information provided by the Valuation Agent.[35]

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32 Each of Henry Bath & Son Limited, Henry Bath LLC, Henry Bath Singapore Pte Limited, Henry Bath Italia Srl, and Henry Bath BV is a member of the Henry Bath Group of companies and a wholly owned subsidiary of J.P. Morgan Ventures Energy Corporation, and is an affiliate of the Sponsor. See Notice, supra note 3, 77 FR at 23773 n.10

33 A Business Day is a day that the Exchange is open for regular trading and that is not a holiday in London, England. See id. at 23775 n.18.

34 The "LME Settlement Price" is, with respect to any Business Day, the official cash sellers price per metric ton of Grade A Copper on the LME, stated in U.S. dollars, as determined by the LME at the end of the morning's second ring session (12:35 p.m. London time) for copper on each day that the LME is open for trading. The LME Settlement Price is made publicly available in real-time through third-party vendors such as Bloomberg and Reuters (on Bloomberg, it is currently displayed on Bloomberg page "LOCADY <comdty>"). It is also made publicly available on a delayed basis on the LME's website at approximately 10:00 p.m. London time. See id. at 23775 n.17.

35 The value of copper depends in part on its location, i.e., copper stored in a location that is low in supply and high in demand carries a higher premium than copper that is stored in a location where supply is high and demand is low. To assist in valuing the Trust's copper, by 9:00 am EST, the Valuation Agent will provide the Administrative Agent the

The Trust will store its copper in both LME-approved warehouses and non-LME-approved warehouses that are maintained by the Warehouse-keeper, but none of the copper held by the Trust will be on LME warrant, and therefore will not be subject to regulation by the LME.[36] Initially, the permitted warehouse locations will be in the Netherlands (Rotterdam), Singapore (Singapore), South Korea (Busan and Gwangyang), China (Shanghai), and the United States (Baltimore, Chicago, and New Orleans). Although the Trust may hold copper in warehouses in any of these locations (or other locations that may be determined by the Sponsor from time to time), the locations at which copper actually is held will depend on the warehouse locations at which authorized participants have actually delivered copper to the Trust and the warehouse locations from which copper is or has been delivered pursuant to the Trust's redemption procedures.

Shares will be created when an authorized participant transfers Grade A Copper of an Acceptable Delivery Brand and having a weight equal to the Creation Unit Weight[37] to one or more acceptable warehouse locations of the Trust and the Trust, in return for the copper, delivers

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locational premia for the locations at which the trust is permitted to hold copper. The locational premium for a warehouse location for a Business Day will be calculated as an amount expressed in U.S. dollars that is equal to the average value of copper per metric ton in such location minus the LME Settlement Price of copper on such Business Day. See id. at 23779.

36 See id. at 23778.

37 The Creation Unit Weight for a particular day will be equal to 25.0 metric tons multiplied by the Creation Unit Ratio in effect for such day. The Creation Unit Ratio will initially be equal to 1.0, but will decline gradually over time to reflect the payment of expenses by the Trust. As a result, the Creation Unit Weight will decline gradually over time as well. The Creation Unit Weight and the Creation Unit Ratio in effect on any Business Day will have been calculated on the prior Business Day, after the calculation of the Trust's NAV on such Business Day. For a discussion of how the Administrative Agent will calculate the Creation Unit Ratio and the Creation Unit Weight, see id. at 23784.

a Creation Unit of Shares[38] to the authorized participant. In creating Shares, if the aggregate weight of the whole lots transferred by the authorized participant falls short of or exceeds the aggregate Creation Unit Weight, the Administrative Agent will instruct the Warehouse-keeper to transfer ownership of copper between the authorized participant's book-entry account ("Reserve Account") and the Warehouse-keeper's book-entry account ("Trust Account") to cover any such amount.

Shares will be redeemed when an authorized participant transfers a Creation Unit of Shares to the Trust and the Trust, in return for such Shares, delivers copper having a weight equal to the Creation Unit Weight to the authorized participant, in accordance with the Selection Protocol.[39] Following the transfer of whole lots of copper, the Administrative Agent will instruct the Warehouse-keeper to adjust for any redemption underweight by transferring ownership of copper from the Trust Account to the relevant authorized participant's Reserve Account.[40] Because the copper held by the Trust in different locations may vary in value based on the

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38 A Creation Unit of Shares is a block of 2,500 Shares. See id. at 23781.

39 According to NYSE Arca, the Selection Protocol is intended to provide a consistent and transparent method of selecting lots, by requiring the Administrative Agent to select lots in the following manner: (1) lots will be selected first from the warehouse where it holds available copper that has the lowest locational premium at a particular time (i.e., the "cheapest-to-deliver location"), and then from other warehouse locations successively based on a ranking of their respective locational premia from lowest to highest; (2) if there are multiple lots in the same warehouse location specified by the first step, lots in such warehouse location will be selected based on the date such lots were first delivered to the relevant account, with the earliest delivered lot being selected first; and (3) if there are multiple lots in the same warehouse location that were first delivered to the relevant account on the same date, lots will be selected based on the actual weight of the lot, with the lot having the lowest actual weight being selected first. See id. at 23781–82.

40 According to NYSE Arca, when copper is redeemed in this manner, the amount of copper received by the authorized participant will equal a pro rata share of the copper held by the Trust based on the weight of the Trust's aggregate copper holdings immediately prior to the processing of redemptions. See id. at 23782.

applicable locational premium, the value of the copper actually received by the authorized participant will depend on the location of the specific whole lot(s) and fractional lots, if any, of the copper transferred to the authorized participant.

Quotation and last-sale information for the Shares will be available via the Consolidated Tape Association. The Exchange also will make available via the Consolidated Tape trading volume, closing prices, and NAV for the Shares from the previous day.[41] In addition, NYSE Arca will calculate and disseminate, approximately every 15 seconds during the Exchange's Core Trading Session, two different IIVs for the Shares: the First-Out IIV and the Liquidation IIV.[42]

On each Business Day, as promptly as practicable after 4:00 p.m. E.T., the Trust will publish the following on its website: (1) the number of outstanding Shares as of the beginning of the Business Day; (2) the NAV of the Trust; (3) the NAV per Share; (4) the locational premium for each warehouse location, as calculated by the Valuation Agent at 5:00 p.m. London time, quoted both in U.S. dollars and as a percentage premium relative to the LME settlement price; (5) the price per metric ton of copper in each warehouse location where the Trust is permitted to hold copper; (6) the aggregate weight in metric tons of all copper owned by the Trust; (7) the

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41 See id. at 23786.

42 The "First-Out IIV" is designed to facilitate arbitrage activity by authorized participants by indicating whether the Shares are trading at a discount or premium during the trading day. See id. at 23785. It represents, as of the time of such calculation, the hypothetical U.S. dollar value per Share of the copper that would need to be transferred to or from the Trust to create or redeem one Share included in a Creation Unit, assuming that copper in the cheapest-to-deliver location was used for such creation or redemption. See id. at 23783. The "Liquidation IIV" is an intraday indicative value that represents, as of the time of the calculation, the hypothetical U.S. dollar value per Share of all of the copper owned by the Trust divided by the number of Shares then outstanding. See id. For a description of how the Exchange will calculate the First-Out IIV and the Liquidation IIV, see id. at 23784–86.

aggregate weight in metric tons of the copper owned by the Trust in each warehouse location; (8) the gross value in U.S. dollars of the copper owned by the Trust in each warehouse location; (9) the Creation Unit Ratio; and (10) the Creation Unit Weight.[43] The Exchange will obtain a representation from the Trust prior to the commencement of trading of the Shares that the NAV will be calculated daily and made available to all market participants at the same time.[44]

Additionally, as promptly as practicable after 4:00 p.m. E.T. on each Business Day, the Trust will make available on its website a downloadable file containing the following information relating to each lot of copper owned by the Trust: (1) the unique identification number of the lot; (2) the warehouse location in which the lot is held; (3) the brand of the lot and, if such brand of copper is not an Acceptable Delivery Brand, an indication that the lot consists of a brand of copper that has been de-registered; (4) the weight in metric tons of the lot; and (5) the date upon which the lot was delivered to the Trust.[45]

The Exchange states that investors may obtain, almost on a 24-hour basis, copper pricing information based on the spot price of copper from various financial information service providers, such as Reuters and Bloomberg.[46] Reuters and Bloomberg provide at no charge on their websites delayed information regarding the spot price of copper and last-sale prices of copper futures, as well as information and news about developments in the copper market.[47] Reuters and Bloomberg also offer a professional service to subscribers for a fee that provides

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43 See id. at 23783.

44 See Amendment No. 1, supra note 15.

45 See Notice, supra note 3, 77 FR at 23783.

46 See id. at 23786.

47 See id.

information on copper prices directly from market participants.[48] There are a variety of public websites providing information on copper, ranging from those specializing in precious metals to sites maintained by major newspapers, such as The Wall Street Journal.[49] The Trust's website will provide ongoing pricing information for copper spot prices and the Shares.[50] The Exchange will provide on its website (www.nyx.com) a link to the Trust's website.[51]

NYSE Arca will require that a minimum of 100,000 Shares be outstanding at the start of trading,[52] which represents 1,000 metric tons of copper. The Trust seeks to initially register 6,180,000 Shares.[53] NYSE Arca represents that the Shares satisfy the requirements of NYSE Arca Equities Rule 8.201, which governs the listing and trading of Commodity-Based Trust Shares, and thereby qualify for listing and trading on the Exchange.[54]

Under NYSE Arca Equities Rule 7.34(a)(5), if the Exchange becomes aware that the NAV is not being disseminated to all market participants at the same time, it must halt trading on the Exchange until such time as the NAV is available to all market participants at the same time. If the First-Out IIV or the Liquidation IIV is not being disseminated as required, the Exchange may halt trading during the day in which the disruption occurs; if the interruption persists past the day in which it occurred, the Exchange will halt trading no later than the beginning of the

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48 See id.

49 See id.

50 See id.

51 See id.

52 See Amendment No. 1, supra note 15.

53 See Registration Statement, supra note 31.

54 With respect to application of Rule 10A-3 (17 CFR 240.10A-3) under the Act (15 U.S.C. 78a), the Trust relies on the exemption contained in Rule 10A-3(c)(7). See Notice, supra note 3, at 23773 n.12.

trading day following the interruption.[55] Further, the Exchange will consider suspension of trading pursuant to NYSE Arca Rule 8.201(e)(2) if, after the initial 12-month period following commencement of trading: (1) the value of copper is no longer calculated or available on at least a 15-second delayed basis from a source unaffiliated with the Sponsor, Trust, or Custodian, or the Exchange stops providing a hyperlink on its website to any such unaffiliated source providing that value; or (2) if the Liquidation IIV is no longer made available on at least a 15-second delayed basis. More generally, with respect to trading halts, the Exchange may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares. Trading on the Exchange in the Shares may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable. These may include: (1) the extent to which conditions in the underlying copper market have caused disruptions and/or lack of trading; or (2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. Additionally, trading in the Shares will be subject to trading halts caused by extraordinary market volatility pursuant to the Exchange's circuit breaker rule.[56]

NYSE Arca represents that its surveillance procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of NYSE Arca rules and applicable federal securities laws.[57] To support this, the Exchange states that, pursuant to NYSE Arca Equities Rule 8.201(g), it is able to obtain information regarding trading

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55 See Amendment No. 1, supra note 15. NYSE Arca Equities Rule 8.201(e)(2) also provides that the Exchange may seek to delist the Shares in the event the underlying commodity or the IIV is no longer calculated or available as required.

56 See NYSE Arca Equities Rule 7.12.

57 See Notice, supra note 3, 77 FR at 23787.

in the Shares, physical copper, copper futures contracts, options on copper futures, or any other copper derivative from ETP Holders acting as registered market makers, in connection with their proprietary or customer trades. More generally, NYSE Arca states that it has regulatory jurisdiction over its ETP Holders and their associated persons, which include any person or entity controlling an ETP Holder, as well as a subsidiary or affiliate of an ETP Holder that is in the securities business.[58] With respect to a subsidiary or affiliate of an ETP Holder that does business only in commodities or futures contracts, the Exchange states that it can obtain information regarding the activities of such subsidiary or affiliate through surveillance sharing agreements with regulatory organizations of which such subsidiary or affiliate is a member.[59] Further, NYSE Arca states that it may obtain trading information via the Intermarket Surveillance Group ("ISG") from other exchanges that are members of the ISG, including the COMEX,[60] and that it has entered into a comprehensive surveillance sharing agreement with the LME that applies with respect to trading in copper and copper derivatives.[61]

Prior to the commencement of trading, the Exchange represents that it will inform its ETP Holders in an Information Bulletin of the special characteristics and risks associated with trading the Shares. Specifically, the Information Bulletin will discuss the following: (a) the procedures for purchases and redemptions of Shares in the Creation Unit (including noting that Shares are not individually redeemable); (b) NYSE Arca Equities Rule 9.2(a), which imposes a duty of due diligence on its ETP Holders to learn the essential facts relating to every customer prior to trading the Shares; (c) how information regarding the IIV is disseminated; (d) the

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58 See Amendment No. 1, supra note 15.

59 See id.

60 See Notice, supra note 3, 77 FR at 23787.

61 See Amendment No. 1, supra note 15.

requirement that ETP Holders deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; (e) the possibility that trading spreads and the resulting premium or discount on the Shares may widen as a result of reduced liquidity of physical copper trading during the Core and Late Trading Sessions after the close of the major world copper markets; and (f) trading information.

The Notice and the Registration Statement include additional information about: the Trust; the Shares; the Trust's investment objectives, strategies, policies, and restrictions; fees and expenses; creation and redemption of Shares; the physical copper market; availability of information; trading rules and halts; and surveillance procedures.[62]

III. Discussion and Commission Findings

After careful review and for the reasons discussed below, the Commission finds that the proposed rule change is consistent with the requirements of the Act, including Section 6 of the Act,[63] and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[64] which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. In addition, the Commission finds that the proposed rule change is consistent

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62 See Notice and the Registration Statement, supra notes 3 and 31, respectively.

63 15 U.S.C. 78f.

64 15 U.S.C. 78f(b)(5).

with Section 6(b)(8) of the Act,[65] which requires that the rules of a national securities exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Commission also finds that the proposed rule change is consistent with Section 11A(a)(1)(C)(iii) of the Act,[66] which sets forth Congress's finding that it is in the public interest and appropriate for the protection of investors to assure the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities. Further, pursuant to Section 3(f) of the Act, the Commission has considered whether the proposed rule change will promote efficiency, competition, and capital formation.

Six commenters submitted fourteen comment letters to explain their opposition to the proposed rule change.[67] Generally, the opposing commenters assert that the proposed rule change is inconsistent with Section 6(b)(5) of the Act.[68] V&F (and EVW), the Copper

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65 15 U.S.C. 78f(b)(8).

66 15 U.S.C. 78k-1(a)(1)(C)(iii).

67 See V&F May 9 Letter, supra note 4; V&F July 13 Letter, supra note 7; Levin Letter, supra note 8; Shatto Letter, supra note 9; Copper Fabricators Letter, supra note 11; V&F August 24 Letter, supra note 11; V&F September 10 Letter, supra note 12; V&F October 23 Letter, supra note 14; AFR October 23 Letter, supra note 14; Rutkowski October 24 Letter, supra note 14; V&F November 16 Letter, supra note 14; AFR November 16 Letter, supra note 14; Rutkowski November 17 Letter, supra note 14; and EVW December 7 Letter, supra note 16. V&F, and subsequently EVW, identified themselves as law firms that represent RK Capital LLC, an international copper merchant, and the Copper Fabricators. See V&F July 13 Letter, supra note 7, at 1; and EVW December 7 Letter, supra note 16, at 1. See also supra note 16 (explaining the change in representation). The Copper Fabricators state that they collectively comprise about 50% of the copper fabricating capacity of the United States. See Copper Fabricators Letter, supra note 11, at 1. AFR identifies itself as a coalition of over 250 groups who advocate for reform of the financial industry. See AFR October 23 Letter, supra note 14, at 1.

68 Ms. Shatto does not tie her objections to any particular provision of the Act. First, she believes that "jp morgan" does not need another derivative product. This principle is not relevant to consideration of the proposed rule change under the Act. Second, she questions whether "jp morgan," which she says "already trades a lot in the commodities market," may be able to "manipulate the market," a concern shared by other commenters.

Fabricators, Senator Levin, and AFR (collectively, "Opposing Commenters") assert that the issuance by the Trust of all of the Shares covered by the Registration Statement within a short period of time would result in a substantial reduction in the supply of global copper available for immediate delivery.[69] The Opposing Commenters assert that this reduction in short-term supply would increase both the price of copper and volatility in the copper market, which would in turn significantly harm the U.S. economy.[70] They further state that the predicted decrease in copper available for immediate delivery would make the physical copper market more susceptible to manipulation.[71]

In response, the Exchange and the Sponsor generally state that the Trust would serve as a transparent and accessible alternative by which participants in the copper market can access or

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She asserts that "jp morgan gets inside information by using their warehouses to buy and sell copper which maximizes profits to the detriment of commercial interests who have to buy copper." Concerns regarding the potential for manipulation are addressed in Section III.D and III.E. Third, she asserts that derivatives often allow short selling, which affects many equities at one time, making the equities market extremely volatile. Ms. Shatto does not provide further information to explain why this concern is relevant to the proposed rule change. Concerns regarding the potential for increased volatility in the copper market are addressed in Section III.C. Fourth, she states: "banks should be banks, not business conglomerations." This principle is not relevant to consideration of the proposed rule change under the Act. Finally, she recommends that the Commission not enable short sellers or options traders. The proposed rule change does not address short selling or approve the listing and trading of options on the Shares. Mr. Rutkowski requests that the Commission deny the proposed rule change for the reasons articulated by AFR.

69 See V&F May 9 Letter, supra note 4, at 3, 6; Levin Letter, supra note 8, at 1, 4; Copper Fabricators Letter, supra note 11, at 3; and AFR October 23 Letter, supra note 14, at 2.

70 See V&F May 9 Letter, supra note 4, at 5–7; Levin Letter, supra note 8, at 1, 7; Copper Fabricators Letter, supra note 11, at 4-5; and AFR October 23 Letter, supra note 14, at 2.

71 See V&F May 9 Letter, supra note 4, at 1, 10; Levin Letter, supra note 8, at 7; AFR October 23 Letter, supra note 14, at 4-5; Copper Fabricators Letter, supra note 11, at 5-6; and AFR October 23 Letter, supra note 14, at 4-5.

offload physical copper inventory and associated price risk.[72] The Sponsor believes that the Trust would move copper from one type of liquid stock to another type of liquid stock, rather than removing inventory from the market, and would track, rather than drive, copper prices.[73] The Exchange and the Sponsor believe the structure of the Trust and the regulatory regime for the Shares and copper derivatives (including non-securities) suggest approval of the proposed rule change would not render the copper market more susceptible to manipulation.[74]

Given the concerns expressed by the commenters that the Trust would remove a substantial amount of the supply of copper available for immediate delivery over a short period of time, which would render the physical copper market more susceptible to manipulation, and that the Trust therefore would provide market participants an effective means to manipulate the price of copper and thereby the price of the Shares,[75] the Commission analyzes the comments to examine, among other things, the extent to which the listing and trading of the Shares may (1) impact the supply of copper available for immediate delivery and the ability of market participants to manipulate the price of copper, and (2) be susceptible to manipulation. The sections below summarize and respond to the comments received.

A. The Trust's Impact on the Supply of Copper Available for Immediate Delivery

The Opposing Commenters believe that the issuance by the Trust of all of the Shares covered by the Registration Statement within a short period of time would result in the withdrawal of substantial quantities of copper from LME and COMEX warehouses, thus

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72 See DP August 24 Letter, supra note 11, at 7; and Arca June 19 Letter, supra note 6, at 5.

73 See DP August 24 Letter, supra note 11, at 11, 13.

74 See id. at 4–5; and Arca June 19 Letter, supra note 6, at 5–6.

75 See V&F May 9 Letter, supra note 4, at 1, 10.

negatively impacting the supply of copper available for immediate delivery.[76] As discussed below, this belief assumes that: (1) copper held by the Trust would not be available for immediate delivery; (2) the global supply of copper available for immediate delivery that could be used to create Shares consists almost exclusively of copper already under LME or COMEX warrant, and therefore the Shares would be created primarily using copper already under LME or COMEX warrant; and (3) the Trust would acquire a substantial amount of copper within a short period of time, such that copper suppliers would not be able to adjust production to replace the copper removed from the market by the Trust. The Commission believes that the record does not support each of the contentions, and thus, for the reasons discussed below, the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery.

1. Availability of the Trust's Copper

Opposing Commenters assert that copper held by the Trust would not be available for immediate delivery, and therefore copper deposited into the Trust would be removed from the market and would be unavailable to end-users.[77] In response, the Sponsor asserts that the Trust would not remove immediately available copper inventory from the market.[78] The Sponsor points out that a report cited by one of the commenters defines inventories held in exchange-

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76 See id. at 3-4; Levin Letter, supra note 8, at 4-5; Copper Fabricators Letter, supra note 11, at 5; and AFR October 23 Letter, supra note 14, at 3.

77 See V&F May 9 Letter, supra note 4, at 1; Levin Letter, supra note 8, at 7; Copper Fabricators Letter, supra note 11, at 3, and AFR October 23 Letter supra note 14, at 3.

78 See, e.g., DP August 24 Letter, supra note 11, at 13.

traded funds as "liquid stocks."[79] The Sponsor asserts that, in effect, the Trust would move copper from one type of liquid stock (warrants) to another type of liquid stock (Shares).[80]

The Commission agrees with the Sponsor that copper held by the Trust will remain available to consumers and other participants in the physical copper market because: (1) the Trust will not consume copper;[81] (2) Shares are redeemable (in size) for copper on every Business Day;[82] and (3) redeeming authorized participants will receive the right to obtain their copper within three business days.[83] Additionally, as the Sponsor explains, the copper received

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79 See DP August 24 Letter, supra note 11, at 13; and DP September 10 Letter, supra note 12, at 5 n.11.

80 See DP August 24 Letter, supra note 11, at 13.

81 See id. at 22.

82 See Notice, supra note 3, 77 FR at 23782.

83 See DP August 24 Letter, supra note 11, at 7. The record is unclear whether authorized participants that are redeeming the Shares will be able to physically remove copper from the warehouse in which it is stored within three business days, or whether this reference is to three business days in addition to the existing time it takes to remove copper from the warehouses. The Registration Statement provides: "Redemption orders will be settled by delivery of copper on the third Trading Day following the redemption order date, provided that, by 3:00 p.m. New York City time on the date such settlement is to take place, the Administrative Agent confirms in writing to the Warehouse-keeper that (x) the Administrative Agent's DTC account has been credited with the Creation Units to be redeemed and (ii) the Authorized Participant has paid the Administrative Agent the applicable transaction fee for such redemption order." Registration Statement, supra note 31 (emphasis in original). One of the Opposing Commenters acknowledged, however, that taking copper off LME warrant, which the commenter considers to be copper available for immediate delivery, takes time; according to that commenter: (1) the amount of time it takes to take copper off LME warrant depends "on the length of the loading out queue" at the LME warehouse; and (2) queues "are currently ranging from 275 working days Vlissingen, Netherlands, 91 working days (4.5 months) in New Orleans, 51 working days (2.5 months) in Johor, Malaysia to under one month in Korea and Rotterdam, Netherlands." V&F August 24 Letter, supra note 11, at 14.

This commenter expresses further concern in its latest comment letter about an increasing length of time that it takes to withdraw metal, including copper, from LME warehouses. The commenter argues that this "troubling new development" may, together with the proposed listing and trading of the Shares, jeopardize the ability of United States copper in exchange for redeemed Shares could be: (1) sold in the OTC market for cash; (2) swapped in the OTC market for copper in a different location or for a different brand; and/or (3) removed from the warehouse and consumed.[84] The Sponsor states that these three types of transactions are commonplace in the copper market.[85] Further, copper delivered from the Trust (in exchange for Shares) could be placed under LME warrant if required by LME market participants.[86] Given the structure of the Trust, the Commission believes that the amount of copper accessible to

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consumers to obtain the physical copper they need in a timely manner. See generally EVW December 7 Letter, supra note 16. By its December 7 submission, the commenter appears to be updating information previously provided about the length of queues, but does not assert any new reason for disapproving the listing and trading of the Shares that is distinct from its original assertion, responded to in the text above, that listing and trading of the Shares will reduce the supply of copper available for immediate delivery.

For purposes of analyzing this proposed rule change, the Commission assumes that copper will be transferred to an authorized participant's book-entry account within three days, and that an authorized participant taking delivery of copper from an LME warehouse will then have to wait in the queues described by this Opposing Commenter, just like other owners withdrawing metal from that warehouse. The Commission believes that waiting up to an extra three business days beyond the time required to take copper off of LME warrant is not a significant enough delay to consider the copper delivered from the Trust unavailable for immediate delivery. In this regard, the Commission notes that the commenter, who acknowledges that taking copper off of LME warrant takes time, considers copper on LME warrant to be available for immediate delivery. See, e.g., V&F July 13 Letter, supra note 7, at 1 (stating its view that there are no substantial sources of copper available for immediate delivery available to the Trust other than warranted copper in LME warehouses). Further, as noted above, the Trust's copper may be held in both LME-approved warehouses and non-LME-approved warehouses, and there is nothing in the record concerning the existence of unloading queues in non-LME warehouses. The Commission also notes that the LME appears to be attempting to address the unloading queue issue, see London Metal Exchange, Consultation on Changes to LME Policy for Approval of Warehouses in Relation to Delivery Out Rates, Notice 12/296 : A295 : W152 (November 15, 2012), available at http://www.lme.com/downloads/notices/12_296_A295_W152_Consultation_on_Changes_to_LME_Policy_for_Approval_of_Warehouses_in_Relation_to_Delivery_Out_Rates.pdf, which applies to LME warehoused aluminum and zinc, not just copper. See also EVW December 7 Letter, supra note 16, at 3.

84 See DP August 24 Letter, supra note 11, at 7.

85 See id. at 8.

86 See id.

industrial users will not meaningfully change as a result of the listing and trading of the Shares. Accordingly, the Commission believes that the proposed rule change will not burden capital formation for users who acquire copper for industrial and other purposes.

The Commission recognizes that one group of end users state that they would not acquire Shares for the purpose of redeeming them to acquire copper because the copper they would receive in exchange for Shares might be in a location far from their plants or might be of brands that are not acceptable to their plants.[87] Regardless of the preferences of these consumers, authorized participants may redeem Shares for copper and the record does not contain any evidence that these or any other consumers of copper could not use the Shares to obtain copper through an authorized participant. Further, the record supports that the same logistical issues exist and are regularly addressed by end-users of copper holding LME warrants. Currently, a purchaser of an LME warrant does not know the location or brand of the underlying copper, and therefore warrant holders sometimes need to swap the warrants to acquire copper of a preferred brand in a convenient location.[88] The end user commenters explain that, because not all available brands of copper held at LME and COMEX warehouses are acceptable for the efficient operation of their fabricating plants, they currently rely on copper merchants to obtain their desired brands of copper by aggregating the lots from copper on warrant at LME and COMEX warehouses.[89] Nothing in the record indicates that copper merchants will not be able to perform the same function in connection with copper delivered in connection with Share redemptions.

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87 See Copper Fabricators Letter, supra note 11, at 7. See also V&F September 10 Letter, supra note 12, at 4; and V&F July 13 Letter, supra note 7, at 7.

88 See DP August 24 Letter, supra note 11, at 8.

89 See Copper Fabricators Letter, supra note 11, at 3.

As discussed above,[90] on a daily basis, the Trust will publish information on the location and brand of copper that will be delivered to the next redeeming authorized participant, and this may assist end users of copper and copper merchants to locate suitable copper.

One of the Opposing Commenters also expresses concern that investors who hold the Shares would not sell them, and therefore Shares would not be readily available for redemption.[91] This claim is unsupported. There is no evidence in the record to suggest that investors holding the Shares will be unwilling to sell them, particularly in response to market movements or changes in investor needs.

The Commission believes that the listing and trading of the Shares, as proposed, could provide another way for market participants and investors to trade in copper, and could enhance competition among trading venues. Further, the Commission believes that the listing and trading of the Shares will provide investors another investment alternative, which could enhance a well-diversified portfolio. By broadening the securities investment alternatives available to investors, the Commission believes that trading in the Shares could increase competition among financial products and the efficiency of financial investment.

2. Source of Copper Used to Create Shares

The Opposing Commenters believe that the global supply of copper available for immediate delivery, and eligible to be used to create Shares, consists almost exclusively of copper already under LME or COMEX warrant, and therefore they believe that Shares would be created primarily using copper already under LME or COMEX warrant.[92] One of the Opposing

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90 See supra text accompanying note 45.

91 See V&F September 10 Letter, supra note 12, at 3.

92 See Levin Letter, supra note 8, at 4–5; Copper Fabricators Letter, supra note 11, at 3 ("The market for copper available for immediate delivery consists of copper on warrant

Commenters states that the size of the market for copper available for immediate delivery is small relative to the size it expects the Trust to attain, asserting that there is only 230,000 metric tons available on the LME, with an additional 60,000 metric tons available on the COMEX, and projects that the Trust would remove as much as 61,800 metric tons from the market, which would be about 21.3% of the copper available for immediate delivery.[93] The Opposing Commenters also assert that the Trust would be funded with copper under warrant in the United States, which would result in a shortage of copper in the United States.[94] These Opposing Commenters urge the Commission to consider collectively the supply impacts of the Trust and the iShares Copper Trust,[95] the shares of which the Exchange also is proposing to list and trade.[96]

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in LME and Comex warehouses. If there is any other copper available for us to purchase and be delivered within a week or two, we are generally not aware of it."); V&F July 13 Letter, supra note 7, at 2–4; and AFR October 23 Letter, supra note 14, at 2.

93 See V&F July 13 Letter, supra note 7, at 8. How opposing commenters measure the projected size of the Trust is discussed infra in Section III.A.3. Another Opposing Commenter states that, in 2011, total global copper stocks were 3.515 million metric tons, of which it believes only 808,000 metric tons were considered to be "liquid." Levin Letter, supra note 8, at 4. The commenter then goes on to assert that: (1) of those liquid stocks, most actually are unavailable for purchase; (2) most of that liquid copper that is available for immediate delivery is under LME or COMEX warrant; and (3) as of August 2011, the LME and COMEX had only 537,500 metric tons under warrant. See id. at 4-5. That commenter estimates that the Trust, which he expects would hold up to 61,800 metric tons of copper, and the iShares Copper Trust (see infra note 95), which would hold up to 121,200 metric tons of copper, collectively would hold approximately 34% of the copper available for immediate delivery. See Levin Letter, supra note 8, at 5. The Commission is not addressing the iShares Copper Trust proposed rule change in this order.

94 See Levin Letter, supra note 8, at 6; V&F May 9 Letter, supra note 4, at 4; V&F July 13 Letter, supra note 7, at 9; Copper Fabricators Letter, supra note 11, at 4–5; and AFR October 23 Letter, supra note 14, at 2.

95 See Securities Exchange Act Release No. 67237 (June 22, 2012), 77 FR 38351 (June 27, 2012) (SR-NYSEArca-2012-66) (notice of proposal to list and trade shares of the iShares Copper Trust).

96 See Levin Letter, supra note 8, at 5, 6; Copper Fabricators Letter, supra note 11, at 3–4; and V&F May 9 Letter, supra note 4, at 6. 10.

In contrast, the Sponsor believes that there are very substantial copper inventories available outside of the LME and COMEX that are deliverable on a short-term basis that could be used to fund the Trust. Specifically, the Sponsor states that, even according to the data provided by one of the Opposing Commenters, there are substantial sources of liquid copper stock inventory outside of the LME and other exchanges, and that most liquid copper stock inventory is non-LME or exchange inventory.[97] The Sponsor provided data that it says shows that liquid global copper inventories that are considered LME-branded are estimated at approximately 1.4 million metric tons as of July 31, 2012, and that approximately 70% of these inventories are not under warrant with the LME, COMEX, or any other exchange.[98] Additionally, the Sponsor asserts that authorized participants would not deposit into the Trust copper exclusively or disproportionately from the U.S.; according to the Sponsor, five of the initial permitted warehouses are located outside of the U.S. and, based on current conditions, the Sponsor states that Shanghai, South Korea, and Singapore are the most likely locations at which copper would be delivered to the Trust.[99]

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97 See DP August 24 Letter, supra note 11, at 13.

98 See DP September 10 Letter, supra note 12, at 2. The Sponsor cites a report by Metal Bulletin Research indicating there are 4.09 million metric tonnes of refined copper stocks worldwide, 1.78 million metric tonnes of which can be considered to be liquid. See DP August 24 Letter, supra note 11, at Annex C-5 at 7, 10 (citing Metal Bulletin Research, "Independent Assessment of Global Copper Stocks," August 22, 2012). According to the Sponsor, Metal Bulletin Research is the research arm of Metal Bulletin Ltd., the Trust's Valuation Agent. See id. at 15 n.44. Metal Bulletin Research estimates that 1.36 million metric tonnes of the 1.78 million metric tonnes considered to be liquid are in the form of LME brands. See id. at Annex C-5 at 7. Metal Bulletin Research further estimates that 249,000 metric tonnes are on LME warrant and 136,000 metric tonnes are LME-branded but located on other exchanges, leaving approximately 70% (or 975,000 metric tonnes) of liquid copper stocks that are eligible to be placed on LME warrant. See id. at Annex C-5 at 10.

99 See DP September 10 Letter, supra note 12, at 8 n.32; and DP August 24 Letter, supra note 11, at 26.

The Commission believes that there is significant uncertainty about the locations from which copper will be purchased to create Shares. Based on the description of the Trust in the proposed rule change, authorized participants and their customers will choose what eligible copper to deposit with the Trust. Further, the Commission understands, based on information submitted by the Sponsor, that premia in different locations have fluctuated historically relative to one another and will continue to change over time, and that a region with the highest locational premia at a given time may have the lowest locational premia at a later date.[100]

The Commission also believes that the record supports the view that there are sufficient copper stockpiles such that up to 61,800 metric tons of copper could be deposited into the Trust without authorized participants taking copper off of either LME or COMEX warrant. For example, the Valuation Agent[101] estimates liquid global copper inventories that are considered LME-branded to be approximately 1.4 million metric tons as of July 31, 2012, and approximately 70% of these inventories are not under warrant with the LME, COMEX, or any

100 The Sponsor provided the following information provided by the Valuation Agent regarding locational premia: (1) in the United States, the average locational premium as a percentage of average physical price was 1.4217% for the year ended December 31, 2010; 1.1377% between January 1 and March 31, 2011, and 1.1590% between April 1 and June 15, 2011; (2) in Europe, the average locational premium as a percentage of average physical price was .9426% for the year ended December 31, 2010; .7035% between January 1 and March 31, 2011, and .7327% between April 1 and June 15, 2011; (3) in Shanghai, China, the average locational premium as a percentage of average physical price was 1.3500% for the year ended December 31, 2010; .3982% between January 1 and March 31, 2011, and .4640% between April 1 and June 15, 2011; and in Singapore, the average locational premium as a percentage of average physical price was 1.1259% for the year ended December 31, 2010; .7117% between January 1 and March 31, 2011, and .4964% between April 1 and June 15, 2011. See DP August 24 Letter, supra note 11, at C-3. The Sponsor states that this data provided in Annex C-3 demonstrates that locational premia vary over time and, as a result, "a region with the highest premia in one interval of time may have the lowest premia at a later date, and vice versa." See id. at 32.

101 The Exchange states that the Valuation Agent is an independent, third-party valuation agent that is not affiliated with the Sponsor. See Notice, supra note 3, 77 FR at 23773.

other exchange.[102] One of the Opposing Commenters argues that this supply of non-warranted copper belongs to producers, consumers, and/or merchants and traders and is not otherwise in the supply pipeline, and that the only copper available for immediate delivery is in LME and COMEX warehouses.[103] The Commission believes, however, that it is more plausible that a sufficient portion of the estimated 1.4 million metric tons of copper inventories cited by commenters currently is available for authorized participants to use to create Shares.

For example, an Opposing Commenter states that there is estimated to be between 500,000 and 600,000 metric tons of bonded copper inventory in Shanghai and Guangzhou, China, and that up to 10% of this stockpile is not deliverable because it has not been kept under cover.[104] In the Commission's view, this leaves between 450,000 and 540,000 tons of copper that may be deliverable to the Trust. The Sponsor says that "Metal Bulletin" estimates that 80% of these bonded stocks are LME acceptable metal given the imported status of such metal and arbitrage activity between the LME and SHFE.[105] One of the Opposing Commenters argues that the Commission should not include copper located in China as inventory available for immediate delivery, noting that China is one of the largest copper-consuming countries in the world, leading the commenter to conclude that China would not export copper.[106] That commenter does not provide any empirical support for this view. That commenter also suggests that copper in China is unavailable because "a substantial percentage of the inventory in bonded warehouses in China

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102 See DP September 10 Letter, supra note 12, at 2.

103 See V&F September 10 Letter, supra note 12, at 2.

104 See V&F August 24 Letter, supra note 11, at 9-10. In contrast, the Sponsor states that there is estimated to be 550,000 metric tons of copper in bonded warehouses in Shanghai alone. See DP August 24 Letter, supra note 11, at 33.

105 See DP August 24 Letter, supra note 11, at 30.

106 See V&F September 10 Letter, supra note 12, at 5.

is being held in financing structures,"[107] but the commenter admits that it does not know either how much of the copper is so encumbered under financing arrangements or how long such copper would be restricted.[108] Further, even if the commenter is correct that, as a practical matter, such copper may be unavailable to U.S. copper consumers, that does not preclude copper in Shanghai from being deposited into the Trust (if it is otherwise eligible), as one of the Trust's initial permitted warehouse locations is Shanghai.

Even assuming that authorized participants will need to remove copper from LME warrant to deposit the copper into the Trust, as discussed above, the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets.[109] Accordingly, the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery.

3. Growth of the Trust

One of the Opposing Commenters believes it is reasonable to expect that the Trust would sell all of the Shares covered by the Registration Statement in the three months after the registration becomes effective because of: (1) "the stated desire to have the Trust remove enough copper from the market each month to move prices upward to cover the costs of storage"; (2) the very limited quantity of copper available for immediate delivery to accomplish the Trust's objective; and (3) the increase in copper prices in the three months following October 2010, when the Trust, iShares Copper Trust, and ETFS Physical Copper were announced.[110]

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107 V&F August 24 Letter, supra note 11, at 9.

108 See id.

109 See supra Section III.A.1.

110 See V&F August 24 Letter, supra note 11, at 20. ETFS Physical Copper is a trust that holds copper under LME warrant and its shares are traded on the London Stock Exchange

That commenter also asserts that the copper supply is inelastic and that supply, therefore, is unlikely to increase fast enough to account for the increased demand that the commenter believes would be unleashed by the creation and growth of the Trust.[111] Opposing commenters state that the Trust would hold approximately 61,800 metric tons of copper if the Sponsor sells all of the 6,180,000 Shares covered by its Registration Statement.[112]

The Sponsor states that it does not expect to sell all registered Shares within three months after the Registration Statement becomes effective, and states: "[l]ike all other physical metal ETVs, the Trust would register significantly more Shares than it initially intends to sell so that it is able to meet any such demand."[113] The Sponsor predicts that, in connection with the initial offering of Shares, the Trust would hold 9,893 metric tons of copper.[114]

As a preliminary matter, the Opposing Commenters appear to conflate the amount of copper held by the Trust with the number of Shares issued. When Commodity-Based Trusts redeem shares, those redeemed shares do not get put "back on the shelf"; once securities are

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and Deutsche Börse. See http://www.etfsecurities.com/en/updates/document_pdfs/ETFS_Physical_Industrial_Copper_Fact_Sheet.pdf. A discussion of the effect of ETFS Physical Copper on the price of copper is included below. See infra Section III.B.

111 See V&F May 9 Letter, supra note 4, at 5. That commenter states that, in the longer term, copper miners are likely to respond to price signals and increase production. See V&F August 24 Letter, supra note 11, at 28. Another Opposing Commenter generally asserted that the Trust actually would change "supply and demand relationships." AFR October 23 Letter, supra note 14, at 4. That commenter offered neither an explanation for nor quantitative data to support its belief. As discussed below, the Commission believes that the Opposing Commenters have not supported their prediction that the assets of the Trust will grow so quickly, and that copper supply is sufficiently inelastic, such that copper prices would be impacted. See infra text following note 118.

112 See V&F May 9 Letter, supra note 4, at 3; Levin Letter, supra note 8, at 5.

113 DP August 24 Letter, supra note 11, at 41.

114 See id.

redeemed, the issuer cannot resell securities of the same amount unless there is either sufficient capacity left on the registration statement (i.e., enough registered securities to cover the new issuance of shares by the issuer) or unless a new registration statement is filed to register the offer and sale of the securities.[115] Accordingly, 6,180,000 issued Shares will correspond with 61,800 metric tons of copper held by the Trust only if authorized participants do not redeem any Shares. Based on the existence of the arbitrage mechanism of the Trust,[116] which is common to many exchange-traded vehicles, the Commission believes it is very unlikely that no Shares will be redeemed.

The Commission believes that the amount of copper held by the Trust will depend on investor demand for the Shares and the extent to which authorized participants fulfill such demand by buying Creation Units and not redeeming issued Shares. Investor demand for the Shares is currently unknown. The Commission notes that ETFS Physical Copper, shares of which are listed and traded on the London Stock Exchange and Deutsche Börse, has not grown to a substantial size since its inception.[117]

As discussed above, the Commission believes that copper held by the Trust will be available for immediate delivery.[118] However, even assuming that the Trust's copper will be

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115 See Sections 5 and 6 of the Securities Act, 15 U.S.C. 77e and 15 U.S.C. 77f, respectively.

116 The Trust's arbitrage mechanism allows authorized participants to create and redeem Shares, and is designed to align the secondary market price per Share to the NAV per Share. See Notice, supra note 3, 77 FR at 23780.

117 According to one Opposing Commenter, on December 17, 2010 (one week after the product was launched), ETFS Physical Copper held 1,445.4 metric tons of copper, and on August 3, 2012, it held 1,763.7 metric tons of copper, although there have been periods where ETFS Physical Copper has held greater quantities of copper, reaching as high as 7,072.9 metric tons of copper in March and April of 2012. See V&F August 24 Letter, supra note 11, at 15.

118 See supra Section III.A.1.

unavailable for immediate delivery, the Commission believes that the Opposing Commenters have not supported their prediction that the Trust would grow so quickly that it would significantly disrupt the supply of copper available for immediate delivery.

4. Other Physical Commodity Trusts

Opposing commenters admit that the introduction of Commodity-Based Trusts that hold other metals had virtually no impact on the available supply, but they assert that these other metals – gold, silver, platinum, and palladium – are fundamentally different because they have traditionally been held for investment purposes, currently are used as currency, and that, as a result, there were ample stored sources available to fund Commodity-Based Trusts overlying those metals.[119] They assert that copper, in contrast, generally is not held as an investment, but rather is used exclusively for industrial purposes, with the annual demand generally exceeding the available supply, and they therefore believe that the introduction of the Trust would impact supply.[120]

In response, the Sponsor states that the majority of the market for silver, platinum, and palladium is industrial in nature.[121] The Sponsor has provided statistics from Thomson Reuters GFMS, a provider of information about the international metals industries, showing that in 2011, industrial use accounted for 84% of global palladium demand, 66% of global platinum demand,

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119 See V&F May 9 Letter, supra note 4, at 2; and Levin Letter, supra note 8, at 6.

120 See V&F May 9 Letter, supra note 4, at 2–3; and Levin Letter, supra note 8, at 7. Senator Levin states that because copper is very expensive to store and difficult to transport, relative to precious metals, copper is not currently held for investment purposes, and predicts that holding copper for investment purposes will have a significantly greater impact on the copper market than the precious metals Commodity-Based Trusts had on their markets and the broader economy. See Levin Letter, supra note 8, at 7.

121 See DP August 24 Letter, supra note 11, at 39. Similarly, the Exchange states that the Trust would not be the first Commodity-Based Trust to hold a metal that is used primarily for industrial purposes. See Arca June 19 Letter, supra note 6, at 6.

and 53% of global silver demand.[122] The Sponsor also states its belief that any holding of physical copper inventories, or of a financial replicating position, is implicitly an investment in copper.[123]

Given the industrial usage of silver, platinum, and palladium as compared to copper,[124] the Commission believes that it is reasonable to project that any impact of the listing and trading of the Shares will not be meaningfully different than that of the listing and trading of shares of these other Commodity-Based Trusts due solely to the nature of the underlying commodity markets. In any event, the Commission's analyses above in Sections III.A.1–3 are the primary bases for our belief that the listing and trading of the Shares is not likely to disrupt the supply of copper available for immediate delivery. The non-impact of those other trusts on the supplies in the underlying precious metals markets is consistent with this view, but it is not a significant factor underlying it.

B. The Trust's Impact on the Price of Copper

The Opposing Commenters assert that, due to the rapid growth of the Trust, which they believe would occur and would remove a substantial portion of the supply of immediately

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122 See DP August 24 Letter, supra note 11, at 39. No other commenter provided comparable statistics regarding the industrial use of palladium, platinum, or silver.

123 See id. at 17, 19. The Sponsor believes copper held for investment purposes would include copper inventories on the LME, SHFE, and COMEX (453,464 metric tons as of July 31, 2012); copper inventories held through exchange-traded vehicles (2,356 metric tons as of July 31, 2012); and non-exchange-registered copper stocks (3.6 million metric tons as of July 31, 2012, 100,000 metric tons of which were held by hedge funds and private investors in private warehousing arrangements). See id. at 17–18.

124 As mentioned above, the Sponsor provided statistics showing that in 2011, industrial use accounted for 84% of global palladium demand, 66% of global platinum demand, and 53% of global silver demand. See supra text accompanying note 122.

available LME-warranted copper,[125] the price of copper would be driven up.[126] As noted above, one of the Opposing Commenters estimates that the Trust, which would hold up to 61,800 metric tons of copper, and the iShares Copper Trust,[127] which would hold up to 121,200 metric tons of copper, collectively would hold approximately 34% of the copper available for immediate delivery.[128] That commenter concludes that, "[i]f the supply of copper available for immediate delivery drops by about 34%, it naturally follows that the price of copper will rise."[129] Another of the Opposing Commenters states: "[t]he LME settlement price is axiomatically affected by the quantity of copper on warrant…because the quantity on warrant defines how much copper is eligible to be delivered against a cash contract, i.e., it is the total supply that is available when setting the settlement price."[130] That commenter also asserts that the launch of the UK-listed ETFS Physical Copper security and announcements about the proposed copper trusts in the United States were part of the cause of a copper price run up,[131] and predicts that the price increases for copper would be especially dramatic in the U.S., where copper currently is relatively inexpensive.[132] Another Opposing Commenter asserts that the value of copper is based

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125 See supra Section III.A.1.

126 See V&F May 9 Letter, supra note 4, at 5; Copper Fabricators Letter, supra note 11, at 4-5; Levin Letter, supra note 8, at 5; and AFR October 23 Letter, supra note 14, at 2, 3.

127 See Levin Letter, supra note 8, at 5. The Commission is not addressing the iShares Copper Trust proposed rule change in this order.

128 See id.

129 See id. Similarly, the Copper Fabricators state that the removal of 183,000 metric tons of copper from LME warehouses, which they believe is virtually all of the copper available for immediate delivery worldwide, would result in prices moving up very sharply. See Copper Fabricators Letter, supra note 11, at 5.

130 See V&F August 24 Letter, supra note 11, at 7.

131 See id. at 16.

132 See V&F May 9 Letter, supra note 4, at 4–5.

on "consumption rather than intrinsic value," and the creation of the Trust would introduce a financial element to copper pricing.[133]

In contrast, the Sponsor asserts that copper cash prices are not determined only by changes in on-warrant LME copper stocks.[134] The Sponsor believes that supply and demand fundamentals, independent of the Trust, drive the price of copper.[135] According to the Sponsor, the main determinants of price in the copper market are production and demand fundamentals such as: demand expectations; mine and refinery capacity; marginal costs of production (in particular, the change in marginal costs of production at different production levels); global and regional industrial growth patterns; cost of financing; and inventory levels.[136] The Sponsor states that: (1) prices have reached the highest level and been among the lowest levels both in a "normal" regime and a low-stocks environment; and (2) copper inventories and prices do not always have an inverse relationship.[137] In response to questions posed by the Commission about the impact of LME inventories on the LME Settlement Price, the Sponsor states that 5-day changes in the supply of LME inventories of 10,000 metric tons or more are not that uncommon,

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133 AFR October 23 Letter supra note 14, at 2. This commenter does not fully explain why the "financialization" of copper would result in higher copper prices. The commenter appears to make the same argument as other commenters: namely, that the Trust will drive up the price of copper by removing it from the market, an activity that the commenter characterizes as "hoarding." See id. at 3. Indeed, the commenter incorporates by reference the Levin Letter. See id. at 2.

134 See DP August 24 Letter, supra note 11, at 11.

135 See id. at 10. See also AFR November 16 Letter, supra note 14, at 6–7 ("It is true that if all other factors were equal, the removal of supply from the market through hoarding would increase prices, leading to a positive correlation between inventory and prices. But other supply and demand factors will frequently introduce exactly the opposite relationship between inventory and price." (footnote omitted)).

136 See DP August 24 Letter, supra note 11, at 10.

137 See id. at 24.

and that inventory builds or withdrawals equivalent to the amount of copper required for the initial creation unit of Shares currently occur at the LME at least one quarter of the time.[138] The Sponsor and the Exchange also state that, due to the Trust's creation/redemption mechanism and the related ability of authorized participants to exchange Shares for physical copper, Shares – like shares of other physical commodity backed trusts – would track rather than drive the price of the commodity it holds.[139]

As discussed above,[140] the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery, which is what the Opposing Commenters predict would increase the price of copper. However, even if the supply of copper under LME warrant would decrease because previously warranted copper were transferred to the Trust, for the reasons discussed below, the Commission does not believe that lower LME inventory level by itself will increase the LME Settlement Price (or any other price of copper).

To analyze the potential impact of changes in the LME inventory level on changes in the LME Settlement Price, Commission staff performed two regression analyses.[141] The first analysis was a linear regression of daily copper price changes, using five years of daily data from 2007–2012, against the following explanatory variables: the change in LME copper inventory from the previous day (i.e., the lagged change in LME copper inventory), and the changes in spot prices of nickel, tin, gold, silver, platinum, and palladium, and the S&P 500, VIX index, and the

138 Id.

139 See id. at 25; and Arca June 19 Letter, supra note 6, at 4.

140 See supra Section III.A.

141 See Memorandum to File, dated November 6, 2012, from the Division of Risk, Strategy, and Financial Innovation ("RF Analysis"). The RF Analysis was designed to look for evidence of price impact related to changes in copper inventory levels and fund flows.

China A-Shares index returns. The results indicate that LME copper inventories do not appear to have any independent statistical effect on prices.[142]

Commission staff also performed a similar regression analysis using monthly data from January 2000 until June 2012 obtained from the International Copper Study Group ("ICSG") to determine whether a relation between copper prices and LME inventories exists over a longer time horizon.[143] The second analysis was a linear regression of monthly copper price changes against the following explanatory variables: the previous month's change in LME copper inventory, total exchange copper inventory (i.e., combined inventory from LME, COMEX, and SHFE), non-exchange copper inventory (i.e., inventory from merchants, producers, and consumers), and spot price changes for nickel, tin, and platinum. This analysis again indicates that LME inventories specifically do not appear to have any independent statistical effect on prices.[144]

Based on these analyses, even if the listing and trading of Shares of the Trust were to result in the removal of copper on warrant from LME inventories, the Commission does not believe that such a supply reduction will by itself directly impact the LME Settlement Price (or any other price of copper). Although total exchange inventories, in contrast to LME inventories, appear to have some effect on monthly copper prices in this linear regression analysis, the

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142 See id. at 10.

143 The Sponsor suggests that some of the inventory data published by the ICSG may be incomplete, but the Sponsor did not question the ICSG LME copper inventory data that was used in the Staff's analysis. See DP August 24 Letter, supra note 11, at 19.

144 See RF Analysis, supra note 141, at 11.

coefficient estimate associated with total exchange inventories indicates that copper prices should decrease when copper is taken off-exchange.[145]

Commission staff also performed Granger causality analyses[146] to test the causal effect the holdings of other Commodity-Based Trusts historically have had on the prices of their underlying commodities. Specifically, to evaluate whether the introduction of the SPDR Gold Trust, iShares Silver Trust, ETFS Platinum Trust, ETFS Physical Palladium Shares, and ETFS Physical Copper trust had an impact on the return of the metals underlying those trusts, using monthly data from their inceptions until September 2012, Commission staff examined flows into these funds and subsequent changes in underlying prices over time.[147] This analysis revealed no observable relation between the flow of assets and subsequent price changes of the underlying metal prices.[148] Commission staff repeated this analysis on a daily frequency for iShares Silver Trust, ETFS Platinum Trust, ETFS Physical Palladium Shares, and ETFS Physical Copper.[149] Again, Commission staff found no evidence that fund flows were statistically related to subsequent changes in the underlying metals prices. Given the industrial usage of silver,

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145 See id.

146 Granger causality is a statistical concept of causality that is based on prediction. If a signal X "Granger-causes" a signal Y, past values of X should contain information that helps predict Y above and beyond the information contained in past values of Y alone. See id. at 3, n.9.

147 See id. at 2–9. Because ETFS Physical Copper is small relative to the potential size of the Trust – holding only approximately 2,000 metric tons of copper as of August 2012 – Commission staff augmented its analysis by comparing asset growth of SPDR Gold Trust, iShares Silver Trust, ETFS Platinum Trust, and ETFS Physical Palladium Shares with changes in spot prices for the underlying metals.

148 See id. at 4.

149 Daily asset data was not available for the SPDR Gold Trust within the Commission's existing data sources.

platinum, and palladium as compared to copper,[150] the Commission believes that it is reasonable to project that any impact of the listing and trading of the Shares will not be meaningfully different than that of the listing and trading of shares of other Commodity-Based Trusts due solely to the nature of the underlying commodity markets.

The Commission received three comment letters regarding the Commission staff's analysis.[151] These letters include comments on both the substantive conclusions reached as well as the methodology used.[152] As described further below, the Commission believes the staff's analysis reasonably evaluates whether historical price impacts are associated with changes in copper supply, one of the Opposing Commenters' contentions.

One of the Opposing Commenters states that the results in Table 4 in the RF Analysis appear to contradict the staff's conclusion that there is no statistically significant relationship between copper inventories and copper prices as the results show a strong positive relationship between total exchange inventories and copper prices.[153] The Commission believes that the

150 As mentioned above, the Sponsor provided statistics showing that in 2011, industrial use accounted for 84% of global palladium demand, 66% of global platinum demand, and 53% of global silver demand. See supra note 122 and accompanying text.

151 See AFR November 16 Letter, supra note 14; V&F November 16 Letter, supra note 14; and Rutkowski November 17 Letter, supra note 14. Mr. Rutkowski urges that the Commission afford the AFR November 16 Letter the attention Mr. Rutkowski believes it deserves. See Rutkowski November 17 Letter, supra note 14. The Commission discusses both the AFR November 16 Letter and the V&F November 16 Letter below.

152 AFR states that "[t]he detailed regression data, models (including computer code), and full results used in [the RF Analysis] should be released to the public." See AFR November 16 Letter, supra note 14, at 3. The Commission does not believe it is necessary to release this information because the RF Analysis includes sufficient data and information to permit commenters to evaluate the staff's analyses.

153 See id. at 2. The commenter's concern appears to be based on its belief that supply changes "on the margin" influence price and that, if supply hoarding increases prices, the key determinant of price levels will be inventories for the source of supply for the marginal unit of copper. The commenter sets forth reasons why it believes the LME

aforementioned linear regression analysis conducted by staff indicates that LME copper inventories do not appear to have any independent statistical effect on copper prices. Further, we recognize that the linear regression analysis summarized in Table 4 also indicates that total exchange inventory has a positive relation to copper prices. Specifically, this linear regression analysis indicates that removal of copper from exchanges would lead to a decrease in the price of copper, thus benefiting market participants who use copper as an input.[154]

This Opposing Commenter also states that the Commission staff's decision to use the inventory of LME-warranted copper, total exchange copper inventory, and total non-exchange inventory as independent variables makes it difficult to interpret any single coefficient.[155] The

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inventory no longer represents the marginal unit of copper, and its belief that total exchange inventory (or potentially off-exchange inventory) is the type of inventory most likely to include the marginal unit of copper inventory on the world market. AFR states that in recent years, inventories have been moving from the LME toward other exchanges, and that since 2008, most inventory flow has been to non-LME exchanges. AFR also argues that LME lending rules would make it illogical to use LME-warranted copper to influence market prices. In addition, AFR asserts that total exchange inventories may be a better guide to price impact since the Trust would hold copper that is not on LME warrant. See id. at 4.

AFR also states that because the Commission staff's analysis "does not properly report the units in which these regression variables are measured in, and does not provide standardized coefficients, it is not possible to fully assess the economic (as opposed to statistical) significance of" total exchange inventories and compare it to other coefficients. See id. at 4 n.4. While the Commission acknowledges this comment, the RF Analysis does not rely on the magnitude of coefficient estimates, but rather on the statistical significance of those estimates.

154 In contrast, the Opposing Commenters argue that the removal from the market of a substantial portion of copper available for immediate delivery would drive up the price of copper. See supra notes 125–132 and accompanying text.

155 See AFR November 16 Letter, supra note 14, at 4. Another commenter asserts that Commission staff "included likely heteroskedastic variables of other LME and LBMA metals prices in the regression, which may in the least, have undermined the cogency of the coefficient pertaining to LME copper inventory levels." See V&F November 16 Letter, supra note 14, at 1–2. There is no evidence in the record of the existence of heteroskedasticity in these variables that would affect the results of the RF Analysis.

commenter states that because LME copper inventory makes up a significant portion of total exchange inventory, the two variables are obviously highly correlated, creating the problem of collinearity between regressors.[156] As a response to these comments, the Commission notes that its staff conducted a separate analysis, in which COMEX and SHFE copper inventory were substituted for total exchange copper inventory (i.e., the inventory of LME-warranted copper was removed from total exchange copper inventory). Consistent with the findings in the RF Analysis, this separate analysis shows that, even when replacing total exchange inventories with non-LME exchange inventories, LME inventories specifically do not appear to have any independent statistical effect on copper prices.[157]

Further, this Opposing Commenter states: "there are growing doubts about the utility of not just LME inventories but any established exchange inventories in representing the true global inventory stocks of copper."[158] The commenter asserts that, if there are large global inventories of copper that are not being measured, the utility of any of the models in the Commission staff's

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156 See AFR November 16 Letter, supra note 14, at 4. This commenter did not identify which independent variables Commission staff should have used and did not provide its own regression analysis for Commission to consider.

157 In this alternative regression specification, the coefficient for non-LME exchange inventories is estimated to be positive and statistically significant, like the coefficient for total exchange inventory in Table 4 of the RF Analysis. This result again implies that taking inventory off these exchanges may result in a decrease in copper prices, as opposed to an increase in prices as predicted by the Opposing Commenters.

158 See AFR November 16 Letter, supra note 14, at 8. AFR states: "Table 4 does include a variable for the off-exchange inventory. The coefficient is large but not statistically significant. It is difficult to assess this finding given the collinearity issue and the lack of detail on how the off-exchange inventory variable is calculated." See id. at 4 n.8. The Commission does not believe that the magnitude of the coefficient for off-exchange inventory in Table 4 of the RF Analysis is relevant as the p-value is statistically insignificant.

analysis is highly doubtful.[159] As discussed above, the Commission believes that there are sufficient copper stockpiles such that up to 61,800 metric tons of copper could be deposited into the Trust without authorized participants taking copper off of either LME or COMEX warrant.[160] This may, as the commenter suggests, limit the utility of the RF Analysis regarding the relation between LME inventories and prices. However, other Opposing Commenters have argued that the price of copper will increase precisely because authorized participants will create Shares by taking copper off of LME and/or COMEX warrant, and the RF Analysis addresses this concern.[161] Moreover, the Commission believes that if there are large global inventories of copper that are not being measured, it is less likely that the listing and trading of the Shares will by itself increase the price of copper compared with the scenario suggested by other commenters who assert that LME inventories drive prices.

This Opposing Commenter also argues that the Commission staff's analysis ignores key "institutional factors" in the copper market.[162] The commenter asserts that price determination in any market is highly dependent on the rules that govern that market, and that for an industrial commodity, factors concerning the practical use of the commodity are important.[163] According to the commenter, the most important institutional factor is the LME's requirement "that any holder of 50 percent or more of LME warrants in any metal must lend its inventory on demand at rates designed to prevent any profit from the dominant position."[164] The commenter asserts that

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159 See id. at 9.

160 See supra Section III.A.2.

161 See supra notes 125–132 and accompanying text.

162 See AFR November 16 Letter, supra note 14, at 8.

163 See id.

164 See id.

the findings in the RF Analysis are based on analyses of exchange-traded funds backed by LME warrants, and asserts that the findings of that analysis likely do not accurately reflect the likely price impact of the Trust as the assets of the Trust would not be backed by LME warrants.[165] As discussed above,[166] however, Commission staff evaluated whether the introduction of the SPDR Gold Trust, iShares Silver Trust, ETFS Platinum Trust, ETFS Physical Palladium Shares, and ETFS Physical Copper had an impact on the return of the metals underlying those trusts. Only ETFS Physical Copper holds LME warrants; the SPDR Gold Trust, iShares Silver Trust, ETFS Platinum Trust, and ETFS Physical Palladium Shares all hold physical gold, silver, platinum, and palladium, respectively, not warrants on those metals. Accordingly, the Commission believes the staff's analysis considers the institutional factor cited by the commenter.

Further, one of the Opposing Commenters asserts that the Commission staff's analysis ignores endogeneity problems.[167] The commenter argues that the Commission staff's Granger causality analyses[168] are inappropriate because they look for a statistical relationship between variables that are simultaneously determined—specifically, asset flows into Commodity-Based Trusts and metals prices.[169] In addition, this commenter argues that the Commission staff's regression analyses, performed to determine whether a relationship exists between copper prices

165 See id. See also supra text accompanying note 147.

166 See supra note 147 and accompanying text.

167 See AFR November 16 Letter, supra note 14, at 5. AFR states that endogeneity refers to the simultaneous determination of quantity and price in supply-demand systems and "involves a causal loop between the dependent and independent variable such that the causal impact of the independent variable cannot be isolated." See id.

168 See supra notes 146–150 and accompanying text.

169 See AFR November 16 Letter, supra note 14, at 5.

and LME inventories,[170] are subject to endogeneity bias.[171] The commenter asserts that the Commission staff's analysis "attempts to retrieve the causal impact of supply hoarding on prices through regressing price on quantity in the market generally."[172] According to the commenter, although, "if all other factors were equal, the removal of supply from the market through hoarding would increase prices, leading to a positive correlation between inventory and prices," other supply and demand factors, such as an inventory buildup in connection with a decline in prices caused by decreased market demand, can lead to a negative correlation between inventory level and prices.[173] Thus, according to the commenter, a correlation between inventory levels and price will not isolate the effect of supply hoarding.[174]

The Commission does not believe that endogeneity biases are problematic with regard to the linear regression analyses and the Granger causality analyses Commission staff conducted because the analyses examine the relation between lagged inventory changes (in case of the regression analyses) or lagged flows (in the case of the Granger causality analyses) and subsequent price changes. For this reason, the inventory and flow variables are determined prior to the price variables being determined, and are not determined simultaneously with prices.[175]

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170 See supra notes 141–144 and accompanying text.

171 See AFR November 16 Letter, supra note 14, at 6.

172 See id.

173 See id. at 6–7.

174 See id. at 7.

175 The commenter asserts: "the most preferred method [to address endogeneity issues] is to use an instrumental variables approach that isolates factors that affect market supply but are unrelated to other causal factors." Id. This commenter, however, did not submit for Commission consideration the analysis it asserts is necessary, nor did the commenter provide any examples of instrumental variables it asserted would rectify the analysis.

Another of the Opposing Commenters states that the Granger causality analyses appear on their face to be incongruous.[176] This commenter states its belief that Commission staff appears to be comparing assets under management to the respective price of the commodity held by the trust, and provides a chart that the commenter purports to show that there is a 92% correlation between the rolling monthly change in NAV of the iShares Silver Trust and the silver price.[177] The Granger causality analysis from Tables 1 and 2 of the RF Analysis examines the relation between dollar flows into the funds and subsequent changes in the prices of the underlying metals. It does not examine the relation between changes in assets under management, which are driven by both flows and returns of the underlying, and the concurrent change in the prices of the underlying metals. Therefore, the Commission believes that the relation between the change in NAV for these funds and the concurrent change in the prices of the underlying metal is irrelevant for the purposes of the cited analysis.

Two of the Opposing Commenters question the time periods used in the Commission staff's analysis. One of these Opposing Commenters states that Commission staff failed to account for the term structure of prices (e.g., whether, and the extent to which, the market is in contango or backwardation).[178] This commenter states: "[t]he correct lag period to test for price impacts on copper consumers depends upon the delivery times and production lead times, which also affect the price impacts of deep backwardation on consumer access to supplies."[179] While this commenter suggests that the Commission staff did not use the correct lag period in its analysis, the commenter did not provide any specific time intervals that should be used from the

176 See V&F November 16 Letter, supra note 14, at 6.

177 See id. at 6–7.

178 See AFR November 16 Letter, supra note 14, at 9.

179 See id.

many possible alternatives, nor did it explain what time intervals would have been more appropriate than those used by Commission staff. The Commission believes the daily periods used in the RF Analysis were reasonable and appropriate because evidence of the relationship between inventories and prices would likely be seen at daily intervals.[180]

Another of the Opposing Commenters suggests that Commission staff should have examined the cash to three month time spread and provides its own analysis, which the commenter concludes demonstrates a strong relationship between LME inventory changes and the cash to three month time spread.[181] This commenter states that if the Trust and the iShares Copper Trust were to sell all of the shares registered through their respective registration statements, the cash to three month time spread "would blow out to a massive backwardation, potentially approaching record levels, making it impossible for copper consumers to finance their inventory."[182] The analysis provided by this commenter, however, does not provide the

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180 In particular, LME inventory data for the previous day is released on the morning of each trading day so that prices are able to react over the course of that day. Moreover, the use of the monthly lag period confirmed the results of the daily analysis and allowed for the examination of the effect of non-exchange copper inventories for which only monthly data were available within the Commission's existing data sources.

181 See V&F November 16 Letter, supra note 14, at 3.

182 See id. The commenter further states that the mechanics of unit creation for Commodity-Based Trusts backed by precious metals are fundamentally different than those for Commodity-Based Trusts backed by industrial metals, citing the lack of copper in unallocated accounts that could be used in creating Shares. According to the commenter, neither producers nor consumers are carrying meaningful inventories of copper, which would require authorized participants to acquire copper from LME and COMEX inventories to create Shares. The commenter asserts that a backwardation would be necessary to trigger the movement of copper to authorized participants, and that consumers would have to compete for this metal or lend to authorized participants. See id. at 4. As discussed above, the Commission believes that the record supports the view that there are sufficient copper stockpiles such that up to 61,800 metric tons of copper could be deposited into the Trust without authorized participants taking copper off of either LME or COMEX warrant. See supra Section II.A.2.

significance level of any test statistics associated with these findings, which would provide an assessment of the likelihood that relations were observed in the data by statistical chance. Without an assessment of statistical significance, it is difficult to conclude whether observed relations in the commenter's data are systematic or anecdotal. In addition, this commenter's analyses appear to analyze inventory changes against concurrent price changes. The Commission does not believe that such a concurrent analysis can isolate the effect of inventory changes on prices because such an analysis cannot distinguish whether price changes lead inventory changes or vice versa.

Further, as discussed above, the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery,[183] and believes that the Opposing Commenters have not supported their prediction that the Trust would grow so quickly that it would significantly disrupt the supply of copper available for immediate delivery.[184]

This Opposing Commenter also asserts that Commission staff erred by using lagged daily LME stock data. This commenter asserts that because there are "many consecutive and non-consecutive days that LME stock levels and LME traded metals do not change while LME prices do . . . , running a daily LME stock series through a regression analysis will yield statistically weak results in most cases."[185] The commenter states that LME inventory data for the prior day is released at 9:00 a.m. in the London trading day, thereby giving the market a full trading day to

183 See supra Section III.A.

184 See supra Section III.A.3.

185 See V&F November 16 Letter, supra note 14, at 2.

digest the data.[186] The lagged daily LME inventory change used in the RF Analysis in fact was regressed against the change in copper prices for the day on which this information was released at 9:00 a.m.[187]

In addition, this Opposing Commenter asserts that there is not a strong statistical relationship between lagged copper inventories and contemporaneous copper prices because the LME represents the copper market's "warehouse of last resort."[188] According to this commenter, when LME stocks are drawn down or added to, market participants "should have already fully discounted the fundamental information contained within that particular stock move."[189] This assertion seems consistent with a hypothesis that price changes precede inventory changes, which is contrary to Opposing Commenters' assertions that inventory changes precede price changes.[190] The Commission believes that this argument provides further weight to the Commission staff's finding that the LME copper inventory changes do not appear to precede price changes.

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186 See id. at 5–6.

187 To confirm this, Commission staff reconciled a sample of historical LME stock data from the LME website (http://www.lme.com/dataprices.asp) and the Bloomberg LME stock data used in the RF Analysis. Additional reconciliation was done against historical LME copper warehouse stock data found at http://www.metalprices.com/historical/database/copper/lme-copper-warehouse-stocks.

188 See V&F November 16 Letter, supra note 14, at 6.

189 See id. at 6 (stating that LME stocks are drawn down by consumers because neither producers nor traders have material to sell to consumers and consumers are willing to go through the logistical hassle of being long LME warrants, swapping the warrants for their preferred brands, and transporting the copper to their individual plant, and that "[i]t is nonsensical to assume that the trading community has not already discounted this information into the LME price"). But see id. at 2 ("Intuitively it doesn't make sense to argue that in a physically settled exchange system that fungible stock levels don't exert some statistically robust influence on metals prices.").

190 See supra note 154 and accompanying text.

This Opposing Commenter suggests that, instead of looking at lagged daily LME stock data, the Commission staff should have looked at the 30 largest quarter-to-quarter LME inventory declines against changes in the LME cash price over the same time periods. The commenter asserts that such analysis, which the commenter submitted, shows that for the 30 largest observations, the median stock decline was 28.6%, and that the LME cash price rose in 25 out of 30 observations, for a median increase of 10.5%.[191] The commenter states that these findings suggest that if LME and COMEX inventories were to decline by more than 50%, which the commenter asserts could happen if the Trust and the iShares Copper Trust were to sell all of the shares registered through their respective registration statements, prices could increase 20–60% in the quarter that the LME and COMEX inventory decline occurs.[192]

The analysis provided by this commenter, however, does not provide the significance level of any test statistics associated with these findings.[193] In addition, this commenter's analysis appears to analyze inventory changes against concurrent price changes. The Commission does not believe that such a concurrent analysis can isolate the effect of inventory changes on prices.[194] Further, as discussed above, the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery,[195] and believes that the Opposing Commenters have not supported their prediction that

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191 See V&F November 16 Letter, supra note 14, at 2.

192 See id. at 2.

193 See supra text following note 182.

194 See supra text following note 182.

195 See supra Section III.A.

the Trust would grow so quickly that it would significantly disrupt the supply of copper available for immediate delivery.[196]

One of the Opposing Commenters states that Commission staff should have considered the impact on locational premia.[197] This commenter asserts that the relationship between COMEX inventory and locational premia in the U.S. is strong, and provides data that the commenter suggests shows that when COMEX inventories are at anemic levels, locational premia can be very high (above $200 per metric ton).[198] Thus, the commenter argues that if the Trust results in the removal of inventory from LME and COMEX warehouses, the associated market impact will be much higher locational premia.[199] The analysis provided by this commenter, however, does not provide the significance level of any test statistics associated with these findings.[200] In addition, this commenter's analysis appears to analyze inventory changes against concurrent price changes. The Commission does not believe that such a concurrent analysis can isolate the effect of inventory changes on prices, as discussed previously.[201] In addition, according to data provided by commenters, locational premia typically appear to be no greater than 2%. Therefore, the Commission believes the degree to which such premia can be

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196 See supra Section III.A.3.

197 See V&F November 16 Letter, supra note 14, at 3, 5. This commenter refers to "physical" premia in describing the manner in which the Trust will value its copper holdings: "Another market price that the SEC could have done well to look into is the physical premia, especially in light of the [Trust's] implied objective to value metal . . . on an in-situ basis, taking into account regional physical price variations." See id. at 5. Consistent with this description, the Commission refers to locational premia rather than physical premia.

198 See id.

199 See id.

200 See supra text following note 182.

201 See supra text following note 182.

influenced is limited. Further, even assuming that copper was taken off LME warrant to be deposited into the Trust, the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets,[202] which will limit the possible effect on locational premia.

Finally, this Opposing Commenter asserts that the listing and trading of the Shares could change the fundamental structure of the copper market, and that Commission staff should "ponder" such a structural change in the copper market.[203] This commenter states that the ex-post implications for copper outright prices in a market that involves listing and trading of the Shares cannot be accurately inferred from what this commenter characterizes as "an overly-simplistic ex-ante statistical analysis of LME/global inventories and LME settlement prices."[204] According to this commenter, never before has it been possible for financial players to "lock up" significant amounts of LME and COMEX inventory in a short period of time and remove that copper from the market.[205] Further, while this commenter indicates that "[o]verall historically the level of LME inventories has been generally indicative of the trading environment, not a driver of the metal price per se," creation of the Trust could change the role of LME inventories from being a function of the fundamentals to being a fundamental, and "arguably THE fundamental, as has become the case in precious metals."[206]

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202 See supra text accompanying note 109.

203 See V&F November 16 Letter, supra note 14, at 3–4.

204 See id. at 4.

205 See id. at 3–4, 8.

206 See id. at 6 (emphasis in original). The commenter states that exchange-traded vehicles backed by silver, platinum, and palladium have become the largest single holder of those metals in a remarkably short period of time (less than eight years) and that exchange-traded vehicles backed by gold are eclipsed at a national level only by the U.S. and Germany. According to the commenter, while the cumulative impact of exchange-traded

The Commission believes that such assertions are speculative and unsupported by the record. As discussed in detail throughout this order, the Commission does not believe that the listing and trading of the Shares is likely to alter the supply and demand fundamentals of the copper market. Further, as discussed above, the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery[207] and, even assuming that copper was taken off LME warrant to be deposited into the Trust, the Commission believes that the Trust's copper will remain available for immediate delivery to consumers and participants in the physical markets.[208]

Lastly, one of the Opposing Commenters cites a study that "examines the hedging activity of sponsors using futures as hedges for the total return swaps" entered into as part of commodity index funds.[209] According to the commenter, the sponsor of a commodity index fund must replace expiring futures contracts with later-maturing futures on a continuous basis

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vehicles on prices has dissipated as these products have matured, "the reality is that they have become a key fundamental in terms of analyzing the precious metals markets," and have become the main asset class. The commenter asserts that it is not certain, and that it should not be assumed, that potential investors in the Trust will "be as sticky as they have been in gold and silver, and to a lesser degree in platinum and palladium." Id. at 7. The commenters "stickiness" argument has been addressed above. See supra Section III.A.1.

207 See supra Section III.A. Even assuming that the Trust's copper will be unavailable for immediate delivery, the Commission believes that the Opposing Commenters have not supported their prediction that the Trust would grow so quickly that it would significantly disrupt the supply of copper available for immediate delivery. See supra Section III.A.3.

208 See supra text accompanying note 109.

209 AFR October 23 Letter, supra note 14, at 4 (citing David Frenk & Wallace Turbeville, Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices (October 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1945570 ("Frenk & Turbeville Study")). The commenter states that these total return swaps do not reference a single commodity, but rather are valued based on indices comprised of a basket of commodity futures. See id. at 3.

(referred to as the "roll").[210] The commenter states that the Frenk & Turbeville Study "found an extremely strong and significant correlation" over a multi-year period between the five-day roll period for hedges of the Goldman Sachs Commodity Futures Index in each month with a movement in the forward price curve toward higher prices in the future.[211] The commenter believes that suppliers hold onto more of the underlying commodity to take advantage of the rising prices signaled by the movement in the forward price curve (although no fundamental market forces have signaled such higher prices), which in turn increases spot prices to attract supply that otherwise could be hoarded.[212] The commenter believes that the proposed trust will have a more direct effect on the copper market as withdrawal of supply in rising-price markets (and flooding of supply in decreasing-price markets) constitutes an actual change in supply and demand relationships.[213]

The Commission is not persuaded that the conclusions of a study on correlations between the roll periods of futures indexes and commodities prices should be extrapolated to predict the impact of the Trust, which will hold physical copper (not copper derivatives), on the price of copper. As discussed above, the Commission believes that copper delivered into and held by the Trust will remain available for immediate delivery and, even if it is "removed from the market" as commenters have suggested, the supply of copper available for immediate delivery is sufficient such that the creation and quick growth of the Trust alone is not expected to impact the price of copper.[214]

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210 See id. at 4.

211 See id.

212 See id.

213 Id.

214 See supra Sections III.A.1 and A.3.

Because the Commission does not believe that the listing and trading of the Shares, by itself, will increase the price of copper, the Commission also believes that approval of the proposed rule change will not have an adverse effect on the efficiency of copper allocation for industrial uses and will also not have an adverse effect on capital formation for industrial uses of copper.

C. The Trust's Impact on Copper Price Volatility

The Opposing Commenters assert that the successful creation and growth of the Trust would make the price of copper, which one of those commenters states already is volatile,[215] even more volatile. Specifically, they assert that the successful creation and growth of the Trust, which would in their view substantially restrict supply and increase copper prices, would create a boom and bust cycle in copper prices.[216] For example, the Copper Fabricators predict that: (1) the Trust would remove copper from the market, and thus would drive the price of copper higher, which in turn would drive the price of the Shares higher; (2) at some point, the anticipated incremental increase in price would either be insufficient to cover the increasing costs of storage or would not be enough to generate a profit; and (3) that when that expected outcome occurs, Share holders would sell their Shares and authorized participants would redeem them, returning the copper held in the Trust to the physical market.[217] The Opposing Commenters predict that this ultimate sell-off would be quick, and predict that the expected "dumping" of thousands of

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215 See V&F May 9 Letter, supra note 4, at 5.

216 See id. at 5; Levin Letter, supra note 8, at 5; Copper Fabricators Letter, supra note 11, at 5–6; and AFR October 23 Letter, supra note 14, at 2. But see V&F November 16 Letter, supra note 14, at 8 (stating that if Commission staff were to analyze whether the discrete flow of ounces in and out of exchange-traded vehicles drives underlying metals price, it would likely show that volatility in precious metals is not solely a function of net metal flow in and out of the exchange-traded vehicles).

217 See Copper Fabricators Letter, supra note 11, at 5–6.

metric tons of copper back onto the market would depress the price of copper and negatively impact the world economy at large.[218]

In contrast, NYSE Arca and the Sponsor assert that the Trust would not increase copper price volatility in this manner and in fact may reduce it. The Exchange states that, because of the arbitrage mechanism common to all exchange-traded vehicles, share prices of physical commodity-backed exchange-traded vehicles generally follow rather than drive the price of the underlying assets.[219] The Sponsor asserts that volatility in prices results when there is a major change in prevailing expectations about fundamental market parameters, and the Trust would not affect any of the fundamental parameters that drive supply and demand.[220] Further, the Sponsor states that the Trust may reduce copper price volatility because, if holders of the Shares act according to their incentives – namely, to sell into rallies and buy on price dips – their actions may tend to reduce peaks and valleys in pricing, and help to reduce volatility.[221]

The Opposing Commenters' prediction that the listing and trading of the Shares would cause a boom and bust is premised upon both the supply and price impacts they predict. As discussed above, the Commission does not believe that the listing and trading of the Shares is

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218 See, e.g., Levin Letter, supra note 8, at 6. More specifically, V&F states that, because of this predicted boom and bust, mines will go bust and resources will be needlessly misallocated. See V&F August 24 Letter, supra note 11, at 28.

219 See Arca June 19 Letter, supra at 6, at 4.

220 See DP August 24 Letter, supra note 11, at 11. The Sponsor also states: (1) changes in realized volatility of physical copper prices and prices of copper derivatives based on changes in global copper supply are not constants; (2) LME prices and price volatility do not increase or decrease based solely on LME copper stocks or on-warrant LME copper stocks; and (3) in general, realized volatility of copper prices tends to be higher in a lower stocks environment, as strong physical demand draws production and distribution systems to full capacity utilization. See id. at 24–25.

221 See id. at 11.

likely to disrupt the supply of copper available for immediate delivery[222] or increase the price of copper.[223] In addition, this boom and bust prediction is unsupported by any empirical evidence. As a result, the Commission does not believe that the proposed listing and trading of the Shares will impact copper volatility in the manner that Opposing Commenters suggest. Further, the Commission does not believe that approval of the proposed rule change will impede the use of copper because the listing and trading of the Shares is not expected to, as discussed above, result in heightened volatility. Therefore, the Commission does not believe that the listing and trading of the Shares will have an adverse effect on the efficiency of copper allocation and capital formation.

D. The Trust's Impact on the Potential to Manipulate the Price of Copper

The Opposing Commenters set forth a number of arguments about why the Trust would increase the potential for manipulation of the copper market. One of the Opposing Commenters asserts that the Trust, in effect, would introduce so much transparency into the copper market that it would allow the Trust to manipulate, or alternatively provide market participants an effective means to manipulate, the price of copper and thereby the price of the Shares. According to that commenter, investors in the Trust would be able to measure how much impact their collective removal of copper from the supply available for immediate delivery would have on copper prices each day, and could adjust their purchasing strategies accordingly.[224] Therefore, that commenter believes that the increased market transparency, which the Exchange asserts would result from the formation and operation of the Trust, would not be in the public

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222 See supra Section III.A.

223 See supra Section III.B.

224 See V&F May 9 Letter, supra note 4, at 9.

interest.[225] Instead, the commenter believes the transparency of the Trust's holdings would provide market participants with critical information about "how much copper needs to be removed on any given day in order to artificially inflate [copper] prices and thus the price of the Trust's shares."[226]

Due to their view of the Trust's impact on the supply of copper available for immediate delivery, Opposing Commenters predict that the Trust would make the copper market more susceptible to squeezes and corners.[227] According to an Opposing Commenter, after a substantial portion of the copper market is deposited in one or more physical copper trusts, the costs of acquiring the remaining inventory would be relatively inexpensive, thus reducing a hurdle to engineering a corner or squeeze.[228] According to another commenter, such manipulative activities could go undetected by the LME because trusts that hold physical commodities are not subject to any form of commodity regulations; by holding physical copper rather than LME warrants, the Trust would be able to control more of the available supply of copper without triggering LME reporting or rules.[229]

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225 See id. at 10.

226 V&F July 13 Letter, supra note 7, at 10.

227 See V&F May 9 Letter, supra note 4, at 1, 10; Levin Letter, supra note 8, at 7; and AFR October 23 Letter, supra note 14, at 4-5. One of the Opposing Commenters describes a squeeze on the copper market as occurring "when a lack of supply and excess demand forces the price upward, and a corner is when one party acquires enough copper to be able to manipulate its price." Levin Letter, supra note 8, at 7.

228 See V&F September 10 Letter, supra note 12, at 7. Senator Levin asserts that the Trust will make the copper market more susceptible to squeezes because it could be used by market participants to remove copper from the available supply in order to artificially inflate the price. See Levin Letter, supra note 8, at 7.

229 See Levin Letter, supra note 8, at 7.

In response, the Exchange states that the Trust instead may reduce the potential for fraud or manipulation in the physical copper market because: (1) the Trust may hold copper in multiple global locations, which is intended to provide a larger, more liquid supply of copper than would be available if creations and redemptions were only permitted using copper held in a single location; (2) the Trust and transactions in the Shares would be transparent, publishing information about its holdings and operations through its website; (3) the Trust would utilize a consistent, transparent, non-discretionary, rules-based, and fully disclosed selection protocol for redemptions; and (4) the Trust's copper would be valued by a recognized, independent valuation agent.[230]

The Sponsor also claims that the Trust may reduce the potential for fraud or manipulation in the physical copper market,[231] which would have an impact on any potential manipulation of the Shares as well. Specifically, the Sponsor asserts that the Trust already has introduced greater transparency into the copper market.[232] According to the Sponsor, prior to July 16, 2011, locational premia (i.e., prices) for physical copper were reported infrequently, available only by subscription, and available only for certain broad regions.[233] Since then, in anticipation of the Trust's potential launch, the Valuation Agent has calculated the locational premium for physical copper in each of the Trust's approved warehouses on a daily basis, and published the locational

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230 See Arca June 19 Letter, supra note 6, at 5–6.

231 See DP August 24 Letter, supra note 11, at 4. The Sponsor also states that neither it nor the Trust could deliberately influence copper prices even if it sought to because the Trust is not managed—it does not take positions or buy and sell copper, and it cannot place large orders that could affect the market. See id. at 12.

232 See id. at 4–5.

233 See id.

premia on a weekly basis.[234] The Sponsor expects that transparency would increase through the listing of the Shares because when trading of the Shares commences: (1) the Trust would post on its website these locational premia on a daily basis; (2) the Exchange would continuously disseminate pricing information as part of its required intraday indicative value ("IIV") reporting; (3) the Sponsor believes that Shares would be created using previously unreported non-exchange-registered stocks, and thus copper market participants would have more information about supply; and (4) the Trust would furnish complete visibility into creation and redemption activity by certain authorized participants.[235]

The Sponsor also argues that the underlying copper market is subject to extensive and explicit regulatory authority, and the increased transparency furnished by the Trust would enhance regulators' ability to oversee the copper market and enforce applicable laws and rules. Specifically, the Sponsor states: (1) the CFTC has explicit anti-fraud and anti-manipulation authority under the CEA that extends over the U.S. physical commodity markets; (2) the Department of Justice has the ability to pursue antitrust violations, such as concerted buying and selling involving commodities, under the federal antitrust laws; and (3) the LME has broad rights to obtain information relating to the activities of LME members and their affiliates if the LME has cause to suspect undesirable or improper trading that affects the copper markets, including the markets for both LME-warranted and non-warranted copper, and therefore the LME can obtain information about both LME and non-LME metal trading activities from J.P. Morgan Securities plc, an affiliate of the Sponsor that is a ring-dealing member of the LME, as well as

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[234] See id.

[235] See id.

from the Sponsor.[236] The Sponsor also asserts that there has been no increased manipulative behavior due to the reduction of copper available for immediate delivery that resulted from the prior years' deficits in copper production versus copper consumption, and that the creation of commodity backed trusts holding gold, silver, platinum, and/or palladium has not led to manipulation of the markets for those precious metals.[237]

The Commission does not believe that the listing and trading of the Shares is likely to increase the likelihood of manipulation of the copper market and, correspondingly, of the price of the Shares. Generally, the Commission believes that increased transparency helps mitigate risks of manipulation. For example, in approving the listing and trading of shares of the iShares Silver Trust, the Commission stated that the dissemination of information about the silver shares would "facilitate transparency with respect to the Silver Shares and diminish the risk of manipulation or unfair informational advantage."[238] In this case, the Commission believes the transparency that the Trust will provide with respect to its holdings, the locational premium for and price per metric ton of the copper in each warehouse location of the Trust, and creation and redemption activity, including the locations of creations and redemptions, as well as the dissemination of quotations for and last-sale prices of transactions in the Shares and the IIV and NAV of the Trust,[239] all are expected to help reduce the ability of market participants to

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236 See id. at 5.

237 See id. at 45, 46.

238 See Securities Exchange Act Release No. 53521 (March 20, 2006), 71 FR 14967, 14975 (March 24, 2006).

239 See DP August 24 Letter, supra note 11, at 43–45, and supra text accompanying notes 43 and 45.

manipulate the physical copper market or the price of Shares.[240] Also, the Commission believes that the listing and trading of the Shares on the Exchange (and any other national securities exchange that trades the Shares pursuant to unlisted trading privileges)[241] may serve to make the overall copper market more transparent if OTC trading of unreported warehouse receipts shifts to trading Shares on exchanges.[242] In particular, additional information regarding the supply of copper will be disseminated, which will enable users of copper to make better-informed decisions. Over the long term, this additional transparency could enhance efficiency in the

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240 Further, the Trust is a passive vehicle, and therefore V&F's concerns about manipulation by the Trust itself are misplaced.

241 When a national securities exchange extends "unlisted trading privileges" to a security, it allows the trading of a security that is not listed and registered on that exchange. See Securities Exchange Act Release No. 35323 (February 2, 1995), 60 FR 7718, 7718 (February 9, 1995) (proposing rules to reduce the period that exchanges have to wait before extending unlisted trading privileges to any listed initial public offering security). A number of national securities exchanges have rules that allow the extension of unlisted trading privileges to issues such as the Shares. See, e.g., Securities Exchange Act Release No. 57806 (May 9, 2008), 73 FR 28541 (May 16, 2008) (SR-Phlx-2008-34); Securities Exchange Act Release No. 58623 (September 23, 2008), 73 FR 57169 (October 1, 2008) (SR-BATS-2008-004).

242 Market participants that acquire a large percentage of the Shares must identify themselves to the Commission by filing Schedules 13D or 13G. See 17 CFR 240.13d-1. Specifically, Section 13(d) of the Act, 15 U.S.C. 78m(d), and the rules thereunder require that a person file with the Commission, within ten days after acquiring, directly or indirectly, beneficial ownership of more than five percent of a class of equity securities, a disclosure statement on Schedule 13D, subject to certain exceptions. See 17 CFR 240.13d-1. Section 13(g) and the rules thereunder enable certain persons who are the beneficial owners of more than five percent of a class of certain equity securities to instead file a short form Schedule 13G, assuming certain conditions have been met. Beneficial owners are also required to report changes in the information filed.

In addition, Section 13(f)(1) of the Act and Rule 13f-1 thereunder require every "institutional investment manager," as defined in Section 13(f)(5)(A) of the Act, that exercises investment discretion with respect to "section 13(f) securities," as defined in Rule 13f-1, having an aggregate fair market value of at least $ 100 million ("Reportable Securities"), to file with the Commission quarterly reports on Form 13F setting forth each Reportable Security's name, CUSIP number, the number of shares held, and the market value of the position.

market for copper and capital formation for participants in this market. In addition, the Commission believes that the listing and delisting criteria for the Shares are expected to help to maintain a minimum level of liquidity and therefore minimize the potential for manipulation of the Shares.[243]

The Opposing Commenters assert serious disruptions in the supply of copper would make corners and squeezes more likely.[244] As discussed above, the Commission does not believe that the listing and trading of the Shares is likely to disrupt the supply of copper available for immediate delivery.[245] Depending on the size of the Trust though, it is possible that copper holdings may be dispersed across an additional market – i.e., less copper may be held under LME and/or COMEX warrant and more copper may be held by the Trust. However, the availability of inter-market arbitrage is expected to help mitigate any potential increase in the ability of market participants to engage in corners or squeezes as a result of any dispersion of copper holdings across markets (as distinguished from a reduction in the copper supply). For example, if the Trust grows large relative to the market for warrants on the LME, LME market participants faced with a potential corner or squeeze may acquire Shares, redeem them (through an authorized participant) for LME warrantable copper, put the copper on LME warrant, and deliver the warrants.[246] Further, although the Exchange currently provides for the listing and trading of shares of Commodity-Based Trusts backed by physical gold, silver, platinum, and

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243 For example, under NYSE Arca Equities Rule 8.201(e)(2)(ii), the Exchange will consider suspending trading in the Shares or delisting the Shares if, following the initial 12-month period following commencement of trading, there are fewer than 50,000 Shares issued and outstanding.

244 See supra notes 227-229 and accompanying text.

245 See supra Section III.A.

246 See supra note 85.

palladium, none of the commenters has identified any evidence that the trading of shares of these Commodity-Based Trusts has led to manipulation of the gold, silver, platinum, or palladium markets.

For the reasons discussed above, the Commission does not believe that the proposed listing and trading of the Shares is likely to render the copper market or the price of Shares more susceptible to manipulation. Correspondingly, the Commission does not believe that approval of the proposed rule change will impose any burden on competition between participants in the market for copper as it will not provide market participants a greater opportunity to achieve an unfair competitive advantage.

E. Surveillance

One of the Opposing Commenters questions whether NYSE Arca's surveillance procedures are adequate to prevent fraudulent and manipulative trading in the Shares. According to that commenter, NYSE Arca's surveillance procedures are not adequate because they are the kind of garden-variety measures that are always in place to prevent collusion and other forms of manipulation by traders.[247] Two other Opposing Commenters assert that the Sponsor would be in a privileged informational position and could improperly trade on that non-public information.[248] One of those commenters asserts that the Sponsor participates in other, non-security copper derivatives markets (namely futures and swaps), and states that the Sponsor has an extensive commodities trading operation and "owns copper warehousing capacity in the United States giving it access to physical supply."[249] The commenter also expresses concern

247 See V&F May 9 Letter, supra note 4, at 10.

248 See Shatto Letter, supra note 9; and AFR October 23 Letter, supra note 14, at 2.

249 See AFR October 23 Letter supra note 14, at 4.

that, if the Sponsor "knows information regarding ETF inflows and outflows and understands the volatility consequences of changes in the holdings of the ETF," it can take advantage of that asymmetrical information and could "be a potential source of disruption to the markets."[250]

NYSE Arca asserts that the statements about its surveillance are unsubstantiated,[251] and states that its surveillance procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.[252] In particular, the Exchange represents the following:

- Pursuant to NYSE Arca Equities Rule 8.201(g), an ETP Holder acting as a registered Market Maker in Commodity-Based Trust Shares must file with the Exchange and keep current a list identifying all accounts for trading in an underlying commodity, related commodity futures or options on commodity futures, or any other related commodity derivatives, which the Market Maker may have or over which it may exercise investment discretion. No Market Maker shall trade in an underlying commodity, related commodity futures or options on commodity futures, or any other related commodity derivatives, in an account in which a Market Maker, directly or indirectly, controls trading activities, or has a direct interest in the profits or losses thereof, which has not been reported to the Exchange as required by NYSE Arca Equities Rule 8.201.

- In addition, pursuant to NYSE Arca Equities Rule 8.201(g), the Exchange is able to obtain information regarding trading in the Shares, physical copper, copper futures contracts, options on copper futures, or any other copper derivative from ETP Holders acting as registered market makers, in connection with their proprietary or customer trades.[253]

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250 Id. Similarly, another opposing commenter asserts that "jp morgan gets inside information by using their warehouses to buy and sell copper which maximizes profits to the detriment of commercial interests who have to buy copper." Shatto Letter, supra note 9.

251 See Arca August 23 Letter, supra note 11, at 1.

252 See Notice, supra note 3, 77 FR at 23787. The Exchange also states that its existing surveillances will be augmented with a product-specific review designed to identify potential manipulative trading activity through the use of the creation and redemption process. See Amendment No. 1, supra note 15.

253 See Notice, supra note 3, 77 FR at 23787. See also Arca August 23 Letter, supra note 11, at 2–3.

- NYSE Arca has regulatory jurisdiction over its ETP Holders and their associated persons, which include any person or entity controlling an ETP Holder, as well as a subsidiary or affiliate of an ETP Holder that is in the securities business.[254]

- With respect to a subsidiary or affiliate of an ETP Holder that does business only in commodities or futures contracts, the Exchange can obtain information regarding the activities of such subsidiary or affiliate through surveillance sharing agreements with regulatory organizations of which such subsidiary or affiliate is a member.[255]

- Commentary .04 of NYSE Arca Equities Rule 6.3 requires an ETP Holder acting as a registered Market Maker in the Shares, and its affiliates, to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of any material nonpublic information with respect to such products, any components of the related products, any physical asset or commodity underlying the product, applicable currencies, underlying indexes, related futures or options on futures, and any related derivative instruments (including the Shares).[256]

- NYSE Arca may obtain trading information via ISG from other exchanges that are members of the ISG, including the COMEX.[257] The Exchange also states that it has entered into a comprehensive surveillance sharing agreement with LME that applies to trading in copper and copper derivatives.[258]

Further, in the context of preventing fraudulent and manipulative acts, the Exchange discusses its authority to halt trading in the Shares in the interest of promoting a fair and orderly market and protecting the interests of investors.[259]

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254 See Amendment No. 1, supra note 15.

255 See id. See also infra text accompanying notes 257–258.

256 See Notice, supra note 3, 77 FR at 23786. See also Arca August 23 Letter, supra note 11, at 3.

257 See Notice, supra note 3, 77 FR at 23787. See also Arca August 23 Letter, supra note 11, at 3.

258 See Amendment No. 1, supra note 15.

259 See Arca August 23 Letter, supra note 11, at 3 ("As stated in the Notice, the Exchange may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares, and trading on the Exchange in the Shares may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable.").

According to the Exchange, the Valuation Agent will exclude any information provided by any JPMorgan-affiliated entity when calculating the locational premium of copper in any permitted warehouse location.[260] In addition, NYSE Arca has obtained a representation from the Sponsor that it will (i) implement a firewall with respect to its affiliates regarding access to material non-public information of the Trust concerning the Trust and the Shares, and (ii) will be subject to procedures designed to prevent the use and dissemination of material non-public information of the Trust regarding the Trust and the Shares.[261] The Commission believes the firewall that the Exchange will require the Sponsor to erect is a reasonable measure to help prevent the flow of non-public information to the Sponsor's affiliates.[262]

More generally, based on the Exchange's representations, the Commission believes that the Exchange's surveillance procedures appear to be reasonably designed to permit the Exchange to monitor for, detect, and deter violations of Exchange rules and applicable federal securities laws and rules.[263] In addition to all of the same surveillance procedures employed with respect to the trading of all other Commodity-Based Trust Shares, NYSE Arca states that a new product specific review will be employed to monitor trading in the Shares to identify potential manipulative trading activity through the use of the creation and redemption process.[264] The commenters have not identified any specific deficiency in the proposed procedures or provided

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260 Notice, supra note 3, 77 FR at 23783.

261 See Amendment No. 1, supra note 15.

262 Further, NYSE Arca represents that it can obtain information about the activities of the Sponsor and its affiliates under the Exchange's listing rules.

263 The Commission has discussed above in Section III.D other reasons why it believes that the listing and trading of the Shares as proposed is unlikely increase the likelihood of manipulation of the copper market and, correspondingly, of the price of the Shares.

264 See Amendment No. 1, supra note 15.

any evidence that the Exchange's surveillance program has been ineffective with respect to trading in other Commodity-Based Trust Shares.

F. Dissemination of Information About the Shares and Copper

The Commission believes the proposal is reasonably designed to promote sufficient disclosure of information that may be necessary to price the Shares appropriately. Specifically, the Commission believes that dissemination of the NAV, IIV, and copper holdings information, as discussed above, will facilitate transparency with respect to the Shares and diminish the risk of manipulation or unfair informational advantage.[265] Further, as noted above, quotation and last-sale information for the Shares will be available via the Consolidated Tape Association, and the Exchange will make available via the Consolidated Tape trading volume, closing prices, and NAV for the Shares from the previous day.[266] Additionally, as discussed above, the Exchange has identified numerous sources of copper price information unconnected with the Exchange that are readily available to investors.[267] The Commission therefore believes that sufficient venues for obtaining reliable copper pricing information exist to allow investors in the Shares to adequately monitor the price of copper and compare it to the NAV of the Shares.

G. Listing and Trading of the Shares

The Commission believes that the Exchange's proposed rules and procedures for the listing and trading of the Shares are consistent with the Act. For example, the Commission believes that the proposal is reasonably designed to prevent trading when a reasonable degree of transparency cannot be assured. As detailed above, NYSE Arca Equities Rules 7.34(a)(5) and

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265 See supra notes 238-242, and accompanying text.

266 See supra text accompanying note 41.

267 See Notice, supra note 3, 77 FR at 23786.

8.201(e)(2) respectively provide that: (1) if the Exchange becomes aware that the NAV is not being disseminated to all market participants at the same time, it must halt trading on the NYSE Marketplace until such time as the NAV is available to all market participants; and (2) the Exchange will consider suspension of trading if, after the initial 12-month period following commencement of trading: (a) the value of copper is no longer calculated or available on at least a 15-second delayed basis from a source unaffiliated with the Sponsor, Trust, or Custodian, or the Exchange stops providing a hyperlink on its website to any such unaffiliated source providing that value; or (b) if the Liquidation IIV is no longer made available on at least a 15-second delayed basis.[268] In addition, the Exchange's general authority to halt trading because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable, also will advance this objective. Further, trading in the Shares will be subject to NYSE Arca Equities Rule 7.12, the Exchange's circuit breaker rule, which governs trading halts caused by extraordinary market volatility.

Further, the Shares will be subject to Exchange rules governing the responsibilities of market makers and customer suitability requirements. In addition, the Shares will be subject to Exchange Rule 8.201 for initial and continued listing of Shares.[269] As discussed above,[270] the Commission believes that the listing and delisting criteria for the Shares are expected to maintain a minimum level of liquidity and therefore minimize the potential for manipulation of the Shares.

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[268] Additionally, if the First-Out IIV or the Liquidation IIV is not being disseminated as required, the Exchange may halt trading during the day in which the disruption occurs; if the interruption persists past the day in which it occurred, the Exchange will halt trading no later than the beginning of the trading day following the interruption. See Amendment No. 1, supra note 15.

[269] See Notice, supra note 3, 77 FR at 23786.

[270] See supra text accompanying note 243.

The Commission also believes that the Information Bulletin will adequately inform members and member organizations about the terms, characteristics, and risks of trading the Shares.

H. Commission Findings

After careful review, and for the reasons discussed in Sections III.A-G above, the Commission finds that the proposed rule change is consistent with the requirements of the Act, including Section 6 of the Act,[271] and the rules and regulations thereunder applicable to a national securities exchange.[272] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[273] which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; with Section 6(b)(8) of the Act,[274] which requires that the rules of a national securities exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act; and with Section 11A(a)(1)(C)(iii) of the Act,[275] which sets forth Congress's finding that it is in the public interest and appropriate for the protection of investors to assure the availability to brokers,

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271 15 U.S.C. 78f.

272 This approval order is based on all of the Exchange's representations.

273 15 U.S.C. 78f(b)(5).

274 15 U.S.C. 78f(b)(8).

275 15 U.S.C. 78k-1(a)(1)(C)(iii).

dealers, and investors of information with respect to quotations for and transactions in securities.[276]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No.1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSEArca-2012-28 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-NYSEArca-2012-28. 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/sro.shtml). Copies of the submissions, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes between the Commission and any person, other than those

276 As noted above (see supra Section II.B), quotation and last-sale information for the Shares will be available via the Consolidated Tape Association, and the Exchange will make available via the Consolidated Tape trading volume, closing prices, and NAV for the Shares from the previous day. See supra text accompanying note 41.

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 filings also will be available for inspection and copying at the principal offices of the Exchanges. 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. All submissions should refer to File Number SR-NYSEArca-2012-28 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change As Modified by Amendment No. 1

As discussed above, the Exchange submitted Amendment No. 1 to make additional representations regarding trading in the Shares, availability of information, and the Exchange's surveillance program.[277] The Commission believes these additional representations are useful to, among other things, help: (1) assure adequate liquidity in the Shares; (2) assure adequate availability of information to investors to support the arbitrage mechanism; (3) assure adequate information available to the Exchange to support its monitoring of Exchange trading of the Shares in all trading sessions; and (4) the Exchange deter and detect violations of NYSE Arca rules and applicable federal securities laws. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,[278] for approving the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after the date of publication of notice in the Federal Register.

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277 See supra note 15.

278 15 U.S.C. 78s(b)(2).

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[279] that the proposed rule change (SR-NYSEArca-2012-28), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

279 15 U.S.C. 78s(b)(2).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68435 / December 14, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3429 / December 14, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15077

In the Matter of STORMY L. DEAN	ORDER DENYING MOTION TO LIFT TEMPORARY SUSPENSION AND DIRECT HEARING

On October 24, 2012, we issued an order instituting proceedings against Stormy L. Dean pursuant to Commission Rule of Practice 102(e)(3)[1] that temporarily suspended him from appearing or practicing before the Commission.[2]

The OIP alleges that Dean was the chief financial officer of infoUSA, Inc. from approximately January 2000 through September 2003 and January 2006 through December 2008, and in that position certified infoUSA's Forms 10-K that were filed with the Commission.[3]

1 Rule of Practice 102(e)(3)(i), 17 C.F.R. § 201.102(e)(3)(i), provides:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney, accountant, engineer, or other professional or expert who has been by name:
>
> > (A) Permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or
> >
> > (B) Found by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party or found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

2 *Stormy L. Dean*, Securities Exchange Act Release No. 68097, 2012 WL 5246491 (Oct. 24, 2012).

3 *Id.* at *1. The OIP also alleges that Dean "passed the certified public accountant ('CPA') examination in 1995 and holds a CPA certificate in the state of Nebraska" but "has never obtained a CPA license." *Id.* at *1.

On March 15, 2010, the Commission filed a complaint in the United States District Court for the District of Nebraska alleging that Dean engaged in securities fraud and other violations of the securities laws by preparing and reviewing infoUSA's Forms 10-K and proxy statements that materially understated and failed to properly disclose perquisite compensation to Vinod Gupta, infoUSA's former chief executive officer and Chairman of the Board of Directors, and failed to properly disclose related party transactions involving Gupta.[4] The complaint also alleged that Dean aided and abetted the filing of infoUSA's false Forms 10-K.

A jury found that Dean violated the antifraud, false proxy statements, false certifications, false statements and omissions to accountants and auditors, and books-and-records provisions of the federal securities laws. A jury also found that Dean aided and abetted infoUSA's violations of the reporting and record-keeping provisions of the Securities Exchange Act of 1934.[5] On May 29, 2012, the district court entered a judgment permanently enjoining Dean from future violations, directly or indirectly, of §§ 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5), and 14(a) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, 13a-14, 13b2-1, 13b2-2, 14a-3, and 14a-9 promulgated thereunder.[6] The judgment also barred Dean from serving as a director or officer of a publicly traded company for a period of three years, and ordered Dean to pay a civil monetary penalty of $50,000.[7]

In issuing the OIP, we found it "appropriate and in the public interest" that Dean be temporarily suspended from appearing or practicing before the Commission based on the District Court's final judgment. We stated that the temporary suspension would become permanent unless Dean filed a petition challenging it within thirty days of service of the order, pursuant to Rule of Practice 102(e)(3)(ii). We further advised that, pursuant to Rule of Practice 102(e)(3)(iii), upon receipt of such a petition, we would either lift the temporary suspension, set the matter down for hearing, or both.

In his petition, Dean requests that the temporary suspension be lifted, arguing that (i) he has appealed the injunction entered against him, and it would be improper and in derogation of his rights "to allow a temporary suspension to become permanent based upon an injunction that may not be upheld on appeal," (ii) the OIP was filed more than ninety days after final judgment and was therefore untimely under Rule 102(e)(3), (iii) the doctrine of collateral estoppel prevents

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4 *SEC v. Stormy L. Dean, et al.*, No. 10-CV-00102 LSC (FG3), *available at* http://www.sec.gov/litigation/complaints/2010/comp21451-dasanddean.pdf.

5 The jury found that Dean violated (i) the antifraud provisions in Exchange Act § 10(b), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; (ii) the false proxy statements provisions of Exchange Act § 14(a), 15 U.S.C. § 78n(a), and Rules 14a-3 and 14a-9 thereunder, 17 C.F.R. §§ 240.14a-3 and 14a-9; (iii) the false certifications provisions of Exchange Act Rule 13a-14, 17 C.F.R. § 240.13a-14; (iv) the false statements and omissions to accountants and auditors provisions of Exchange Act Rule 13b2-2, 17 C.F.R. § 240.13b2-2; and (v) the books-and-records provisions of Exchange Act § 13(b)(5), 15 U.S.C. § 78m(b)(5), and Rule 13b2-1 thereunder, 17 C.F.R. § 240.13b2-1. The jury further found that Dean aided and abetted infoUSA's violations of (i) the issuer reporting requirements in Exchange Act § 13(a), 15 U.S.C. § 78m(a), and Exchange Act Rules 12b-20 and 13a-1 thereunder, 17 C.F.R. §§ 240.12b-20 and 240.13a-1; and (ii) the books-and-records provisions of Exchange Act § 13(b)(2), 15 U.S.C. § 78m(b)(2).

6 *SEC v. Stormy L. Dean, et al.*, Civil Action No. 8:10-cv-00102.

7 *Id.*

the Commission from imposing a permanent suspension based on findings made by the district court, and (iv) the suspension is not in the public interest. The Division of Enforcement has not filed an opposition to Dean's petition.

Rule 102(e)(3)(i)(a) permits the Commission to suspend any accountant or other professional or expert who has been "[p]ermanently enjoined . . . from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder."[8] Generally, a respondent in a "follow-on" proceeding is precluded from challenging the basis for, or findings in, the underlying injunction action.[9] Although Dean is entitled to appeal the underlying case against him, the possibility of an appeal to the court of appeals "does not alter the effect" of the jury's finding of securities law violations or the court's imposition of an injunction here.[10]

At this stage it appears that the findings made in the injunctive proceeding and the injunction issued against Dean "justify the continuance of his suspension until it can be determined what, if any, action may be appropriate to protect the Commission's processes."[11] As provided in Rule 102(e)(3)(iii),[12] therefore, we will set the matter down for public hearing.

Accordingly, IT IS ORDERED that this proceeding be set down for public hearing before an administrative law judge in accordance with Rule of Practice 110. As specified in Rule of Practice 102(e)(3)(iii), the hearing in this matter shall be expedited in accordance with Rule of Practice 500; it is further

ORDERED that the administrative law judge shall issue an initial decision no later than 210 days from the date of service of this order; and it is further

ORDERED that the temporary suspension of Stormy L. Dean, entered on October 24, 2012, remain in effect pending a hearing and decision in this matter.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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8 17 C.F.R. § 201.102 (e)(3)(i)(A).

9 *See, e.g., Jose P. Zollino*, Exchange Act Release No. 55107, 2007 WL 98919, at *4 n.20 (Jan. 16, 2007) (noting that the appropriate forum for respondent's challenges to underlying litigation is the appellate court).

10 *Daniel S. Lezak*, Exchange Act Release No. 50729, 2004 WL 2721400, at *2 n.16 (Nov. 23, 2004); *see also Michael T. Studer*, Exchange Act Release No. 50411, 2004 WL 2104496, at *3 (Sept. 20, 2004) (noting that "the fact that Studer is still litigating that action [on appeal] does not affect our statutory authority to conduct this proceeding"), *aff'd*, 148 F. App'x 58 (2d Cir. 2005).

11 *Williams D. Shovers*, Exchange Act Release No. 59874, 2009 WL 1271170, at *2 (May 6, 2009).

12 17 C.F.R. § 201.102 (e)(3)(iii).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68438; File No. AN-OCC-2012-04)

December 14, 2012

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing to Revise the Method for Determining the Minimum Clearing Fund Size to Include Consideration of the Amount Necessary to Draw on Secured Credit Facilities

I. Introduction

On October 18, 2012, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") an advance notice concerning a proposed rule change AN-OCC-2012-04 pursuant to Section 806(e) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[1] entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Title VIII" or "Clearing Supervision Act") and Rule 19b-4 under the Securities Exchange Act of 1934 ("Exchange Act").[2] The advance notice was published in the Federal Register on November 20, 2012.[3] The Commission did not receive comments on the advance notice publication. This publication serves as a notice of no objection to the proposed rule change discussed in the advance notice.

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 68225 (November 14, 2012), 77 FR 69668 (November 20, 2012). OCC also filed a proposed rule change under Section 19(b)(1) of the Exchange Act relating to these changes. See Securities Exchange Act Release No. 68130 (November 1, 2012), 77 FR 66900 (November 7, 2012)(Proposing Release). The Commission did not receive comments on the proposed rule change.

II. Description of Proposed Rule Change

A. Background

On September 23, 2011, the Commission approved a proposed rule change by OCC to establish the size of OCC's clearing fund as the amount that is required, within a confidence level selected by OCC, to sustain the maximum anticipated loss under a defined set of scenarios as determined by OCC, subject to a minimum clearing fund size of $1 billion.[4] OCC implemented this change in May 2012. Until that time, the size of OCC's clearing fund was calculated each month as a fixed percentage of the average total daily margin requirement for the preceding month, provided that the calculation resulted in a clearing fund of $1 billion or more.[5]

Under the formula that is implemented for determining the size of the clearing fund as a result of the May 2012 change, OCC's Rule 1001 provides that the amount of the fund is equal to the larger of the amount of the charge to the fund that would result from (i) a default by the single "clearing member group"[6] whose default would be likely to result in the largest draw against the clearing fund or (ii) an event involving the near-simultaneous default of two randomly-selected "clearing member groups" in each case as calculated by OCC with a

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4 Securities Exchange Act Release No. 65386 (September 23, 2011), 76 FR 60572 (September 29, 2011) (SR-OCC-2011-10).

5 If the calculation did not result in a clearing fund size of $1 billion or more, then the percentage of the average total daily margin requirement for the preceding month that resulted in a fund level of at least $1 billion would be applied. However, in no event was the percentage permitted to exceed 7%. With the rule change approved in September 2011, this 7% limiting factor on the minimum clearing fund size was eliminated.

6 The term "clearing member group" is defined in Article I of OCC's By-Laws to mean a clearing member and any member affiliates of the clearing member.

confidence level selected by OCC.[7] The size of the clearing fund continues to be recalculated monthly, based on a monthly averaging of daily calculations for the previous month, and it is subject to a requirement that its minimum size may not be less than $1 billion.

B. Proposed Change

The proposed rule change will implement a minimum clearing fund size equal to 110% of the amount of committed credit facilities secured by the clearing fund so that the amount of the clearing fund likely will exceed the required collateral value that would be necessary for OCC to be able to draw in full on such credit facilities. OCC's clearing fund is primarily intended to provide a high degree of assurance that market integrity will be maintained in the event that one or more clearing members, settlement banks, or banks that issue letters of credit on behalf of clearing members as a form of margin fails to meet its obligations.[8] This includes the potential use of the clearing fund as a source of liquidity should it ever be the case that OCC is unable to

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7 The confidence levels employed by OCC in calculating the charge likely to result from a default by OCC's largest "clearing member group" and the default of two randomly-selected "clearing member groups" were approved by the Commission at 99% and 99.9%, respectively. However, the Commission approval order notes that OCC retains discretion to employ different confidence levels in these calculations provided that OCC will not employ confidence levels of less than 99% without first filing a proposed rule change.

8 Under Article VIII, Section 1 of OCC's By-Laws, the clearing fund may be used to pay losses suffered by OCC: (1) as a result of the failure of a clearing member to perform its obligations with regard to any exchange transaction accepted by OCC; (2) as a result of a clearing member's failure to perform its obligations in respect of an exchange transaction or an exercised/assigned options contract, or any other contract or obligations in respect of which OCC is liable; (3) as a result of the failure of a clearing member to perform its obligations in respect of stock loan or borrow positions; (4) as a result of a liquidation of a suspended clearing member's open positions; (5) in connection with protective transactions of a suspended clearing member; (6) as a result of a failure of any clearing member to make any other required payment or to render any other required performance; or (7) as a result of a failure of any bank or securities or commodities clearing organization to perform its obligations to OCC.

obtain prompt delivery of, or convert promptly to cash, any asset credited to the account of a suspended clearing member.

OCC's committed credit facilities are secured by assets in the clearing fund and certain margin deposits of the suspended clearing member. In light of the uncertainty regarding the amount of margin assets of a suspended clearing member that might be eligible at any given point to support borrowing under the secured credit facilities, OCC has considered the availability of funds based on a consideration of the amount of the clearing fund deposits available as collateral. As an example, for OCC to draw on the full amount of its current credit facilities secured by the clearing fund, the size of the clearing fund likely would need to be approximately $2.2 billion. The $2.2 billion figure reflects a 10% increase above the total size of such credit facilities, which is meant to account for the percentage discount applied to collateral pledged by OCC in determining the amount available for borrowing.

Based on monthly recalculation information, the size of OCC's clearing fund during the period from July 2011 to July 2012 was less than $2.2 billion on eight occasions. Therefore, to reduce the risk that the assets in the clearing fund might at any time be insufficient to enable OCC to meet potential liquidity needs by accessing the full amount of its committed credit facilities that are secured by the clearing fund, OCC is amending the current minimum clearing fund be size requirement of $1 billion by providing instead that the minimum clearing fund size is the greater of either $1 billion or 110% of the amount of such committed credit facilities. OCC is denoting the credit facility component of the minimum clearing fund requirement as a percentage of the total amount of the credit facilities that OCC actually secures with clearing fund assets because OCC negotiates these credit facility agreements, including size and other terms, on an annual basis and the total size is therefore subject to change.

III. Analysis of Advance Notice

Standard of Review

A registered clearing agency that has been designated as a systemically important financial market utility ("FMU") by the Financial Stability Oversight Council ("FSOC") must provide advance notice of all proposed changes to its rules, procedures, or operations that could, as defined in the rules of the supervisory agency, materially affect the nature or level of risks presented by the clearing agency.[9] Absent an extension or request for additional information, as discussed in greater detail below, the Commission is required to notify the clearing agency of any objection regarding the proposed change within the 60 day time frame established by Title VIII.[10] A designated clearing agency may not implement a change to which its supervisory agency has objected;[11] however, the clearing agency is explicitly permitted to implement a change if it has not received an objection from its supervisory agency within the same 60 day time period.[12]

Although Title VIII does not specify a standard that the Commission must apply to determine whether to object to an advance notice, the Commission believes that the purpose of

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9 12 U.S.C. 5465(e). See also Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, Securities Exchange Act Release No. 67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (Adopting Release).

10 12 U.S.C. 5465(e)(1)(E).

11 12 U.S.C. 5465(e)(1)(F).

12 12 U.S.C. 5465(e)(1)(G).

Title VIII, as stated under Section 802(b),[13] is relevant to the review of advance notices.

The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability, by (among other things) authorizing the Federal Reserve Board to promote uniform risk management standards for systemically important FMUs, and providing an enhanced role for the Federal Reserve Board in the supervising of risk management standards for systemically important FMUs.[14] Therefore, the Commission believes that when reviewing advance notices for FMUs, the consistency of an advance notice with Title VIII may be judged principally by reference to the consistency of the advance notice with applicable rules of the Federal Reserve Board governing payment, clearing, and settlement activity of the designated FMU.[15]

Section 805(a) requires the Federal Reserve Board and authorizes the Commission to prescribe standards for the payment, clearing, and settlement activities of FMUs designated as systemically important, in consultation with the supervisory agencies. Section 805(b) of the Clearing Supervision Act[16] requires that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- Promote robust risk management;
- Promote safety and soundness;
- Reduce systemic risks; and

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13 12 U.S.C. 5461(b).

14 12 U.S.C. 5461(b).

15 See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

16 12 U.S.C. 5464(b).

- Support the stability of the broader financial system.

The relevant rules of the Federal Reserve Board prescribing risk management standards for designated FMUs by their terms do not apply to designated FMUs that are clearing agencies registered with the Commission.[17] Therefore, the Commission believes that the objectives and principles by which the Federal Reserve Board is required and the Commission is authorized to promulgate such rules, as expressed in Section 805(b) of Title VIII,[18] are the appropriate standards at this time by which to evaluate advance notices.[19] Accordingly, the analysis set forth below is organized by reference to the stated objectives and principles in Section 805(b).

Discussion of Advance Notice

The proposed rule change is designed to allow OCC to take full advantage of its liquidity resources that are secured by the clearing fund by collecting an amount that is at least 10% above the total size of the credit facilities to account for any collateral haircut that may be applied. This should assist OCC in maintaining market integrity in the event that one or more clearing members, settlement banks, or banks that issue letters of credit on behalf of clearing members as a form of margin fails to meet its obligations. By increasing the likelihood that OCC can take full advantage of its liquidity resources that are secured by the clearing fund, the proposed rule

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17 12 CFR 234.1(b).

18 12 U.S.C. 5464(b).

19 The risk management standards that have been adopted by the Commission in Rule 17Ad-22 are substantially similar to those of the Federal Reserve Board applicable to designated FMUs other than those designated clearing organizations registered with the CFTC or clearing agencies registered with the Commission. See Clearing Agency Standards, Securities Exchange Act Release No. 68080 (Oct.22, 2012), 77 FR 66219 (Nov. 2, 2012). To the extent such Commission standards are in effect at the time advance notices are reviewed in the future, the standards would be relevant to the analysis. Moreover, the analysis of clearing agency rule filings under the Exchange Act would incorporate such standards directly.

change should promote robust risk management and safety and soundness, reduce systemic risks, and support the stability of the broader financial system. For these reasons, the Commission does not object to the advance notice.

IV. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[20] that, the Commission DOES NOT OBJECT to proposed rule change (File No. AN-OCC-2012-04) and that OCC be and hereby is AUTHORIZED to implement proposed rule change (File No. AN-OCC-2012-04) as of the date of this notice or the date of the "Order Approving Proposed Rule Change to Revise the Method for Determining the Minimum Clearing Fund Size to Include Consideration of the Amount Necessary to Draw on Secured Credit Facilities" (File No. SR-OCC-2012-22), whichever is later.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

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20. 12 U.S.C. 5465(e)(1)(I).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68434; File Numbers SR-OCC-2012-14 and AN-OCC-2012-01)

December 14, 2012

Self-Regulatory Organizations; Options Clearing Corporation; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, and Notice of No Objection to Advance Notice, Modified by Amendment No. 1 Thereto, Relating to the Clearance and Settlement of Over-the-Counter Options

I. Introduction

On August 30, 2012, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change SR-OCC-2012-14 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder[2] ("Proposed Rule Change") and as an Advance Notice (SR-OCC-2012-01) pursuant to Section 806(e) of Title VIII of the Dodd-Frank Act ("Title VIII" or "Clearing Supervision Act")[3] (the Proposed Rule Change with the Advance Notice, the "Proposal"). The Proposed Rule Change and Advance Notice were published for comment in the Federal Register on September 18, 2012[4] and September 27, 2012,[5] respectively. On October 26, 2012, the Commission extended the time within which to act on the Proposal.[6] The Commission received

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

2 17 CFR 240.19b-4.

3 12 U.S.C. 5465(e).

4 Securities Exchange Act Release No. 67835 (September 12, 2012), 77 FR 57602 (September 18, 2012).

5 Securities Exchange Act Release No. 67906 (September 21, 2012), 77 FR 59431 (September 27, 2012).

6 Notice of Designation of a Longer Period for Commission Action on Proposed Rule Change Relating to the Clearance and Settlement of Over-the-Counter Options, Release No. 34-68112 (October 26, 2012); 77 FR 66497 (November 5, 2012); Notice of Extension of Review Period of Advance Notice to Establish the Legal and Operational Framework for Providing Central Clearing of OTC Index Options on the S&P 500 Index That Are Negotiated Bilaterally in the Over-The-Counter Market and Submitted to OCC for Clearance, Release No. 34-68111 (October 26, 2012), 77 FR 66196 (November 2, 2012).

no comment letters. On November 30, 2012, OCC filed Amendment No. 1 to the Proposal.[7] This Order approves the Proposed Rule Change and serves as notice of no objection to the Advance Notice.

II. Description of the Proposal

The purpose of this Proposal is to establish a legal and operational framework for OCC to provide central clearing of certain OTC index options on the S&P 500 Index ("OTC S&P 500 Index Options").[8] OCC will not commence clearing of OTC S&P 500 Index Options until a subsequent proposal concerning certain enhancements to OCC's risk modeling and risk management procedures ("Risk Management Proposal")[9] is approved by the Commission and implemented by OCC.[10] OCC anticipates using the same legal and operational framework as contained in the Proposal for clearing additional OTC equity options or OTC equity index options in the future, subject to the requisite regulatory approvals.[11]

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7 In Amendment No. 1, OCC proposed to amend Article XVII of its By-laws to clarify that Section 6 of that Article, pertaining to OTC Index Options, are inoperative until further notice by OCC, as well as to amend Item 3 of the proposed rule change to clarify that the clearing of OTC Options will not occur until certain enhancements related to longer-tenor options have been approved and implemented.

8 The proposed rule change replaces a previously proposed rule change which was withdrawn by OCC. See Securities Exchange Act Release No. 34-66090 (January 3, 2012), 77 FR 1107 (January 9, 2012) (SR-OCC-2011-19).

9 OCC is in the process of implementing risk modeling enhancements with respect to longer-tenor options, including OTC S&P 500 Index Options. The enhancements are part of OCC's ongoing efforts to test and improve its risk management operations with respect to all longer-tenor options that OCC currently clears. These procedures will be submitted for review in a separate proposed rule change and advance notice filing, and OCC represents that it will not commence clearing of OTC S&P 500 Index Options until such procedures have been approved and implemented. See also supra note 7.

10 Notice of Filing of Advance Notice Relating to the Clearance and Settlement of Over-the-Counter Options, Rel. No. 34-67906 at 15 (Sept. 21, 2012), 77 FR 59431, 59434 (Sept. 27, 2012); Notice of Filing of Proposed Rule Change Relating to the Clearance and Settlement of Over-the-Counter Options, Rel. No. 34-67835 at 15 (Sept. 12, 2012), 77 FR 57602, 57606 (Sept. 18, 2012). See also supra note 7.

11 See supra notes 9 and 10 and accompanying text.

OTC Options

OCC has entered into a license agreement with Standard & Poor's Financial Services LLC ("S&P") that allows OCC to clear OTC options on three equity indices published by the S&P: the S&P 500 Index, the S&P MidCap 400 Index, and the S&P SmallCap 600 Index. The Proposal would allow OCC to clear only OTC S&P 500 Index Options,[12] and only subject to the filing and approval of the Risk Management Proposal, as discussed above.[13] OTC S&P 500 Index Options are limited in tenor to between four months and five years and have minimum notional values of either 500,000 or 100,000 times the value of the S&P 500 Index.[14] OCC may propose to clear OTC options on other indices and on individual equity securities in the future, subject to Commission approval of one or more additional rule filings. In establishing a legal and operational framework for the potential future clearing of OTC options referencing other equities or equity indices, the Proposal defines "OTC option" and "OTC index option" (both of which terms include OTC S&P 500 Index Options) generically in order to simplify future amendments to provide for additional underlying interests. As noted above, however, the Proposal by its terms would permit only the clearing of OTC S&P 500 Index Options,[15] and only after the Commission's approval and OCC's implementation of a subsequent Risk Management Proposal.[16]

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12 See Proposed By-laws, Section 6, Interpretations and Policies .01, Proposed Rule Change and Advance Notice by OCC (SR-OCC-2012-14), available at http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_12_14.pdf.

13 See supra notes 10 and 10 and accompanying text.

14 See Proposed By-laws, Section 6, Interpretations and Policies .01, Proposed Rule Change and Advance Notice by OCC (SR-OCC-2012-14), available at http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_12_14.pdf.

15 See id. See also supra notes 9 and 10 and accompanying text.

16 See supra notes 10 and 10 and accompanying text.

OTC S&P 500 Index Options will be similar to exchange-traded standardized equity index options called "FLEX Options." FLEX Options are put and call options traded on various options exchanges that allow for customization of certain terms. For example, FLEX index Options traded on the Chicago Board Options Exchange have six customizable terms: (1) underlying index, (2) put or call, (3) expiration date, (4) exercise price, (5) American or European exercise style, and (6) method of calculating settlement value.[17] OCC is the issuer and guarantor of FLEX Options and clears FLEX Options traded on multiple exchanges.

Similar to FLEX Options referencing the S&P 500 Index, OTC S&P 500 Index Options will allow for customization of a limited number of variable terms with a specified range of values that may be assigned to each as agreed between the buyer and seller. Parties submitting transactions in OTC Options for clearing by OCC will be able to customize six discrete terms: (1) underlying index;[18] (2) put or call; (3) exercise price; (4) expiration date; (5) American or European exercise style; and (6) method of calculating exercise settlement value on the expiration date.[19] The variable terms and permitted values will be specified in the proposed Section 6 of Article XVII of the By-Laws.

Clearing of OTC Options

OCC proposes to clear OTC S&P 500 Index Options subject to the same basic rules and procedures used for the clearance of listed index options, with such modifications to reflect the

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17 See CBOE Rule 24A.4, Terms of FLEX Options, available at http://www.cchwallstreet.com/CBOETools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F25%5F5&manual=%2FCBOE%2Frules%2Fcboe%2Drules%2F.

18 Initially, pursuant to this Proposal, the S&P 500 Index will be the only permitted underlying index.

19 The expiration date of an OTC option must fall on a business day. The method of determining the exercise settlement value of an OTC option on its expiration date may be either the opening settlement value or the closing settlement value of the underlying index (calculated by S&P using the opening or closing price, as applicable, in the primary market of each component security of the underlying index on the specified expiration date), in each case as reported to OCC by CBOE.

unique characteristics of OTC Options. Transactions in OTC options[20] will not be executed through the facilities of any exchange, but will instead be entered into bilaterally and submitted to OCC for clearance through one or more providers of trade affirmation services.[21] In addition, the proposed rules require that the counterparties to the OTC Options must be eligible contract participants ("ECPs"), as defined in Section 3a(65) of the Act,[22] and Section 1a(18) of the Commodity Exchange Act,[23] as amended (the "CEA"). Because an OTC S&P 500 Index Option is a "security" as defined in the Act, the proposed rules also require that the transactions be cleared through a clearing member of OCC that is registered with the Commission as a broker-dealer or one of the small number of clearing members that are "non-U.S. securities firms" as defined in OCC's By-Laws. OCC is not requiring clearing members to meet any different financial standards for clearing OTC Index Options, as defined in OCC's By-laws and Rules, than those to which they are presently subject. However, clearing members must be specifically approved by OCC to clear OTC Index Options pursuant to proposed new Interpretation and Policy .11 to Section 1 of Article V in order to ensure the operational readiness of such clearing members to clear OTC Index Options. Clearing members seeking to clear OTC Index Options will be required to submit a business expansion request and complete an operational review. The operational review is to consist of an initial meeting with the clearing member's staff to evaluate

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20 As noted above, the Proposal by its terms would permit only the clearing of OTC S&P 500 Index Options, and only after the Commission's approval and OCC's implementation of a subsequent Risk Management Proposal. See supra notes 9, 10, and 14 and accompanying text. Also as discussed above, while OCC anticipates using the same legal and operational framework contained in the Proposal to clear additional OTC equity options or OTC equity index options in the future, OCC could only do so upon OCC's filing and the Commission's approval of one or more additional rule filings.

21 See infra note 266 and accompanying text.

22 15 U.S.C. 78c(a)(65).

23 7 U.S.C. 1a(18).

the staff's experience, confirming the staff's familiarity with current OCC systems and procedures, completion of an operational questionnaire, performing a high level review of the clearing member's systems and processing capabilities, and reviewing other pertinent operational information. Successful testing of messaging capability between the clearing member, the OTC Trade Source,[24] and OCC is also necessary. These procedures will determine whether the firm is operationally ready to clear OTC Index Options.

Exercise of an OTC S&P 500 Index Option will be settled by payment of cash by the assigned writer and to the exercising holder through OCC's cash settlement system on the business day following exercise in exactly the same manner as is the case with exercise settlement of listed index options. As in the case of listed index options, the exercise-settlement amount will be equal to the difference between the current value of the underlying interest and the exercise price of the OTC Index Option, times the multiplier that determines the size of the OTC Index Option. In the case of OTC S&P 500 Index Options, the multiplier will be fixed at 1 (i.e., equal to the value of the S&P 500 Index).

OTC S&P 500 Index Options may be carried in a clearing member's firm account, in market-maker accounts or in its securities customers' account, as applicable. Although customer positions in OTC S&P 500 Index Options will be carried in the securities customers' account (an omnibus account), OCC will use a "customer ID" to identify positions of individual customers based on information provided by clearing members.[25] However, positions are not presently intended to be carried in individual customer sub-accounts, and positions in OTC S&P 500 Index Options will be margined at OCC in the omnibus customers' account on the same basis as listed

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24 See infra note 266 and accompanying text.

25 Such customer IDs are necessary in order to allow OCC to comply with certain terms of OCC's license agreement with S&P. As described further below, customer IDs will be used for other purposes as well.

options. If a clearing member takes the other side of a transaction with its customer in an OTC S&P 500 Index Option, the transaction will result in the creation of a long or short position (as applicable) in the clearing member's customers' account and the opposite short or long position in the clearing member's firm account. The positions could also be includable in the internal cross-margining account, subject to any necessary regulatory approvals.

OCC has stated that OTC S&P 500 Index Options will be fungible with each other to the extent that there are OTC S&P 500 Index Options in the system with identical terms. However, OCC has stated that it will not treat OTC S&P 500 Index Options as fungible with index options listed on any exchange, even if an OTC S&P 500 Index Option has terms identical to the terms of the exchange-listed option.

Clearing members that carry customer positions in cleared OTC S&P 500 Index Options will be subject to all OCC rules governing OCC-cleared options generally, as well as all applicable rules of the Commission and of any self-regulatory organization, including the Financial Industry Regulatory Authority ("FINRA"), of which they are a member. Section 8 of Article III of OCC's By-Laws provides that, subject to the By-Laws and Rules, "the Board of Directors may suspend Clearing Members and may prescribe and impose penalties for the violation of the By-Laws or the Rules of the Corporation, and it may, by Rule or otherwise, establish all disciplinary procedures applicable to Clearing Members and their partners, officers, directors, and employees." As a condition to admission, Section 3(c) of Article V of the By-Laws provides that a clearing member must agree, among other things, to "pay such fines as may be imposed on it in accordance with the By-Laws and Rules." OCC Rule 305 permits OCC to impose restrictions on the clearing activities of a clearing member if it finds that the financial or operational condition of the clearing member makes it necessary or advisable to do so for the protection of OCC, other clearing members, or the general public. OCC Rule 1201(a) provides that OCC "may censure, suspend, expel or limit the activities, functions or operations of any Clearing Member for any violation of the By-Laws and Rules or its agreements with the Corporation." In addition to, or in lieu of, such actions, OCC is permitted under the same paragraph to impose fines. OCC Rule 1202(b) establishes procedures for taking any such disciplinary actions. The foregoing provisions are sufficient to permit OCC to fine or otherwise discipline a clearing member that fails to abide by OCC's By-Laws and Rules applicable to OTC options, or to prohibit such clearing member from continuing to clear such options.

MarkitSERV Trade Submission Mechanics

The trade data for an OTC S&P 500 Index Option trade will be entered into the system of MarkitSERV or another trade confirmation/affirmation vendor approved by OCC for this purpose ("OTC Trade Source").[26] While MarkitSERV will be the only OTC Trade Source at launch, OCC has stated that it will permit additional OTC Trade Sources in the future in response to sufficient market demand from OCC's clearing members and subject to the ability of any such OTC Trade Source to meet OCC's requirements for operational readiness and interoperability with OCC's systems, as well as requirements with respect to relevant business experience and reputation, adequate personnel and expertise, financial qualification, and such other factors as OCC deems relevant.

[26] MarkitSERV, LLC is owned by Markit Group Limited, Markit Group Holdings Limited and The Depository Trust & Clearing Corporation. MarkitSERV Limited is a wholly-owned U.K. subsidiary of MarkitSERV, LLC. MarkitSERV, LLC and MarkitSERV Limited (collectively, "MarkitSERV") provide derivatives transaction processing, electronic confirmation, portfolio reconciliation services, and other related services for firms that conduct business in the over-the-counter derivatives markets through a variety of electronic systems, including the MarkitWire system. MarkitWire, owned by MarkitSERV Limited, is an OTC derivatives electronic confirmation/affirmation service offered by MarkitSERV as part of its post-trade processing suite of products. The role of MarkitSERV and MarkitWire in OCC's clearing of OTC options is described in further detail below.

MarkitSERV will provide an interface to OCC that allows OCC to receive messages containing details of transactions in OTC S&P 500 Index Options submitted for clearing by clearing members with access to MarketWire and also allows OCC to transmit messages to MarkitWire participants identifying the status of submitted transactions. MarkitSERV will use a "confirmation/affirmation" procedure in which one party to the trade enters the trade data to the MarkitWire platform, which issues a confirmation to the counterparty to be affirmed, rejected, or requested to be revised. If the trade details are confirmed, the trade will then be submitted to OCC for clearance and MarkitSERV will affirm such submission to both parties. OCC will then validate the trade information for compliance with applicable requirements, such as the identification of an account of an eligible clearing member in which each side of the trade will be cleared, that the variable terms are within permissible ranges, and that minimum size requirements under OCC's license agreement with S&P are met.[27] This validation will be completed by OCC immediately upon submission. OCC's clearing system will automatically accept the trade if it passes the validation process and will otherwise reject it. Once accepted, a trade is guaranteed by OCC.[28] A trade that is rejected by OCC may be corrected and submitted as a new transaction. Parties may submit trades for clearance that were entered into bilaterally at any time in the past, provided that the eligibility for clearance will be determined as of the date the trade is submitted to OCC for clearance.[29] Clearing members and customers with access to

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27 MarkitWire applications use product-specific templates to simplify deal entry and negotiations. The templates specify the data required for a given product and also the business validation rules for each field. MarkitSERV has included OCC's validation requirements for OTC options in its trade templates.

28 Note, however, that OTC options for which the premium payment date communicated by MarkitSERV to OCC is prior to the business day on which the OTC option is submitted to OCC for clearing ("Backloaded OTC Option") will not be accepted and guaranteed until the selling clearing member has met its initial morning cash settlement obligations to OCC on the following business day.

29 OCC's license agreement with S&P imposes certain requirements relating to minimum time remaining to expiration of an OTC option.

MarkitSERV will be able to determine whether a trade has been accepted or rejected both through MarkitSERV and, in the case of clearing members, through their interface with OCC's clearing system.

Proposed By-Law and Rule Changes[30]

Article I of the By-Laws contains defined terms used throughout the By-Laws and Rules. OCC proposes to modify certain existing definitions and include certain new definitions in order to incorporate OTC options into existing rules and facilitate the creation of new provisions unique to OTC options. Throughout the By-Laws and Rules, OCC proposes to replace the term "Exchange transaction," which is currently defined in Article I, in relevant part, as "a transaction on or through the facilities of an Exchange for the purchase, writing or sale of a cleared contract" with the term "confirmed trade" so as to make the relevant portions of the By-Laws and Rules applicable to transactions in OTC options as well as listed options. "Confirmed trade" is proposed to be defined in Article I to include transactions "effected on or through the facilities of an exchange" or "affirmed through the facilities of an OTC Trade Source" in order to include transactions in both listed options and OTC options. The current definition of "confirmed trade" in OCC Rule 101 is proposed to be deleted as unnecessary given the new definition. OCC is also proposing to add an Interpretation and Policy to the new definition of "confirmed trade" in order to avoid any ambiguity concerning how such terms should be interpreted in any such agreement.

OCC proposes to add a new Interpretation and Policy .11 to Section 1 of Article V of the By-Laws, providing the additional criteria that must be met by a clearing member in order to

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30 As noted above, the Proposal by its terms would permit only the clearing of OTC S&P 500 Index Options, and only after the Commission's approval and OCC's implementation of a subsequent Risk Management Proposal. See supra notes 9, 10, and 12 and accompanying text. Also as discussed above, while OCC anticipates using the same legal and operational framework contained in the Proposal to clear additional OTC equity options or OTC equity index options in the future, OCC could only do so upon OCC's filing and the Commission's approval of one or more additional rule filings.

clear OTC index options. Among these new criteria are that clearing members seeking to clear OTC index options on underlying indices published by S&P must execute and maintain in effect a short-form license agreement in such form as specified from time to time by S&P.

The Interpretations and Policies under Section 1, Article VI allow clearing members to adjust their positions with OCC for certain enumerated reasons. OCC proposes to amend the Interpretations and Policies to clarify that adjustment of positions in OTC options will be effected through a manual process (as opposed to the electronic process available to post-trade adjustments in listed options), to the extent permitted by OCC. For the same reason, OCC is proposing to amend OCC Rule 403 to prohibit clearing member trade assignment ("CMTA") transactions in OTC options. Trade "give-ups" that are effected through the CMTA process in the case of listed options will, in the case of OTC options, be effected through MarkitSERV before the trades are submitted to OCC for clearing.

Article XVII of the By-Laws governs index options in general and OCC is proposing amendments to Article XVII in order to set forth the terms applicable to the initial OTC options proposed to be cleared by OCC — options on the S&P 500 Index — and to differentiate OTC index options from other index options cleared by OCC. For example, certain amendments to the definitions are necessary because OTC options will be permitted to have a much wider range of expiration dates than exchange-traded options (other than FLEX Options). Additional definitional amendments ensure that OTC index options will constitute a separate class of options from other cash-settled index options even if both index options have the same terms and cover the same underlying interest.

Section 3 of Article XVII provides for adjustment of the terms of outstanding index options as necessary to reflect possible changes in the underlying index — such as those creating a discontinuity in the level of the index — that could theoretically make an adjustment necessary to protect the legitimate expectations of holders and writers of options on the index. Pursuant to paragraph (g) of Section 3, most but not all such adjustments would be made, in the case of listed index options, by an adjustment panel consisting of representatives of the exchanges on which the options are traded. In the case of OTC options, any such adjustments will be made by OCC in its sole discretion. However, in exercising that discretion, OCC may take into consideration any adjustment made by the adjustment panel with respect to exchange-traded options covering the same underlying index.

OCC proposes to add a new Section 6 to Article XVII to set forth certain provisions unique to OTC index options, including the variable terms allowed for OTC index options and the general limitations on such variable terms. In general, all OTC index options must conform to the terms and limitations set forth in Section 6, and additional specific requirements applicable to specific OTC index options will either be set forth in the Interpretations and Policies under Section 6 or published separately on OCC's website. Section 6 also makes clear that although OTC index options are not fungible with exchange-traded index options, OTC index options of the same series (i.e., options having identical terms) will be fungible with each other. Interpretations and Policies .01 to Section 6 would provide that only the S&P 500 Index will have been approved by OCC as an underlying index for OTC Index Options and would specify the additional terms for an OTC S&P 500 Index Option.[31]

Unless another exemption from the registration requirements of the Securities Act of 1933 ("Securities Act")[32] is available, OCC intends to rely upon Rule 506 of Regulation D[33]

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[31] See supra note 12.

[32] 15 U.S.C. 77a et seq.

[33] 17 CFR 230.506.

under the Securities Act, which is a safe harbor under the Securities Act exemption in Section 4(a)(2)[34] for offerings by an issuer not involving a public offering.[35] OCC represents that it intends to satisfy the conditions of Rule 506 of Regulation D as in effect at the time OCC relies upon the safe harbor. OTC Index Options will be available for purchase only by highly sophisticated investors that are both "eligible contract participants," as defined in Section 3a(65) of the Act,[36] and "accredited investors," as defined in Rule 501(a) under Regulation D.[37] Accordingly, Section 6(f) of Article XVII will establish that clearing members will be deemed to have made a number of representations and warranties to OCC in connection with their activities in OTC options each time they affirm a confirmed trade entered into an OTC Trade Source. These representations and warranties include, among others, that (i) the offer and sale of the OTC Index Option are exempt from the registration requirements of the Securities Act; (ii) in the case where the transaction is effected for the account of a customer, the customer is an ECP, as defined in Section 3a(65) of the Act; (iii) unless OCC notifies clearing members that the OTC Index Options will no longer be offered and sold pursuant to Rule 506 of Regulation D under the Securities Act, the clearing member has not offered or sold the OTC Index Options to any person that is not an "accredited investor", as defined in Rule 501(a) under Regulation D and has otherwise complied with applicable conditions to the exemption set forth in Rule 506; and (vi) unless OCC notifies clearing members that such restriction no longer applies, the clearing

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34 15 U.S.C. 77d(a)(2).

35 The OCC submitted a rulemaking petition requesting exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act. See SEC File No. 4-644 (submitted January 13, 2012), *available at* http://www.sec.gov/rules/petitions/2012/petn4-644.pdf. This Order does not address the relief requested under the rulemaking petition, nor does it represent a position on the availability of any exemption under the Securities Act.

36 15 U.S.C. 77c(a)(65).

37 17 CFR 230.501.

member has not offered or sold the OTC Index Options by any form of general solicitation or general advertising that, at the time of such activities, is or may be deemed to constitute general solicitation or general advertising, as described in Rule 502(c) of Regulation D.

In addition, each clearing member would represent and warrant to OCC that the transaction has been effected by the clearing member in accordance with, the clearing member's participation in such transaction is in compliance with, and the clearing member will continue with respect to such transaction to comply with, all applicable laws and regulations including, without limitation, all applicable rules and regulations of the Commission, of FINRA, and any other regulatory or self-regulatory organization to which the clearing member is subject.

Chapter IV of the OCC's Rules sets forth the requirements for reporting of confirmed trades to OCC, and OCC Rule 401 thereunder governs reporting of transactions in listed options by participant Exchanges. OCC is proposing to add new Rule 404 to govern the details of reporting of confirmed trades in OTC options by an OTC Trade Source.

OCC has stated that positions in OTC options will generally be margined in the same manner as positions in listed options using STANS and pursuant to Chapter VI of the OCC's Rules. However, OCC proposes to amend its Rule 611 to establish different procedures for the segregation of long positions in OTC options for margining purposes.[38] Long positions in listed options are held in a clearing member's customers' account or firm non-lien account and by

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[38] Specifically, Proposed OCC Rule 611(d) provides:

> (d) In the case of a long position in OTC options carried in the securities customers' account of a Clearing Member and for which the Corporation has received a customer ID, to the extent permitted under all applicable laws and regulations (including the rules of the Financial Industry Regulatory Authority, Inc. and any other regulatory or self-regulatory organization to which the Clearing Member is subject), the Corporation shall automatically unsegregate such long position to the extent that the Corporation identifies a qualifying spread position where the short leg of the spread is carried under the same customer ID. The Clearing Member shall not carry a qualifying spread position for a customer unless the customer's margin requirement has been reduced in recognition of the spread, and the carrying of a qualifying spread position for the account of a customer shall constitute a representation to the Corporation that the customer's margin has been so reduced.

default are deemed to be "segregated," meaning that they are not subject to OCC's lien and are given no collateral value when determining the margin requirement in the account. Such positions may be unsegregated only when a clearing member instructs OCC to unsegregate a long position and represents to OCC that the long position is part of a spread transaction carried for a single customer whose margin requirement on the corresponding short position has been reduced in recognition of the spread. OCC will then unsegregate the long position and so reduce OCC's margin requirement. However, in case of long positions in OTC options that are carried in a clearing member's customers' account and for which OCC has received a customer ID, OCC proposes that it will automatically unsegregate such long positions if OCC identifies a qualifying short position in OTC options carried under the same customer ID. Clearing members will not be required to give an affirmative instruction to OCC to unsegregate a long position in OTC options or make a separate representation regarding the spread transaction. Instead, by carrying a qualifying spread position in a customer account, clearing members are deemed to have represented to OCC that the customer's margin has been reduced in recognition of the spread. Based on discussion with its clearing members, OCC's understanding is that, in practice, broker-dealers reduce customers' margin requirements to reflect spread positions. Therefore, OCC has stated that it believes automatic recognition of such spreads by OCC together with the deemed representation will greatly increase operational efficiency while providing equal assurance that long positions in OTC options will be unsegregated only if an identified customer will receive the benefit of the reduced margin required for spread transactions.

OCC Rule 1001 sets forth the amount of the contribution that each clearing member is required to make to the clearing fund. OCC proposes to amend OCC Rule 1001(c) so that, for purposes of calculating the daily average number of cleared contracts held by a clearing member in open positions with OCC during a calendar month (which number is used in turn to determine the clearing member's contribution to the clearing fund), open positions in OTC options will be adjusted as needed to account for any differences between the multiplier or unit of trading with respect to OTC options relative to non-OTC options covering the same underlying index or interest so that OTC options and non-OTC options are given comparable weight in the computation.[39]

In general, the rules in Chapter XI governing the suspension of a clearing member will apply equally to clearing members that transact in OTC options. OCC Rule 1104 provides broad authority for OCC to liquidate a suspended clearing member's margin and clearing fund deposits "in the most orderly manner practicable." OCC Rule 1106 provides similarly worded authority to close out open positions in options and certain other cleared contacts carried by a suspended clearing member. In 2011, the Commission approved an OCC rule change providing OCC the express authority to use a private auction as one of the means by which OCC may close out open positions and liquidate margin and clearing fund deposits of a suspended clearing member.[40] OCC has stated that it anticipates it will use this auction process for OTC options as well.

As an additional tool to ensure its ability to close out positions in OTC options promptly, OCC is proposing to amend OCC Rule 1106 to provide for an alternative auction procedure specifically applicable only to OTC index options and related positions hedging, or hedged by, OTC index options ("OTC Options Auction"). An OTC Options Auction would be used only in

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39 For example, the index multiplier applicable to OTC index options on the S&P 500 Index will be fixed at 1. In comparison, the index multiplier applicable to listed index options is 100.

40 See Securities Exchange Act Release No. 34-65654 (October 28, 2011), 76 FR 68238 (November 3, 2011) (SR-OCC-2011-08). OCC subsequently filed and obtained approval for a rule change to provide for detailed procedures for the conduct of such an auction. See Securities Exchange Act Release No. 34-67443 (July 16, 2012), 77 FR 42784 (July 20, 2012) (SR-OCC-2012-11); Securities Exchange Act Release No. 34-67733 (August 27, 2012), 77 FR 53241 (August 31, 2012) (approving SR-OCC-2012-11).

unusual circumstances where OCC determines it is not feasible to close out open positions in OTC index options through the other means provided in OCC's Rules and By-Laws.[41] The amendments to OCC Rule 1106 summarize the OTC Options Auction procedures and incorporate by reference the detailed procedures contained in a document entitled "OTC Options Auction Procedures," which will be posted on the OCC's website and otherwise made available to clearing members upon request of OCC.

OCC Rule 1106(e)(2)(C) clarifies that, in the event that the liquidation of a clearing member results in a deficiency that would otherwise result in a proportionate charge against the clearing fund contributions of other clearing members, each OTC Index Option Member (as defined below) that failed to purchase or assume its share of an auction portfolio will be the first to absorb the deficiency, through a "Priority Charge" against such clearing members' clearing fund contributions. The Priority Charge is a "first loss" mechanism, and is not intended to increase a clearing member's total maximum exposure to OCC.

Under the OTC Options Auction procedures, all clearing members authorized to clear transactions in OTC index options ("OTC Index Option Members"), other than the defaulting clearing member, will be required to participate in the OTC Options Auction by submitting competitive bids for all or a portion of the defaulting clearing member's OTC index option portfolio. Each such participant will be subject to a minimum participation level based on the participant's proportionate share of the total "risk margin" requirement posted by all OTC Index Options Members in the previous month for all positions (not limited to OTC option positions) held in accounts eligible to hold OTC options positions ("OTC Eligible Accounts"), after

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41 OCC anticipates that it would propose to apply these procedures to other OTC derivatives that may be cleared by OCC in the future.

removing the defaulting clearing member.[42] This method of calculating the minimum participation level in the OTC Options Auction results in all OTC Index Option Members being required to participate in the OTC Options Auction based on their clearing activity related to all positions in OTC Eligible Accounts. Required participation ensures that the OTC Options Auction will have sufficient participants authorized to clear transactions in OTC index options and that the most active clearing members in OTC index options will submit bids for the largest percentage of the auction portfolio, increasing the likelihood of the acquisition of OTC index options positions by clearing members with appropriate financial strength, risk management capabilities, and trading expertise.

Each participant may submit bids at varying quantities and varying prices, so long as the participant's bids equal or exceed its minimum participation level. A participant may use bids from non-OTC Index Options Members and non-clearing members in order to meet its minimum participation level, subject to certain OCC requirements including that it guarantee the performance of such third parties. Each bid will indicate what percentage of the auction portfolio the participant is bidding on and the amount of the bid. Bids will be stated in terms of a price for the entire auction portfolio, and may be either positive or negative. (Negative bids imply an auction portfolio that has a negative net asset value and indicate how much OCC would be required to pay the participant to assume the relevant percentage of the auction portfolio.) OCC will rank the submitted bids from best to worst and the auction portfolio will be allocated among the bidding participants accordingly until the auction portfolio is exhausted. The bid

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42 This minimum participation level will be multiplied by 1.15 to calculate each participant's minimum bid size, such that the sum of all participants' bids will equal 115% of the auction portfolio, in order to increase the likelihood that the entire auction portfolio will be allocated to participants.

price that is sufficient to clear the entire auction portfolio will become the single price to be used for all winning bids, even if a participant's stated bid was better.

In order to provide a strong incentive to ensure competitive bidding by the OTC Index Option Members required to participate in an OTC Options Auction, OTC Index Options Members who fail to win their minimum participation in the auction will be subject to a potential priority charge against its clearing fund contribution. If all OTC Options Auction participants submit bids such that each receives an allocation of OTC index options positions equal to its minimum participation level, no priority charge will be made regardless of whether or not there is a liquidation shortfall. If a liquidation shortfall remains after any priority charges, or if no priority charges were required, OCC will then make a proportionate charge against the clearing fund contributions of all clearing members, including those that participated in the OTC Options Auction, in the usual manner pursuant to Section 5 of Article VIII of OCC's By-Laws.

In order to protect the estate of the suspended clearing member, OCC reserves some discretion in supervising the auction. In the event that the bid price that clears the entire auction portfolio is determined by OCC to be an outlier bid, OCC may choose as the winning bid a price that clears at least 80% of the auction portfolio. The remaining auction portfolio will then be re-auctioned as described above.

Impact of Clearing OTC Options on Other OCC-Cleared Products

An OTC option may have economic characteristics that are substantially similar or identical to the characteristics of options in series of listed options that OCC clears. While it is possible that in any given instance a market participant may elect to enter into an OTC S&P 500 Index Option in lieu of an economically similar listed product, OCC has stated that it does not believe that its clearing of OTC options will adversely affect the efficiency or liquidity of the listed markets. According to OCC, the OTC options markets accommodate a variety of commercial and other needs of market participants, including the ability to customize the terms of transactions. While the availability of an OCC guarantee for OTC transactions in which the parties would otherwise be exposed to each other's creditworthiness may cause transactions that currently occur in the non-cleared OTC markets to migrate to the cleared-OTC markets, OCC does not believe it will cause significant migration from the listed markets to the cleared-OTC options markets. OCC has stated that the limitation of the OTC options markets to ECPs as well as the significant minimum transaction size and tenor requirements that are applicable to OTC options under the S&P License Agreement will limit their use appropriately and should help to ensure that there is no substantial migration from the listed markets to the OTC markets for this product. OCC has stated that the existing bilateral OTC options markets have existed for years alongside the listed options markets, and OCC believes that dealers in such bilateral options often use the listed markets to hedge positions taken in such bilateral options and other OTC derivatives.

III. Analysis of the Proposed Rule Change

Section 19(b)(2)(B) of the Act[43] directs the Commission to approve a proposed rule change of a SRO if the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of the clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing

[43] 15 U.S.C. 78s(b)(2)(B).

agency or for which it is responsible, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions and, in general, to protect investors and the public interest.[44]

The Proposal contains provisions requiring clearing members to make representations necessary to ensure that OTC S&P 500 Index Options trades submitted to OCC for clearing involve only parties that are ECPs, were transacted in accordance with the conditions of Regulation D under the Securities Act, and are in compliance with other regulatory requirements. Consistent with the objective of OCC's safeguarding securities and funds within its control, such provisions help to ensure that OCC avoids clearing trades that are not in compliance with regulatory requirements.

The Proposal, as an initial step toward enabling OCC to provide central clearing for OTC S&P 500 Index Options, is consistent with the objective under Section 17A(b)(3)(A) of the Exchange Act of removing impediments to and perfecting the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. Clearing OTC options using the existing market infrastructure at OCC will allow market participants to retain the benefits of the features of OTC options on the S&P 500 Index, such as expiration dates and strike prices that can be customized to match market participants' unique needs, while reducing less favorable aspects such as counterparty risk. Clearing OTC S&P 500 Index Options may also allow for capital and market efficiencies because it extends the use of existing market infrastructure at OCC into a related new product category, and eliminates the need for individual counterparties to bilaterally exchange option premiums and collect and maintain margin on a

44 In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

daily basis. As such, cleared OTC S&P 500 Index Options should represent a safer and more efficient use of capital than their uncleared counterpart.

Additionally, clearing OTC S&P 500 Index Options should benefit the markets and regulators by centralizing and allowing for access to information about the OTC markets that has otherwise been unavailable.

The Proposal is consistent with the protection of customers and the public interest. Only OTC S&P 500 Index Options between counterparties that are ECPs and that meet the notional minimums and other OCC requirements, as well as the conditions of Rule 506 of Regulation D under the Securities Act and other regulatory requirements, will be eligible for clearing by OCC. In addition, customers are expected benefit from substituting their credit exposure to a clearing member with exposure to OCC itself.

Although customer positions in OTC S&P 500 Index Options will be carried in an omnibus account, OCC will use a "customer ID" to identify OTC S&P 500 Index Options positions of individual customers based on information provided by the clearing member. This should allow customers holding OTC S&P 500 Index Options to benefit from additional capital efficiencies resulting from OCC's ability to unsegregate and offset long positions in OTC S&P 500 Index Options with qualifying short spread positions belonging to the same customer without compromising customer protections.[45]

Finally, the Proposal is in the public interest in that it represents an initial step in enabling OCC to provide central clearing for OTC S&P 500 Index Options, which ultimately should help to reduce systemic risk. Allowing for the substitution of OCC as the buyer for every seller and

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45 See supra 38 and accompanying text.

the seller for every buyer should reduce bilateral credit risk, replacing it with the credit risk of the more robustly risk-managed central counterparty. Thus, clearing OTC S&P 500 Index Options could potentially decrease risk to end-users of such products and, as a result, decrease systemic risk overall.

The Proposal is designed to bring about the clearing of options in sizes that are not already traded in the listed (cleared) markets. While the availability of an OCC guarantee for OTC transactions in which the parties would otherwise be exposed to each other's credit risk could cause transactions that currently occur in the listed markets to migrate to less transparent cleared-OTC markets, OCC has indicated that it does not believe this will be the case for OTC S&P 500 Index Options. The limitation to ECPs, as well as the significant minimum transaction size and tenor requirements established as part of OCC's license with S&P, are intended to minimize and should limit migration of index options referencing the S&P 500 Index from the listed to the OTC markets. OTC S&P 500 Index Options will have a minimum notional value of $500,000 times the value of the S&P 500 Index for initial maturities greater than four months but less than or equal to nine months, and a minimum notional value of at least $100,000 times the value of the S&P 500 Index for initial maturities greater than nine months but less than three years after the date the trade was originally executed.[46] The Commission expects to monitor the clearing of OTC S&P 500 Index Options and the trading of equivalent options on listed markets to consider the possible impact the clearing of OTC S&P 500 Index Options may have on the listed markets.

OCC has stated, and the Commission notes, that the existing bilateral OTC options markets have existed for years alongside the listed options markets and believes that dealers in

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46 The value of the S&P 500 Index has hovered around 1,400 points in recent months; therefore, the current notional values of such minimum transaction amounts are approximately $700,000,000 and $140,000,000, respectively.

bilateral options often use the listed markets to hedge positions taken in bilateral options and other OTC derivatives.

The Commission believes OCC's clearing of OTC S&P 500 Index Options can lead to greater efficiency. Increases in efficiency may be achieved through lower transaction costs and appropriately risk-based margin reductions for clearing members and customers. Clearing of OTC S&P 500 Index Options will increase the volume of transactions cleared at OCC and should thereby reduce transaction costs.

Another improvement in efficiency will come from margin offsets, which will free up costly capital for other uses. In particular, in clearing OTC S&P 500 Index Options, clearing members would be expected to gain margin efficiencies by (i) clearing in the same account both OTC contracts and the hedges to those positions that are traded on the listed markets; and (ii) netting positions and/or obtaining margin offsets among OTC positions in the same account that would otherwise be spread across multiple accounts and OTC counterparties. Customers may gain margin efficiencies from OCC's ability to identify unsegregated long and short positions associated with the same customer ID. By moving OTC S&P 500 Index Options to OCC for clearing, OCC clearing members and their customers trading these products may be expected to benefit from reduced counterparty credit risk by introducing OCC as central counterparty.

Finally, central clearing of OTC derivatives will bring more transparency for regulators concerning a market that is presently more asymmetric in terms of information available to regulators than the exchange-traded derivatives market. The Commission believes that the introduction of OTC S&P 500 Index Options for clearing by OCC should result in OCC and the Commission having more complete information regarding options market activity and clearing member positions overall. This should assist OCC in its risk management practices and the Commission in its supervisory and other regulatory efforts.

The impact of OCC's clearing of OTC S&P 500 Index Options on capital formation is not as direct as it is on efficiency and competition. Derivative contracts are risk management products used to hedge different risks, a practice that supports the investments that lead to capital formation. However, it is unclear whether the effects of the Proposal would be large enough to affect capital formation.

IV. Analysis of the Advance Notice

Standard of Review

A registered clearing agency that has been designated as a systemically important financial market utility ("FMU") by the Financial Stability Oversight Council ("FSOC")[47] must provide advance notice of all changes to its rules, procedures or operations that could, as defined in the rules of the supervisory agency, materially affect the nature or level of risk presented by the clearing agency.[48] Absent an extension or request for additional information, as discussed in greater detail below, the Commission is required to notify the clearing agency of any objection regarding the proposed change within the 60 day time frame established by Title VIII.[49] A designated clearing agency may not implement a change to which its supervisory agency has

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47 On July 18, 2012, the FSOC designated OCC as a systemically important FMU. See Financial Stability Oversight Council, 2012 Annual Report 145 (2012).

48 12 U.S.C. 5465(e). See also, Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, Rel. No. 34-63557 (December 15, 2010), 75 FR 82490 (December 30, 2010) (Proposing Release); Rel. No. 34-67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (Adopting Release).

49 12 U.S.C. 5465(e)(1)(E).

objected;[50] however, the clearing agency is explicitly permitted to implement a change if it has not received an objection from its supervisory agency within the same 60 day time period.[51]

Although Title VIII does not specify a standard that the Commission must apply to determine whether to object to an advance notice, the Commission believes that the purpose of Title VIII, stated under Section 802(b),[52] is relevant to the review of advance notices.

The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability, by (among other things) authorizing the Federal Reserve Board to promote uniform risk management standards for systemically important FMUs, and providing an enhanced role for the Federal Reserve Board in the supervising of risk management standards for systemically important FMUs.[53] Therefore, the Commission believes that when reviewing advance notices related for FMUs, the consistency of an advance notice with Title VIII may be judged principally by reference to the consistency of the advance notice with applicable rules of the Federal Reserve Board governing payment, clearing, and settlement activity of the designated FMU.[54]

Section 805(a) requires the Federal Reserve Board and authorizes the Commission to prescribe standards for the payment, clearing, and settlement activities of FMUs designated as systemically important, in consultation with the supervisory agencies. Section 805(b) of the

50 12 U.S.C. 5465(e)(1)(F).

51 12 U.S.C. 5465(e)(1)(G).

52 12 U.S.C. 5461(b).

53 12 U.S.C. 5461(b).

54 See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

Clearing Supervision Act[55] requires that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- Promote robust risk management and safety and soundness;
- Reduce systemic risks; and
- Support the stability of the broader financial system.

The relevant rules of the Federal Reserve Board prescribing risk management standards for designated FMUs by their terms do not apply to designated FMUs that are clearing agencies registered with the Commission.[56] Therefore, the Commission believes that the objectives and principles by which the Federal Reserve Board is authorized to promulgate such rules, as expressed in Section 805(b) of Title VIII,[57] are the appropriate standards at this time by which to evaluate advance notices.[58] Accordingly, the analysis set forth below is organized by reference to the stated objectives and principles in Section 805(b).

Promote Robust Risk Management and Safety and Soundness

By establishing the legal and operational framework for central clearing of OTC S&P 500 Index Options, the Proposal paves the way for shifting counterparty credit risk stemming from the over-the-counter trading of these products between bilateral counterparties to OCC. As a central counterparty that collects margin and mutualizes the risk of loss among its members in

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55 12 U.S.C. 5464(b).

56 12 CFR 234.1(b).

57 12 U.S.C. 5464(b).

58 The risk management standards that have been adopted by the Commission in Rule 17Ad-22 are substantially similar to those of the Federal Reserve Board applicable to designated FMUs other than those designated clearing organizations registered with the CFTC or clearing agencies registered with the Commission. See Clearing Agency Standards, Exchange Act Release No. 68080 (Oct. 22, 2012), 77 FR 66220 (November 2, 2012). To the extent such Commission standards are in effect at the time advance notices are reviewed in the future, the analysis of clearing agency rule filings under the Exchange Act would incorporate such standards directly.

the event of a member default, OCC is generally expected to be better situated to manage the risks associated with OTC S&P 500 Index Options than the original bilateral counterparties. By laying the groundwork for OCC's clearing of OTC S&P 500 Index Options, the Proposal is consistent with the objective of promoting safety and soundness.

With regard to the credit risk that OCC would face once it begins to clear OTC S&P 500 Index Options, changes in membership or additional trading in OTC S&P 500 Index Options that results from the OTC S&P 500 Index Options being available for clearing (i.e., is not listed traffic that is migrating to OCC) could increase OCC's total exposure to its members and hence credit risk to OCC. On the other hand, credit risk to OCC could decrease because, by clearing OTC S&P 500 Index Options, OCC would have better visibility into the OTC S&P 500 Index Options positions of its members and thereby be better able to monitor its members' financial conditions, thus improving its own credit risk management. OCC's financial risks are managed through a set of financial safeguards, including strict membership rules, the collection of high-quality collateral, and additional assessment powers that protect OCC in the event of a default by a member.

Reduce Systemic Risks

As discussed above, the Proposal would allow OCC to lay the groundwork for clearing OTC S&P 500 Index Options. Substitution of a central counterparty as a buyer to each seller and seller to each buyer is expected to reduce counterparty risk inherent in the markets for OTC derivatives, including OTC options. To the extent the Proposal eventually leads to eliminating bilateral credit risk in OTC S&P 500 Index Options and replacing it with the credit risk of OCC, the more robustly risk-managed central counterparty, the Proposal should decrease risk to end-users of such products and, as a result, should reduce systemic risk overall.

Support the Stability of the Broader Financial System

OCC is the only central counterparty currently clearing exchange-listed options; any prolonged interruption to these services likely would prevent the exchanges from trading until they were restored. As such, OCC plays a primary role in the trading and clearing of options in the United States. OCC also maintains relationships with financial market utilities, settlement banks, clearing members, credit facility lenders, custodians, exchanges, cross-margining entities, and pricing vendors.

OTC options directly indexed to the S&P 500 amounted to more than $1.1 trillion as of 2010,[59] representing a market with a significant trading volume that currently does not reap any of the risk mitigation benefits of central clearing. The Commission believes that, by establishing the legal and operational framework for clearing OTC S&P 500 Index Options, the Proposal will pave the way for systemic risk reducing benefits and thus support the stability of the broader financial system.

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59 See *Nina Mehta, Nandini Sukumar, and Jeff Kearns, Over-The-Counter S&P 500 Index Options Will Shift to Clearinghouse in 2011, Sept. 20, 2010,* http://www.bloomberg.com/news/2010-09-20/over-the-counter-s-p-500-index-options-will-shift-to-clearinghouse-in-2011.html.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[60] that the Proposed Rule Change (File No. SR-OCC-2012-14), as Modified by Amendment No. 1 Thereto, be and hereby is APPROVED as of the date of this order, provided that OCC will not commence clearing of OTC S&P 500 Index Options until the Risk Management Proposal referenced above is filed by OCC, approved by the Commission, and implemented by OCC.

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[61] that the Commission DOES NOT OBJECT to proposed rule change (File No. AN-OCC-2012-01), as Modified by Amendment No. 1 Thereto, provided that OCC will not commence clearing of OTC S&P 500 Index Options until the Risk Management Proposal referenced above is filed by OCC, approved by the Commission, and implemented by OCC.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

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60 15 U.S.C. 78s(b)(2).

61 12 U.S.C. 5465(e)(1)(I).

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68446 / December 14, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15131

In the Matter of **JAMES WARREN MARGULIES,** **Respondent.**	**ORDER OF FORTHWITH SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

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

II.

The Commission finds that:

1. James Warren Margulies, 48, was at all relevant times an attorney admitted to practice law in Ohio and New York.

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

2. Margulies was convicted on July 19, 2011 in the Supreme Court of New York, New York County, of grand larceny in the first degree (2 counts); violations of the General Business Law (Martin Act) (2 counts); scheme to defraud in the first degree (1 count); conspiracy in the fourth degree (1 count); and falsifying business records in the first degree (24 counts) as a result of his participation in a securities fraud involving the stock of Industrial Enterprises of America, Inc.

3. As a result of these convictions, Margulies was sentenced to a prison term of seven to 21 years and ordered to pay restitution in the amount of $7,000,000.

4. On November 1, 2011, the Supreme Court of Ohio suspended Margulies's license based upon his felony convictions in New York. *In re Administrative Actions dated November 2, 2011*, 130 Ohio St.3d 1420, 956 N.E.2d 310, 2011-Ohio-5627 (Ohio Nov 2, 2011) (Table).

5. On February 21, 2012, the Supreme Court of New York, Appellate Division, First Judicial Department, disbarred Margulies, effective July 19, 2011, based on his felony convictions in New York. *In re Margulies*, 93 A.D.3d 145, 940 N.Y.S. 2d 19, 2012 N.Y. Slip Op. 01343 N.Y.A.D. 1 Dept., Feb. 21, 2012 (No. M-5482).

III.

In view of the foregoing, the Commission finds that Margulies has been convicted of felonies involving moral turpitude, suspended by the Supreme Court of Ohio, and disbarred by the Supreme Court of New York, Appellate Division, First Judicial Department, within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68449 / December 17, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3431 / December 17, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15133

In the Matter of J. Brian Laib, CPA, Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND 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 that public administrative proceedings be, and hereby are, instituted against J. Brian Laib, CPA ("Respondent" or "Laib") pursuant to Section 4C[1] of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

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1 Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (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 Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and 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[3] that:

A. SUMMARY

1. This matter involves improper professional conduct by J. Brian Laib in connection with audits conducted by Murrell Hall, McIntosh & Co. PLLP and Eide Bailly LLP of the financial statements of Life Partners Holdings, Inc. ("Life Partners" or the "Company") for fiscal years ended February 28, 2005 through 2009. Laib failed to conduct Murrell Hall's fiscal year 2005 through 2008 audits and Eide Bailly's fiscal year 2009 audit in accordance with Public Company Accounting Oversight Board ("PCAOB") standards,[4] and Life Partners' fiscal year 2006 through 2009 financial statements did not present fairly, in all material respects, Life Partners' financial position, operating results, and cash flows in conformity with generally accepted accounting principles ("GAAP").

2. On January 3, 2012, the Commission filed a complaint against Life Partners and three of its senior executives for their involvement in a fraudulent disclosure and accounting scheme involving life settlements.[5] The Commission alleges, in part, that Life Partners materially misstated net income from fiscal year 2007 through the third quarter of fiscal year 2011 by prematurely recognizing revenues and understating impairment expense related to its investments in life insurance policies. The Commission also alleges that Life Partners backdated certain transactional documents to hide the Company's premature revenue recognition from its auditors from 2004 through 2010.

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

4 Citations to PCAOB Standards and Rules refer to standards and rules in effect at the time of the conduct discussed herein.

5 See Litigation Release No. 22219, January 4, 2012.

B. RESPONDENT

J. Brian Laib, 48, is a certified public accountant licensed in the state of Oklahoma. From January 2005 to August 1, 2008, Laib was a partner with Murrell Hall, McIntosh & Co. PLLP, an accounting firm that was registered with the PCAOB. Laib became a partner with Eide Bailly LLP, a PCAOB-registered accounting firm, on August 1, 2008, following Eide Bailly's acquisition of Murrell Hall's assets.

C. RELEVANT ENTITY

Life Partners Holdings, Inc. is a Texas corporation headquartered in Waco, Texas. Life Partners' common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act, and the Company is subject to the reporting requirements of the Exchange Act. Since 2000, Life Partners' common stock has traded on the NASDAQ exchange under the ticker symbol "LPHI."

D. FACTS

<u>Life Partners' Revenue Recognition</u>

1. Life Partners brokers the sale of life insurance policies by policy owners to investors in the secondary market, in transactions referred to as "life settlements." Life Partners derives its revenues from the difference between the amounts investors pay to acquire an interest in a life settlement and the amounts for which policy owners agree to sell their policies.

2. In a typical life settlement transaction brokered by the Company, a policy owner interested in selling his or her policy executes a "Seller Agreement," which grants Life Partners an option to purchase the policy on behalf of investors at an agreed upon price. The Company's standard Seller Agreement defines the "Closing Date" as "the date upon which the consideration for the transaction described herein is transferred from the Escrow Agent to the Seller." Prior to the Closing Date, neither the policy owner nor Life Partners are contractually obligated to proceed with the sale, as each may rescind the agreement at any time and for any reason without incurring a penalty. Additionally, during the 15-day period following the Closing Date (the "Rescission Period"), the policy owner has the option to rescind his or her agreement to sell the policy for any reason without penalty. Moreover, death of the insured covered by the policy prior to or during the Rescission Period triggers an automatic rescission under the Seller Agreement (collectively, the "Rescission Rights").

3. Life Partners typically identifies potential investors in life settlements through its network of independent buyers' agents. Potential investors generally deposit funds with Life Partners' escrow agent and deliver signed, but undated, "Policy Funding Agreements" to the Company in advance of identifying specific policies in which they intend to purchase an interest. The Policy Funding Agreement specifies the policy to be purchased, the acquisition price, and the escrow arrangements for receipt and disbursement of funds.

4. After receipt of the Policy Funding Agreement, the Seller Agreement, and the accompanying assignment documents, Life Partners forwards to the escrow agent the documents necessary for closing. A life settlement transaction closes when the seller gets paid – i.e., on the Closing Date, as defined in the Seller Agreement.

5. Rather than wait until the Closing Date to recognize revenues, Life Partners routinely recognized revenue as of the date listed on the Policy Funding Agreement. This date purportedly represented the date the investor committed to purchase an interest in the policy; however, Life Partners routinely backdated Policy Funding Agreements and other transaction documents. Additionally, the Company did not wait until it had identified investors to purchase 100% of a policy to recognize revenue. Instead, Life Partners recognized a pro rata portion of the total revenue it expected to earn when it completed the sale of 100% of the interests in that policy. According to Life Partners' policy, if the Company had received Policy Funding Agreements from purchasers to acquire 2% of a policy and certain other transaction documents, the Company would recognize 2% of the total revenue anticipated from that life settlement transaction.

Applicable Authoritative Accounting Literature

6. Under GAAP, revenue can be recognized only when it is both (i) realized or realizable and (ii) earned. Revenue is "realized or realizable" when products or services (in this case, life settlements) are exchanged or readily convertible to known amounts of cash or claims to cash. Revenues are "earned" when "the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues" (*See* Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 605-10-25, Revenue Recognition (also contained in FASB Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, paragraphs 83(a) and 83(b)) and Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 1A, Paragraph 1.

Life Partners' Improper Revenue Recognition

7. Life Partners' revenue recognition policy is contrary to GAAP because the Company recognized revenues prior to being (i) realized or realizable and (ii) earned, which occurred, at the earliest on the Closing Date. Revenue is not realized or realizable before the Closing Date because Life Partners receives no cash, and has no claim to cash, until a life settlement is purchased by investors and the policy owner/seller is paid by the escrow agent, which occurs on the Closing Date. Similarly, revenue is not earned before the Closing Date because the policy owner is not obligated to sell the policy to Life Partners prior to the Closing Date. Additionally, Life Partners' revenues do not qualify as "earned" until such time as it fully brokers the sale of 100% of a policy. Policy owners sell their policies in a single transaction under the Seller Agreement, not on a prorated basis, as Life Partners identifies investors interested in purchasing fractional interests in the policy. Consequently, after the Company identifies one or more interested investors in a given policy, Life Partners has substantial continuing obligations to identify additional investors sufficient to purchase any unsold interests in the policy before it becomes entitled to any portion of the proceeds from the sale. Life Partners is not entitled to any

proceeds from the sale until investors purchase 100% of a policy, which does not happen until the Closing Date, at the earliest.

Life Partners' Restatement

8. In its Form 10-K filed on November 22, 2011for its fiscal year ended February 28, 2011, Life Partners restated its financial statements for fiscal years 2007 through 2010 and for the first three quarters of 2011 to correct accounting errors related to revenue recognition, accounts receivable, impairment of investments in Company-owned policies, accrued liabilities, and the related tax impact. The Company's restatement of revenues resulted from changing the date of revenue recognition from the date that purchasers commit to buy policies to the date that policy closings are funded, i.e., the Closing Date.

Audits of Life Partners Fiscal Year 2005 through 2009 Financial Statements

9. Laib served as the engagement partner and supervised and conducted Murrell Hall's fiscal year 2005 through 2008 audits and Eide Bailly's fiscal year 2009 audit of Life Partners' financial statements.

10. An auditor is required to plan and perform the audit "to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud" (*See* PCAOB Auditing Standards, *Responsibilities and Functions of the Independent Auditor,* AU § 110.02). "The auditor's response to the assessment of the risks of material misstatement due to fraud involves the application of professional skepticism in gathering and evaluating audit evidence." (*See* PCAOB Auditing Standards, *Consideration of Fraud in a Financial Statement Audit* AU § 316.46).[6] "Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence" (*See* PCAOB Auditing Standards, *Consideration of Fraud in a Financial Statement Audit* AU § 316.13). The auditor's response should be general, by, for example, considering management's selection and application of significant accounting principles and whether management's accounting policies are being applied in an inappropriate manner to create a material misstatement of the financial statements, and specific, by impacting the nature, timing, and extent of auditing procedures to address identified risks, including the risk of management override of controls (*See* AU § 316.48-67).

11. In connection with the 2005 audit, Laib identified risks of material misstatements due to fraud but failed to maintain an attitude of professional skepticism in assessing such risks and failed to respond appropriately to such risks related to revenue recognition. For example, in planning the 2005 audit, Murrell Hall concluded that management was very aggressive in recording revenue based, in part, on identified business and fraud risk factors. Yet, Murrell Hall's work papers do no document the auditor's evaluation of whether management's revenue recognition policies comply with GAAP or any changes to planned procedures to address identified fraud risks. Laib also became aware during planning the 2005 audit that a member of management had alleged to Murrell Hall that the dates on Policy Funding Agreements had been changed in order to process life settlement transactions in another period. Yet again, Murrell

6 *See* also PCAOB Auditing Standards, Due Professional Care in the Performance of Work, AU §230.07.

Hall's work papers document no procedures performed to address the identified risk of management override of controls or any inquiries of other members of management or any discussions with the audit committee. Instead, Murrell Hall's work papers document only that it was unable to verify the practice. Murrell Hall's 2006 audit work papers contain identical documentation. Despite management's efforts to obstruct Laib by concealing improper revenue recognition practices (i.e., backdating documents), had he appropriately planned and performed Murrell Hall's audits, Laib may have discovered that Life Partners prematurely recognized revenue.

12. An auditor is to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under audit (*See* PCAOB Auditing Standards, *Evidential Matter*, AU § 326.01). Although evidential matter includes representations from management, management's representations are not a substitute for performing sufficient auditing procedures to afford a reasonable basis for an opinion regarding the financial statements under audit (*See* PCAOB Auditing Standards, *Management Representations*, AU § 333.02). The nature, timing, and extent of the procedures to be applied, as well as the validity and sufficiency of required evidence, depend on the circumstances and the auditor's judgment (*See* PCAOB Auditing Standards, AU § 326.13 and .21-22). With respect to such judgment, however, the procedures adopted should be adequate to obtain evidential matter sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements (*See* PCAOB Auditing Standards, AU § 326.13). Furthermore, due professional care requires the auditor to exercise professional skepticism, which requires the auditor to conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present and an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred (*See* PCAOB Auditing Standards, AU § 316.13). In developing his or her opinion, the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements (*See* PCAOB Auditing Standards, AU § 326.25).

13. Murrell Hall and Eide Bailly's 2005 through 2009 audit work papers document certain testing that was designed to confirm the existence, completeness, and accuracy of signed transaction documents, including Sales Agreements, Policy Funding Agreements, and funding status reports that purportedly reflected investor commitments to purchase policies prior to period-end. Laib, nonetheless, failed to evaluate whether Life Partners' revenue recognition policy was in accordance with GAAP. Laib understood that Life Partners recognized revenues prior to the Closing Date. When he initially became involved with the Life Partners' engagement, Laib recalls looking at example transactional files to get familiar with documents related to life settlement transactions. Laib, however, did not read, and did not direct an assistant to read, the transactional documents in sufficient detail to identify and document contractual provisions relevant to the timing of revenue recognition under GAAP. Had Laib done so, he would have identified contractual provisions that contradict management's representations as to when revenue can be recognized. In particular, he would have discovered the Seller Agreement was nonbinding on both the seller and the Company and he would have identified the seller's Rescission Rights. Accordingly, Laib would have known a life settlement is not legally sold prior to the Closing Date and that the Company's revenue recognition policy was not consistent with GAAP. Additionally, Laib also failed to notice or ignored indications in Murrell Hall's and Eide Bailly's work papers

that should have raised questions about Life Partners' revenue recognition policies. Murrell Hall's and Eide Bailly's work papers include schedules detailing, by month, each life settlement transaction which Life Partners recognized revenue. The schedules include adjustments for rescissions and other items to reconcile the total anticipated revenue for each transaction to the revenue the Company actually recorded for each month, including adjustments related to rescissions of life settlement for which Life Partners had recognized revenues in prior quarters. There is no documentation that Laib questioned the circumstances of the rescissions or whether rescissions contradicted management's representation concerning the timing of revenue recognition.[7]

14. Laib did not consider or respond to adequately the possibility of illegal acts in connection with the 2005 through the 2009 audits (*See* PCAOB Auditing Standards, AU § 317, *Illegal Acts by Clients*). Specifically, Laib reviewed Murrell Hall and Eide Bailly work papers documenting the existence of loans to certain executive officers; however, he failed to consider whether such loans violated Section 13(k) of the Securities Exchange Act of 1934, which prohibits any issuer to make, directly or indirectly, "personal loans" to any executive officer.

15. PCAOB Auditing Standard No. 3, *Audit Documentation,* requires, in part, that "documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement: (a) to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and (b) to determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review" *(See* PCAOB Auditing Standard No. 3, paragraph 6). Laib failed to adequately document the nature, timing, and extent of procedures performed, the evidence obtained, and the underlying rationale for certain conclusions reached in connection with the 2005 through 2009 audits. The 2005 through 2009 audit work papers fail to adequately document consideration as to whether revenues were recognized in accordance with GAAP, whether receivables from officers were prohibited transactions under Section 13(k) of the Exchange Act of 1934, or whether receivables from officers should be disclosed as related party transactions.

E. VIOLATIONS

Rule 102(e) of the Commission's Rules of Practice and Section 4C of the Exchange Act

16. Rule 102(e)(1)(ii) of the Commission's Rules of Practice and Section 4C of the Exchange Act authorize the Commission to censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to accountants who are found to have engaged in improper professional conduct. Under Rule 102(e)(1)(iv), the term "improper professional conduct" means, in part, "repeated instances of unreasonable conduct, each resulting

[7] Murrell Hall and Eide Bailly's work papers identify one to five rescissions per year of the approximately 200 life settlement transactions reported as being closed in each of fiscal years 2005 through 2009. As a result of the rescissions, Life Partner's quarterly revenues were misstated in 15 of the 20 quarters during this period, including three quarters in which revenues, net of brokerage fees, were misstated in excess of 10%, as Life Partners transitioned to policies with larger face amounts which generate larger net revenues per transaction.

in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission."

17. Laib's conduct during Murrell Hall's fiscal year 2005 through 2008 audit engagements and Eide Bailly's fiscal year 2009 audit engagement is unreasonable and fails to conform to applicable professional standards. Laib failed to (i) obtain sufficient competent evidential matter with respect to revenues and cost of revenues; (ii)) comply with PCAOB Auditing Standards, AU § 317, *Illegal Acts by Clients*, with respect to certain loans to executive officers; and (iii) comply with PCAOB Auditing Standard No. 3, *Audit Documentation*.

F. <u>FINDINGS</u>

18. Based on the foregoing, the Commission finds that Laib engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) and 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice.

IV.

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

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

A. Laib is denied the privilege of 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 PCAOB 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 PCAOB 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 PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (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 PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. 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

Elizabeth M. Murphy
Secretary

Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9375 / December 17, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3515 / December 17, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15135

In The Matter Of JOSEPH A. SCHLIM, 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 Joseph A. Schlim ("Schlim" or "Respondent").

II.

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

A. SUMMARY

1. This case involves complex structured financial products known as collateralized debt obligations ("CDOs"). CDOs are securities backed by debt obligations including, for example, subprime residential mortgage-backed securities. The underlying mortgage-backed, or other, securities are packaged and generally held by a special purpose vehicle that issues notes entitling their holders to payments derived from the underlying assets.

2. In late 2006, Aladdin Capital Management LLC ("Aladdin Management") marketed to its clients two CDOs that it was managing and stated that it would co-invest in the same CDOs. Aladdin Management did not co-invest as it represented. Aladdin Capital LLC ("Aladdin Capital") collected a placement fee from the CDOs' underwriters. At the pertinent times, Schlim had responsibility for ensuring that Aladdin Management co-invested alongside its clients, but ultimately failed to ensure that Aladdin Management did so with respect to these two CDOs.

B. RESPONDENT AND RELATED ENTITIES

3. **Schlim**, age 47, of New Canaan, Connecticut is a former principal and CFO of Aladdin Capital and Aladdin Management. Schlim has obtained, and currently possesses, Series 4, 7, 24, 27 and 63 licenses issued by the Financial Industry Regulatory Authority.

4. **Aladdin Management** is an SEC-registered investment adviser based in Stamford, Connecticut. During the relevant time period, Aladdin Management had assets under management of approximately $20 billion, which consisted predominantly of cash and synthetic CDOs, collateralized loan obligations ("CLOs"), several credit hedge funds, and separately managed accounts. Aladdin Management's typical practice was to act as the collateral manager for CDOs and CLOs underwritten by major investment banks.

5. **Aladdin Capital**, during the relevant time period, was an SEC-registered broker-dealer based in Stamford, Connecticut. Aladdin Capital primarily placed CDO and CLO securities. On January 30, 2012, Aladdin Capital filed a Form BDW with the Commission, thus seeking to terminate its registration as a broker-dealer. It became effective on March 30, 2012.

C. FACTS

Aladdin's MAST Program and Marketing Statements

6. In 2005, Aladdin Management began an investment advisory program called the "Multiple Asset Securitized Tranche" ("MAST") program. Schlim, along with two Aladdin Capital registered representatives, created the MAST program. Under the MAST program, Aladdin Management and its clients signed investment management agreements by which Aladdin Management agreed to render investment management services, and the client agreed to commit to invest in the equity tranche of certain upcoming CDO or CLO deals that would be managed by Aladdin Management. Aladdin Management did not receive a separate advisory fee from its MAST clients; rather it received a management fee from the CDOs and CLOs in which the MAST clients invested. Aladdin Capital placed the equity interest with its customer and

typically received a negotiated (usually ten-percent) placement fee or commission from the CDOs' or CLOs' underwriters for doing so.

7. When marketing the MAST program, Aladdin Management and Aladdin Capital stated that Aladdin Management would co-invest in the same equity tranches of each CDO or CLO alongside its clients. Schlim was personally involved in creating the co-investment feature of the MAST program. Schlim knew that Aladdin Management's co-investment representation was a key feature of, and selling point for, the MAST program. For example, Aladdin Management explained in marketing material that, "[w]e align our interests with MAST investors by co-investing in every transaction with them. And don't forget, we are not investing in other firms' transactions. Instead, we only invest in deals where we can control the management of the collateral – our own programs." In the same marketing piece, Aladdin Management also posed the question, "[w]hy is an investor better off just investing in Aladdin sponsored CLOs and CDOs?" Aladdin answered by emphasizing that the "most powerful response I can give to your question is that Aladdin co-invests alongside MAST investors in every program. Putting meaningful 'skin in the game' as we do means our financial interests are aligned with those of our MAST investors." Aladdin Capital also emphasized that Aladdin Management would co-invest in the same products when marketing specific CDOs to potential MAST participants.

8. Schlim was significantly involved in the MAST program on a day-to-day basis. He made sales calls on potential MAST clients, and he negotiated with CDO and CLO underwriters about the amount of equity in those securities that Aladdin Capital could place with its customers, or purchase for itself. Schlim also negotiated the placement fees to be received by Aladdin Capital for securing MAST investments in the equity tranches of each CDO or CLO.

9. As Aladdin Management explained in its marketing materials, co-investing in the same CDO deals as its clients was one of the most "powerful" statements it could make because it showed that Aladdin Management had "skin in the game" and that its financial interests were aligned with those of its clients. Also, because the equity tranche of the CDOs were typically the riskiest tranche and in the first loss position, having the CDO manager as an investor in the same tranche gave investors additional assurances that they could trust the CDO.

Aladdin Management Stated It Would Co-Invest Alongside Each MAST Participant in the Fortius and Citius CDOs

10. Despite the centrality of its representations that it would co-invest, and had co-invested, in CDOs alongside its MAST clients, Aladdin Management failed to co-invest in two CDOs that it offered to MAST clients in late 2006. In particular, Aladdin Management failed to co-invest in the Fortius II Funding, Ltd. ("Fortius") CDO and the Citius II Funding Ltd. ("Citius") CDO despite the fact that three MAST clients invested in the equity tranches of those CDOs.

Aladdin Management Did Not Co-Invest Alongside a Municipal Retirement Plan in the Fortius CDO

11. One potential MAST client that Aladdin Management pursued was a retirement plan for approximately 10,000 employees of a municipal transportation agency (the "Municipal Retirement Plan"). Aladdin Management and Aladdin Capital began pitching the MAST program to the Municipal Retirement Plan in 2005 or 2006.

12. When pitching the MAST program, Aladdin Management and Aladdin Capital emphasized that Aladdin Management would co-invest alongside the Municipal Retirement Plan's CDO investments. Aladdin made such representations at key points in the Municipal Retirement Plan's decision-making process. For example, in early 2006, Aladdin highlighted to the Municipal Retirement Plan that Aladdin Management invested alongside MAST participants in the same investments. Subsequently, in April 2006, one of the Municipal Retirement Plan's representatives recommended that the Plan invest in MAST in part based on the "key feature" that MAST had a "significant alignment of interest with [Aladdin Management] co-investing alongside MAST investors."

13. During the process of soliciting the Municipal Retirement Plan's investment in the MAST program, Aladdin Management and Aladdin Capital (including Schlim) continued to emphasize the co-investment benefit of the MAST program. In particular:

a. On May 11, 2006, Schlim and another Aladdin Capital registered representative presented an "Aladdin overview" and "MAST summary" to the Municipal Retirement Plan. Schlim personally stated that Aladdin Management co-invests in the equity tranche of CDOs in the MAST program, up to at least ten percent of the client's MAST investment;

b. On May 12, 2006, an Aladdin Capital registered representative sent an email, which was copied to Schlim, to the Municipal Retirement Plan stating that: "As Joe Schlim mentioned yesterday, Aladdin also co-invests in the identical equity tranches up to at least 10 % of your MAST allocation, further aligning our economic interests with those of our clients in this regard;"

c. On July 18, 2006, another Aladdin Capital registered representative (who was also an Aladdin Management employee) emailed to the Municipal Retirement Plan a MAST "executive summary" and other marketing material. Both documents highlighted Aladdin Management's co-investment representation. In the cover email, the employee noted: "[a]s outlined in the enclosures, we also co-investment [sic] in the same CDO equity tranches as our clients, which we believe helps to align our economic interests;"

d. On August 3, 2006, Aladdin Management provided the Municipal Retirement Plan with a sample MAST report, which contained the co-investment representation.

14. Even after the Municipal Retirement Plan signed an investment agreement to participate in the MAST program, Aladdin continued to represent that it would invest alongside the Municipal Retirement Plan in the particular CDO programs its client had chosen.

15. Aladdin Capital offered the Municipal Retirement Plan an investment in the Fortius CDO. On November 21, 2006, a former Aladdin Capital registered representative specifically informed the Municipal Retirement Plan that Aladdin Management would co-invest in Fortius. On December 6, 2006, the Municipal Retirement Plan purchased $5,000,000 in the equity tranche of the Fortius CDO directly from the underwriter of the Fortius CDO. Aladdin Management did not make the required $500,000 investment in the Fortius CDO.

16. When Aladdin Management made its statements to the Municipal Retirement Plan that it would co-invest in the Fortius CDO, it had taken no steps to make that co-investment. To the contrary, by November 3, 2006, which was the pricing date for the Fortius CDO, Schlim knew that the Fortius CDO's underwriter had preliminarily allocated $5,000,000 of the equity tranche of the Fortius CDO to Aladdin and/or its clients. Promptly after being informed that the Fortius CDO's underwriter had allocated $5,000,000 of the Fortius CDO's equity tranche to Aladdin, Schlim instructed his subordinates to ensure that the Municipal Retirement Plan would purchase that entire $5 million allocation. Schlim took no steps, either internally or in communications with the Fortius CDO's underwriter, to reserve for Aladdin a portion of the equity tranche of the Fortius CDO. To the contrary, during November 2006, Aladdin Capital communicated to the underwriter of the Fortius CDO that the Municipal Retirement Plan would instead purchase Aladdin's entire allocation of the Fortius CDO's equity tranche.

17. Soon after the Municipal Retirement Plan's $5 million purchase of the Fortius CDO, upon Schlim's request, Aladdin Capital communicated with the underwriter for the Fortius CDO and requested that it be paid the previously agreed-upon 10 percent placement fee (in the amount of $500,000) for its work in placing Fortius securities with the Municipal Retirement Plan. The underwriter paid Aladdin that fee in December 2006. Schlim was aware of that payment.

Aladdin Management Did Not Co-Invest Alongside Two Other MAST Program Participants in the Citius CDO

18. In December 2006, Aladdin Capital sold investments in the equity tranche of the Citius CDO to two MAST participants as part of the MAST program. The two clients were a pension plan for a chain of retail stores (the "Pension Plan"), and an individual entrepreneur who invested his personal funds and also the funds of his charitable foundation in the MAST program (the "Individual Client").

19. Both the Pension Plan and the Individual Client decided to participate in the MAST program, and were informed that Aladdin Management would co-invest alongside them in each CDO investment they made as part of the MAST program. Schlim was generally aware of these representations that Aladdin Management would co-invest.

20. Specifically, in 2005, Aladdin Management sent the Individual Client a "letter of intent" concerning his plan to participate in the MAST program and thus invest in CDOs

managed by Aladdin Management. The letter of intent contained a provision representing that "Aladdin will co-invest with Client in the identical Preference Share equity tranches in the MAST program. Aladdin's investment, in aggregate, will be equal to at least 10 % of Client's total Preference Share investment in the MAST program." After receiving this letter, the Individual Client agreed to participate in the MAST program, and invested in several CDOs and CLOs in late 2005 and early 2006. Aladdin Management co-invested in each of these CDOs and CLOs. Throughout 2006, Aladdin Management sent the Individual Client MAST investment reports indicating that Aladdin co-invests in each CDO investment made as part of the MAST program.

21. Beginning in September 2006, Aladdin Capital offered the Individual Client an investment in the Citius CDO. On December 1, 2006, Aladdin Capital – on behalf of the Individual Client – purchased $4,100,000 in the equity tranche of the Citius CDO from the underwriter of the Citius CDO. Subsequently, in early 2007, Aladdin transferred the entire investment to the Individual Client. Aladdin Management did not make the required $410,000 co-investment in the Citius CDO.

22. Despite its statements in MAST materials about its co-investments with clients, Aladdin Management took no steps to co-invest in the Citius CDO. In mid-2006, when Aladdin Management was engaged to manage the Citius CDO by its underwriter, Aladdin Management committed to the underwriter that it or its clients would purchase at least 25% of the $16 million equity tranche of the Citius CDO.

23. By September 26, 2006, Aladdin Management had taken no action to reserve for itself a portion of the equity tranche of the Citius CDO. Another party had agreed to underwrite $8 million in the equity and Aladdin Capital sought to place the remaining $8 million with its own customers for a placement fee without investing any of its own money. On September 26, 2006, Schlim informed the underwriter for the Citius CDO that Aladdin Capital wanted to "soft circle the remaining 4.1 mm in equity and get paid 10 pts [points]" for selling it. In response to the underwriter's question about when Aladdin Capital would be firm on selling the remaining portion of the equity tranche, Schlim responded that he should know by the end of the "week" and could know by "tomorrow."

24. Also on September 26, 2006, an Aladdin Capital registered representative offered a $4,100,000 investment in the Citius CDO to the Individual Client, and the Individual Client agreed to make that investment. Schlim was informed about the offer of $4,100,000 in the equity tranche of the Citius CDO to the Individual Client.

25. Schlim took no steps, either internally or in communications with the Citius CDO's underwriter to reserve for Aladdin Management an investment of $410,000 in the equity tranche of the Citius CDO.

26. On or about December 1, 2006, the underwriter for the Citius CDO paid Aladdin Capital a $410,000 placement fee for its work in placing Citius securities with the Individual Client.

27. With respect to the Pension Plan, Aladdin pitched the MAST program to this client in July 2005. The Pension Plan received the standard MAST program letter of intent, and other standard MAST marketing materials, which included the co-investment representation.

28. In 2005, the Pension Plan agreed to participate in the MAST program.

29. In approximately October 2006, Aladdin Capital offered to sell to the Pension Plan an investment in the equity tranche of the Citius CDO. The Pension Plan agreed to invest in the equity tranche of the Citius CDO, in the amount of $3,900,000.

30. On or about December 1, 2006, the underwriter for the Citius CDO paid Aladdin Capital a $390,000 placement fee for its work in placing Citius securities with the Pension Plan. Schlim was aware of this payment.

31. Despite being involved in, and primarily responsible for, communications with the underwriters for both the Fortius CDO and the Citius CDO about Aladdin Capital's commitment to place a portion of the equity tranche of those securities, and the communications with those underwriters in which Aladdin made sure to reserve the amount to be purchased by MAST clients, Schlim made no effort to communicate with the underwriters for these two CDOs to reserve an amount to be purchased by Aladdin Management pursuant to its co-investment obligations.

32. Schlim, as the CFO of Aladdin, was responsible for reserving Aladdin Management funds with which to co-invest alongside its MAST clients. With respect to the Fortius CDO and the Citius CDO, although he did not supervise Aladdin's Legal or Compliance departments, Schlim failed to ensure that Aladdin Management reserved or allocated its funds to make co-investments alongside Aladdin Management's clients in either CDO.

33. Schlim knew that Aladdin used the co-investment representation as a significant marketing feature of its pitches to MAST clients. Schlim was also aware when the representation that Aladdin Management co-invested alongside all of its clients in MAST programs was made to MAST clients and potential MAST clients. Schlim failed to take any action to ensure that such representations were accurate when they were made.

D. VIOLATIONS

35. Section 17(a)(2) of the Securities Act prohibits any person "in the offer or sale of any securities or securities-based swap agreement . . . [from] obtain[ing] money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Scienter is not required to establish violations of Section 17(a)(2). *See Aaron v. SEC*, 446 U.S. 680, 697 (1980). Instead, violations of this section may be established by showing negligent conduct. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997).

36. 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." Proof of scienter is not required to establish a violation of Section 206(2), but rather a violation "may rest on a finding of simple negligence." *SEC v.*

Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bur., Inc.*, 375 U.S. 180, 194-95 (1963)); *see also SEC v. Wash. Inv. Network*, 475 F.2d 392, 396 (D.C. Cir. 2007).

37. As a result of the negligent conduct described above, Schlim violated Section 17(a)(2) of the Securities Act.

38. As a result of the negligent conduct described above, Schlim caused Aladdin Capital's violations of Section 17(a)(2) of the Securities Act and caused Aladdin Management's violation of Section 206(2) of the Advisers Act.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Schlim shall cease and desist from committing or causing any violations and any future violation of Section 17(a)(2) of the Securities Act and Section 206(2) of the Advisers Act;

B. Schlim shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways: (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341,6500 South MacArthur Boulevard, Oklahoma City, OK 73169. Payments by check or money order must be accompanied by a cover letter identifying Respondent's name as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to John T. Dugan, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110;

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, prejudgment interest and penalties referenced in paragraph B above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he 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

Elizabeth M. Murphy
Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9374 / December 17, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3514 / December 17, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15134

In The Matter Of ALADDIN CAPITAL MANAGEMENT LLC AND ALADDIN CAPITAL LLC, Respondents.	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 Aladdin Capital Management LLC ("Aladdin Management") and Aladdin Capital LLC ("Aladdin Capital" and collectively, with Aladdin Management, "Aladdin" or "Respondents").

II.

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

A. SUMMARY

1. This case involves complex structured financial products known as collateralized debt obligations ("CDOs"). CDOs are securities backed by debt obligations including, for example, subprime residential mortgage-backed securities. The underlying mortgage-backed, or other, securities are packaged and generally held by a special purpose vehicle that issues notes entitling their holders to payments derived from the underlying assets.

2. In late 2006, Aladdin Management marketed to its clients two CDOs that it was managing and stated that it would co-invest in the same CDOs. Aladdin Management did not co-invest as it represented. Aladdin Capital collected a placement fee from the CDOs' underwriters. From 2007 to 2010, after three clients had invested in these two CDOs, Aladdin Management erroneously continued to inform its clients that Aladdin Management co-invests alongside them.

B. RESPONDENTS

3. **Aladdin Management** is an SEC-registered investment adviser based in Stamford, Connecticut. During the relevant time period, Aladdin Management had assets under management of approximately $20 billion, which consisted predominantly of cash and synthetic CDOs, collateralized loan obligations ("CLOs"), several credit hedge funds, and separately managed accounts. Aladdin Management's typical practice was to act as the collateral manager for CDOs and CLOs underwritten by major investment banks.

4. **Aladdin Capital**, during the relevant time period, was an SEC-registered broker-dealer based in Stamford, Connecticut. Aladdin Capital primarily placed CDO and CLO securities. On January 30, 2012, Aladdin Capital filed a Form BDW with the Commission, thus seeking to terminate its registration as a broker-dealer. It became effective on March 30, 2012.

C. FACTS

Aladdin's Advisory Program and Marketing Statements

5. In 2005, Aladdin Management began an investment advisory program called the "Multiple Asset Securitized Tranche" ("MAST") program. Under the MAST program, Aladdin Management and its clients signed investment management agreements under which Aladdin Management agreed to render investment management services, and the client agreed to commit to invest in the equity tranche of certain upcoming CDO or CLO deals that would be managed by Aladdin Management. Aladdin Management represented to its MAST clients that it was serving as their investment adviser and

disclosed to the Commission on its Form ADV that MAST accounts were a type of separately managed account. Aladdin Management did not receive advisory fees directly from MAST clients; rather Aladdin Management informed its clients and the Commission on its Form ADV that Aladdin Management would be compensated from the management fees that it earned through managing the CDOs that its clients invested in. Aladdin Capital placed the equity interest with the client and typically received a negotiated (usually ten-percent) placement fee or commission from the CDOs' or CLOs' underwriter for doing so.

6. When marketing the MAST program, Aladdin Management and Aladdin Capital stated that Aladdin Management would co-invest in the same equity tranches of each CDO or CLO alongside its clients. Aladdin Management's co-investment representation was a key feature of, and selling point for, the MAST program. For example, Aladdin Management explained in marketing material that, "[w]e align our interests with MAST investors by co-investing in every transaction with them. And don't forget, we are not investing in other firms' transactions. Instead, we only invest in deals where we can control the management of the collateral - our own programs." In the same marketing piece, Aladdin Management also posed the question, "[w]hy is an investor better off just investing in Aladdin sponsored CLOs and CDOs?" Aladdin Management answered by emphasizing that the "most powerful response I can give to your question is that Aladdin co-invests alongside MAST investors in every program. Putting meaningful 'skin in the game' as we do means our financial interests are aligned with those of our MAST investors." Aladdin Capital also emphasized that Aladdin Management would co-invest in the same products when marketing specific CDOs to potential MAST participants.

7. In addition, Aladdin Management continued to represent that it co-invests in the same CDOs as its clients after those clients had made their investments. Investment reports sent to clients each quarter indicated that: "Aladdin Capital Management co-invests in each of the CDO equity investments represented in the MAST program." The standard investment management agreement and the quarterly MAST investor reports also indicated that Aladdin Management acted as a fiduciary to the MAST program.

8. As Aladdin Management explained in its marketing materials, co-investing in the same CDO deals as its clients was one of the most "powerful" statements it could make because it showed that Aladdin Management had "skin in the game" and that its financial interests were aligned with those of its clients. Also, because the equity tranche of the CDOs were typically the riskiest tranche and in the first loss position, having the CDO manager as an investor in the same tranche gave investors additional assurances that they could trust the CDO.

Aladdin Management Stated That It Would Co-Invest Alongside Each MAST Participant But Failed To Co-Invest In the Fortius and Citius CDOs

9. Despite the centrality of its representations that it would co-invest, and had co-invested, in CDOs alongside its MAST clients, Aladdin Management failed to co-invest in two CDOs that it offered to MAST clients in late 2006. In particular, Aladdin Management failed to co-invest in the Fortius II Funding, Ltd. ("Fortius") CDO and the Citius II Funding Ltd. ("Citius") CDO despite the fact that three MAST clients invested in the equity tranches of those CDOs.

Aladdin Management Stated it Would Co-Invest Alongside A Municipal Retirement Plan in the Fortius CDO

10. One potential MAST client that Aladdin pursued was a retirement plan for approximately 10,000 employees of a municipal transportation agency (the "Municipal Retirement Plan"). Aladdin Management and Aladdin Capital began pitching the MAST program to the Municipal Retirement Plan in 2005 or 2006.

11. When pitching the MAST program, Aladdin Management and Aladdin Capital emphasized that Aladdin Management would co- invest alongside the Municipal Retirement Plan's CDO investments. Aladdin made such representations at key points in the Municipal Retirement Plan's decision-making process. For example, in early 2006, Aladdin highlighted to the Municipal Retirement Plan that Aladdin Management invested alongside MAST participants in the same investments. Subsequently, in April 2006, one of the Municipal Retirement Plan's representatives recommended that the Plan invest in MAST in part based on the "key feature" that MAST had a "significant alignment of interest with [Aladdin Management] co-investing alongside MAST investors."

12. During the process of soliciting the Municipal Retirement Plan's investment in the MAST program, Aladdin Management and Aladdin Capital continued to emphasize the co-investment benefit of the MAST program. In particular:

a. On May 11, 2006, Aladdin Capital registered representatives presented an "Aladdin overview" and "MAST summary" to the Municipal Retirement Plan. One of those employees stated that Aladdin Management co-invests in the equity tranche of CDOs in the MAST program, up to at least ten percent of the client's MAST investment;

b. On May 12, 2006, a registered representative of Aladdin Capital sent an email to the Municipal Retirement Plan stating that: "As [another former employee of Aladdin] mentioned yesterday, Aladdin also co-invests in the identical equity tranches up to at least 10 % of your MAST allocation, further aligning our economic interests with those of our clients in this regard;"

c. On July 18, 2006, another Aladdin Capital registered representative (who was also an Aladdin Management employee) emailed to the Municipal Retirement Plan a MAST "executive summary" and other marketing material. Both documents highlighted Aladdin Management's co-investment representation. In the cover email, the employee noted: "[a]s outlined in the enclosures, we also co-investment [sic] in the same CDO equity tranches as our clients, which we believe helps to align our economic interests"; and

d. On August 3, 2006, Aladdin Management provided the Municipal Retirement Plan with a sample MAST report, which contained the co-investment representation.

13. Even after the Municipal Retirement Plan signed an investment agreement to participate in the MAST program, Aladdin continued to represent that it would invest alongside it in the particular CDO programs it chose to invest in.

14. Aladdin Capital offered the Municipal Retirement Plan an investment in the Fortius CDO. On November 21, 2006, Aladdin Capital specifically informed the Municipal Retirement Plan that Aladdin Management would co-invest in Fortius. On December 6, 2006, the Municipal Retirement Plan purchased $5,000,000 in the equity tranche of the Fortius CDO directly from the underwriter of the Fortius CDO. Aladdin Management did not make the required $500,000 co-investment in the Fortius CDO.

15. When Aladdin Management made its statements to the Municipal Retirement Plan that it would co-invest in the Fortius CDO, it had taken no steps to make that co-investment. To the contrary, by November 3, 2006, which was the pricing date for the Fortius CDO, Aladdin knew that the Fortius CDO's underwriter had preliminarily allocated $5,000,000 of the equity tranche of the Fortius CDO to Aladdin and/or its clients. A former Aladdin employee informed other former employees of Aladdin that the Municipal Retirement Plan would purchase the entire $5 million allocation. Aladdin Management took no steps, either internally or in communications with the Fortius CDO's underwriter, to reserve for itself a portion of the equity tranche of the Fortius CDO. To the contrary, during November 2006, Aladdin Capital communicated to the underwriter of the Fortius CDO that the Municipal Retirement Plan would instead purchase Aladdin's entire allocation of the Fortius CDO's equity tranche.

16. Soon after the Municipal Retirement Plan's $5 million purchase of the Fortius CDO, Aladdin Capital communicated with the underwriter for the Fortius CDO and requested that it be paid the previously agreed-upon 10 percent placement fee (in the amount of $500,000) for its work in placing Fortius securities with the Municipal Retirement Plan. The underwriter paid Aladdin Capital that fee in December 2006.

17. From 2007 to 2010, Aladdin Management sent periodic investment reports to the Municipal Retirement Plan reflecting the performance of the Plan's investment in

the Fortius CDO. The investment reports indicated that Aladdin Management co-invests in each CDO investment made as part of the MAST program. This representation was inaccurate, and it was contained in numerous investment reports.

Aladdin Management Stated It Would Co-Invest Alongside Two Other MAST Program Participants in the Citius CDO

18. In December 2006, Aladdin Capital sold investments in the equity tranche of the Citius CDO to two MAST participants. The two clients were a pension plan for a chain of retail stores (the "Pension Plan"), and an individual entrepreneur who invested his personal funds and also the funds of his charitable foundation in the MAST program (the "Individual Client").

19. Both the Pension Plan and the Individual Client decided to participate in the MAST program, and were informed that Aladdin Management would co-invest alongside them in each CDO investment they made as part of the MAST program.

20. Specifically, in 2005, Aladdin Management sent the Individual Client a "letter of intent" concerning his plan to participate in the MAST program and thus invest in CDOs managed by Aladdin Management. The letter of intent contained a provision representing that "Aladdin will co-invest with Client in the identical Preference Share equity tranches in the MAST program. Aladdin's investment, in aggregate, will be equal to at least 10 % of Client's total Preference Share investment in the MAST program." After receiving this letter, the Individual Client agreed to participate in the MAST program, and invested in several CDOs and CLOs in late 2005 and early 2006. Throughout 2006, Aladdin Management sent the Individual Client MAST investment reports indicating that Aladdin Management co-invests in each CDO investment made as part of the MAST program.

21. Beginning in September 2006, Aladdin Capital offered the Individual Client an investment in the Citius CDO. On December 1, 2006, Aladdin Capital - on behalf of the Individual Client - purchased $4,100,000 in the equity tranche of the Citius CDO from the underwriter of the Citius CDO. Subsequently, in early 2007, Aladdin Capital transferred the entire investment to the Individual Client. Aladdin Management did not make the required $410,000 co-investment in the Citius CDO.

22. Despite its statements in MAST materials about its co-investments with clients, Aladdin Management took no steps to co-invest in the Citius CDO. In mid-2006, when Aladdin Management was engaged to manage the Citius CDO by its underwriter, Aladdin Management committed to the underwriter that it or its clients would purchase at least 25% of the $16 million equity tranche of the Citius CDO.

23. By September 26, 2006, Aladdin Management had taken no action to reserve for itself a portion of the equity tranche of the Citius CDO. Another party had agreed to underwrite $8 million in the equity and Aladdin Capital sought to place the remaining $8 million with its own customers for a placement fee without investing any of

its own money. On September 26, 2006, a former Aladdin executive informed the underwriter for the Citius CDO that Aladdin Capital wanted to "soft circle the remaining 4.1 mm in equity and get paid 10 pts [points]" for selling it. In response to the underwriter's question about when Aladdin Capital would be firm on selling the remaining portion of the equity tranche, the former Aladdin executive responded that he should know by the end of the "week" and could know by "tomorrow."

24. Also on September 26, 2006, Aladdin Capital offered a $4,100,000 investment in the Citius CDO to the Individual Client, and the Individual Client agreed to make that investment.

25. Aladdin Management took no steps, either internally or in communications with the Citius CDO's underwriter, to reserve for itself an investment of $410,000 in the equity tranche of the Citius CDO.

26. On or about December 1, 2006, the underwriter for the Citius CDO paid Aladdin Capital a $410,000 placement fee for its work in placing Citius securities with the Individual Client.

27. From 2007 to 2010, Aladdin Management sent periodic investment reports to the Individual Client reflecting the performance of his investment in the Citius CDO. The investment reports indicated that Aladdin Management co-invests in each CDO investment made as part of the MAST program. This representation was inaccurate, and it was contained in numerous investment reports.

28. With respect to the Pension Plan, Aladdin pitched the MAST program to this client in July 2005. The Pension Plan received the standard MAST program letter of intent, and other standard MAST marketing materials, which included the co-investment representation.

29. In 2005, the Pension Plan agreed to participate in the MAST program.

30. In approximately October 2006, Aladdin Capital offered to sell to the Pension Plan an investment in the equity tranche of the Citius CDO. The Pension Plan agreed to invest in the equity tranche of the Citius CDO, in the amount of $3,900,000.

31. On or about December 1, 2006, the underwriter for the Citius CDO paid Aladdin Capital a $390,000 placement fee for its work in placing Citius securities with the Pension Plan.

D. VIOLATIONS

32. Section 17(a)(2) of the Securities Act prohibits any person "in the offer or sale of any securities or securities-based swap agreement . . . [from] obtain[ing] money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances

under which they were made, not misleading." Scienter is not required to establish violations of Section 17(a)(2). *See Aaron v. SEC*, 446 U.S. 680, 697 (1980). Instead, violations of this section may be established by showing negligent conduct. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997).

33. 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." Proof of scienter is not required to establish a violation of Section 206(2), but rather a violation "may rest on a finding of simple negligence." *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bur., Inc.*, 375 U.S. 180, 194-95 (1963)); *see also SEC v. Wash. Inv. Network*, 475 F.2d 392, 396 (D.C. Cir. 2007).

34. As a result of the conduct described above, Aladdin Capital violated Section 17(a)(2) of the Securities Act and Aladdin Management violated Section 206(2) of the Advisers Act.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Aladdin Management shall cease and desist from committing or causing any violations and any future violation of Section 206(2) of the Advisers Act;

B. Aladdin shall, jointly and severally, pay disgorgement in the amount of $900,000 and prejudgment interest in the amount of $268,831. This sum shall be paid to the Securities and Exchange Commission on or before December 31, 2012. 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 shall be due and payable immediately, without further application. Payment must be made in one of the following ways: (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341,6500 South MacArthur Boulevard, Oklahoma City, OK 73169. Payments by check or money order must be accompanied by a cover letter identifying Respondents' names as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to John T. Dugan, Associate Regional Director, Division of

Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110;

C. Aladdin shall, jointly and severally, pay a civil money penalty in the amount of $450,000. This sum shall be paid to the Securities and Exchange Commission on or before December 31, 2012. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways: (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341,6500 South MacArthur Boulevard, Oklahoma City, OK 73169. Payments by check or money order must be accompanied by a cover letter identifying Respondents' names as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to John T. Dugan, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110;

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, prejudgment interest and penalties referenced in paragraphs B and C above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, 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 Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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. 68448 / December 17, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15132

In the Matter of **ALLIANZ SE,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTY**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Allianz SE ("Allianz" 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 the Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order And Civil Penalty ("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 violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") by Allianz SE ("Allianz" or the "Company"), through its Indonesian majority-owned subsidiary, PT Asuransi Allianz Utama ("Utama"). Between 2001 and 2008, Utama managers made improper payments to employees of state-owned entities in Indonesia in order to obtain and retain business. Allianz learned of the improper payments from two complaints made several years apart. The first complaint was submitted in 2005 alleging significant misconduct, including unsupported payments to agents. A subsequent audit of Utama's accounting records uncovered that managers at Utama were using "special purpose accounts" to make illicit payments, many to government officials, in order to secure business in Indonesia. Despite the audit, the conduct continued. The second complaint was lodged in 2009 to Allianz's external auditors and alleged that Allianz created illicit off-the-books accounts. In response, Allianz began an internal investigation. The Commission staff opened an investigation in April 2010 after receiving an anonymous complaint of possible FCPA violations. The investigation determined that from at least 2001 through December 2008, the Utama managers, with the assistance of others in the Indonesian office, made payments to employees of state-owned entities in Indonesia to procure or retain insurance contracts related to large government projects in Indonesia. As a result of improper payments of approximately \$650,626 to agents and employees of state-owned entities and others, Allianz realized \$5,315,649 in profits.

2. The payments were improperly recorded as legitimate transaction costs, thereby causing Allianz's books and records to be inaccurate. Allianz failed to devise and maintain a system of internal controls sufficient to provide reasonable assurances to detect and prevent such payments.

Respondent

3. Allianz SE ("Allianz") was founded in 1890 and is headquartered in Munich, Germany. Allianz and its subsidiaries primarily engage in property and casualty insurance, life and health insurance, and asset management businesses worldwide. The Company operates in 70 countries, has 150,000 employees and in fiscal year 2011, the Company reported revenue of 103.6 billion euro. From November 3, 2000 to October 23, 2009, Allianz's American Depositary Shares and bonds were registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange ("NYSE"). As such, Allianz was an "issuer" within the meaning of the FCPA. The conduct at issue occurred when Allianz was a U.S. issuer. On October 23, 2009, Allianz voluntarily delisted its securities from the

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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.

NYSE and soon thereafter terminated its reporting obligations with the Commission. The Company also delisted its ordinary shares from the London, Milan, Paris, and Swiss stock exchanges. Presently, Allianz's shares trade only on German stock exchanges.

Other Relevant Entities and Persons

4. Allianz of Asia-Pacific and Africa GmbH ("AZAP") is a German corporation and a wholly-owned subsidiary of Allianz. During the relevant period, AZAP's financials were consolidated into Allianz's financial statements.

5. PT Asuransi Allianz Utama Indonesia ("Utama") is located in Jakarta, Indonesia and is a majority-owned subsidiary of Allianz. Utama offers general insurance products to individuals and corporate clients. On June 6, 1989, Utama was formed as a joint venture with AZAP, PT Asuransi Jasa Indonesia ("Jasindo") and PT Asuransi Wuwungan.[2] Jasindo is an Indonesian state-owned entity. During the relevant period, AZAP owned 75 percent of Utama and Jasindo owned the remaining 25 percent. During the relevant period, Utama was treated as a subsidiary of Allianz, and Utama's financials were consolidated into Allianz's financial statements.

6. manroland AG ("Manroland") was a private German company that manufactured printing systems. In July 2006, Allianz Capital Partners, a wholly-owned subsidiary of Allianz, acquired a majority interest and majority voting rights in Manroland.

7. Utama CEO 1, a German citizen, was the Utama Chief Executive Officer ("CEO") from 1998 to 2001. Utama CEO 1 established the special purpose account for the purpose of making illicit payments to government officials. Utama CEO 1 is retired from the Company.

8. Utama CEO 2, a German citizen, was the Utama CEO from 2003 to 2006. Utama CEO 2 was aware that the special purpose account was used to make improper payments and that the practice continued after Utama was directed to close the account. Allianz terminated Utama CEO 2 in August 2011.

9. Utama Marketing Manager, an Indonesian citizen, was a member of the Utama senior management from 1990 to 2011. Utama Marketing Manager used the special purpose account to make improper payments. Allianz terminated the Utama Marketing Manager in August 2011.

10. Indonesian Agent, an Indonesian citizen, served as an agent for Utama since 1998. He was aware that the special purpose account was used to make improper payments to Indonesian officials. The Agent allowed the special purpose account to be opened in his name in return for a monthly fee. The Indonesian Agent is a current agent for Utama, not involved in the direct business.

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2 PT Asuransi Wuwungan is no longer part of the joint venture.

Facts

11. In 1981, Allianz commenced its operations in Indonesia with a representative office that provided financing and insurance for large government projects in Indonesia. Simultaneous with the opening of the office, Allianz opened a special purpose bank account with a local Indonesian broker. From 1981 to 1989, the account was used to pay legitimate commissions to the local Indonesian broker for business it generated for Allianz. In 1989, Allianz established Utama and continued the practice of using special purpose accounts for paying commissions to agents that generated business for Allianz. However, in February 2001, Indonesian Agent, an agent for Utama, Utama CEO 1 and Utama's Chief Financial Officer ("CFO") opened a separate, off-the-books account in the Indonesian Agent's name (the "Agent special purpose account"). The Agent special purpose account was used to make improper payments to employees of Indonesian state-owned entities and others for the purpose of obtaining and retaining insurance contracts. In February 2001, Indonesian Agent and Utama CEO 1 executed a "Paying Agency Agreement" that set up the scheme to make the payments to employees of state-owned entities. This agreement established the off-the-books account that served as a slush fund to make bribe payments to foreign officials and others as instructed by Utama.

A. Utama's 2001-2005 Improper Payments

12. During the period 2001 to 2005, Utama Marketing Manager made payments from the Agent special purpose account to account introducers employed by state-owned entities to secure insurance contracts on large government projects in Indonesia.[3] Utama Marketing Manager received approval from Utama management to use the Agent special purpose account for improper purposes. Utama CEO 2, the CEO from 2003-2006, was aware of the Agent special purpose account and the improper payments to foreign officials.

13. The improper payments made to foreign officials were disguised in the Utama insurance contracts as "overriding commissions." Each insurance contract outlined two parts of the overall insurance premium: the technical premium (the actual cost of the coverage), which was usually 75-95% of the premium, and the non-technical premium (the overriding commission), which was typically 5-25% of the premium. The overriding commission was the portion that was paid to the foreign official as an inducement to purchase the Utama insurance product. Once the entire premium was deposited in the Utama bank account and booked in Utama's internal accounting system, Utama Marketing Manager would submit a "commission payment request" to the finance department. Once the request was approved the overriding commission portion was transferred to the Agent special purpose account. Utama Marketing Manager would withdraw the commission in cash from the Agent special purpose account and deliver the funds to the foreign official. Despite the fact that Allianz has a majority share of Utama and consolidated the subsidiary's accounts into its own books and records, Utama's accounting system was maintained in Indonesia and Allianz did not have effective controls over

[3] Most of the account introducers were foreign officials because they were employees of Indonesian state-owned entities, who acted in their official government capacity to procure or retain insurance contracts from Allianz on government projects.

the accounting. Allianz did not have the ability to access Utama's accounting system and, therefore, did not detect the movement of funds to the Agent special purpose account. In addition, the Agent special purpose account was maintained in the name of the Indonesian Agent to make it appear that all movement of funds to this account was for legitimate commission payments. Likewise, Allianz did not have effective controls over the commission payment request process, which allowed payments to go to the Agent special purpose account without supporting documentation.

14. On December 1, 2005, a whistleblower complaint concerning the special purpose account was submitted to both the Allianz whistleblower hotline and Utama's joint venture partner Jasindo, and then forwarded to the head of AZAP. The complaint itemized a number of control weaknesses, most notably, the existence of the Agent special purpose account and its lack of transparency. On December 8, 2005, Allianz Group Audit initiated an audit of the Indonesian office; however, the review was limited to embezzlement from the Company. The audit identified the Agent special purpose account as an account mainly used by Utama Marketing Manager as a "vehicle to pay project development and overriding commissions to the special projects and clients for securing business with Utama." It also identified two internal accounts related to the Indonesian Agent; one for the agent's normal commissions, and one for "various" purposes. However, no additional steps were taken to determine the nature and purpose of the accounts or to identify the recipients of payments from the accounts. On December 12, 2005, based on the audit findings Allianz directed the Utama management to close the Agent special purpose account. Although the Utama management agreed to close the account and to stop making the payments, it continued making improper payments to secure business for Allianz through 2008.

B. <u>Utama's Post-2005 Improper Payments</u>

15. Despite the directive to close the account and to stop making payments, Utama Marketing Manager continued to use the Agent special purpose account to make improper payments to foreign officials from 2005 to 2008. In an email dated May 20, 2006, the Utama Chief Technical Officer emailed Utama Marketing Manager and Utama CEO 2 that the finance department had detected that the Agent special purpose account had been used to make payments in connection with two government insurance contracts. Utama Marketing Manager acknowledged that he used the Agent special purpose account to make the payments because the account introducers expected to receive the promised improper payments on the government insurance contracts. Utama CEO 2 approved the continued use of the Agent special purpose account to make payments on the two government insurance contracts at issue. Later, Utama Marketing Manager and his staff expanded the improper payments to numerous other foreign officials on government insurance contracts.

16. From 2005 to 2008, Utama Marketing Manager employed various methods to make payments to foreign officials. In addition to booking payments through the Agent special purpose account, Utama Marketing Manager made payments by either: 1) booking commissions to an agent that was not associated with the account for the government insurance contract and then withdrawing the funds booked to the agent's account as cash to pay the foreign official; or 2) overstating the amount of a client's insurance premium, booking the excess amount to an

unallocated account and then "reimbursing" the excess funds to the foreign officials, who were responsible for procuring the government insurance contracts.

17. Similar to the Agent special purpose account, Allianz did not have effective controls over the Utama accounting system or the commission payment process, which allowed payments to be made to an agent's account without supporting documentation. Allianz did not have any controls over the use of the unallocated account that was maintained at Utama. As a result, Utama Marketing Manager was able to take funds from Utama to pay foreign officials without detection. In March 2009, Allianz's outside auditor received an anonymous complaint alleging that an Allianz executive created or initiated slush funds during his tenure with AZAP. Between December 2005, when the Allianz Executive Vice-President of the Asia-Pacific Division directed Utama to close the Agent special purpose account and the March 2009 Whistleblower complaint, Allianz took no steps to ensure that the Agent special purpose account was closed and that similar improper payments were not being made.

C. Investigation and Remediation

18. In response to the March 2009 Whistleblower complaint, Allianz convened a Whistleblower Committee to do an internal investigation and retained counsel to conduct an internal investigation of Utama's payment practices in Indonesia. Allianz did not report the conduct to the Commission staff.

19. In April 2010, the staff opened an investigation after receiving an anonymous complaint of possible FCPA violations. The staff contacted Allianz concerning the allegations. Allianz's cooperation in the staff's investigation and the timeliness of its response to the Commission's requests for documents and information improved over time. Allianz hired new counsel and took steps to further its cooperation and remedial efforts.

20. The staff's investigation uncovered 295 government insurance contracts that were obtained or retained by improper payments of approximately $650,626 to Indonesian government officials and others from 2001 through 2008. As stated above, in some instances the nature of the improper payments was disguised in invoices as an "overriding commission" or as a commission for an agent that was not associated with the government insurance contract. In other instances the improper payments were structured as an overpayment by the government insurance contract holder, who was later "reimbursed" for the overpayment. The excess funds were then paid to foreign officials, who were responsible for procuring the government insurance contracts.[4]

21. Allianz took various remedial measures, including employment action against several individuals who were involved in the conduct or failed to stop the conduct. Allianz issued new or enhanced FCPA compliance and internal accounting control policies and procedures, including mandating strict scrutiny of payments to third party intermediaries. Allianz also updated the anti-corruption clause in its third-party contracts to specifically refer to

4 In late 2010, Allianz reported to the staff that Manroland, AG, an entity in which Allianz had invested in through its private equity arm, was under investigation by German tax authorities. The German tax investigation focused on the tax-deductibility of certain sales-related expenses, many of which occurred after Allianz ceased being an issuer. None of the irregularities in payments involve government projects or payments to foreign officials.

the FCPA. Allianz provided enhanced FCPA compliance training to its employees and improved its current global anti-corruption compliance program.

Legal Standards and Violations

22. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder, and upon any other person that is, was, or would be a cause of the violation, due to an act of omission the person knew or should have known would contribute to such violation.

FCPA Violations

23. The FCPA, enacted in 1977, added Section 13(b)(2)(A) of the Exchange Act to require public companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

24. The FCPA also added Section 13(b)(2)(B) of the Exchange Act to require public companies to, among other things, devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions: (i) are executed in accordance with management's general or specific authorization; and (ii) are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets. *See* 15 U.S.C. §§ 78m (b)(2)(A) and 78m(b)(2)(B). Section 13(b)(2)(A) of the Exchange Act does not require that the amounts involved be "material," nor is it necessary to prove "scienter" under its provisions. *SEC v. World-Wide Coin Invs. Ltd.*, 567 F. Supp. 724, 749-51 (N.D. Ga. 1983). Similarly, there is no scienter requirement for establishing a violation of Section 13(b)(2)(B). *Id.*

25. Utama, a majority-owned subsidiary of Allianz, made improper payments to foreign officials to obtain or retain government insurance contracts. Utama improperly recorded the payments as legitimate transaction costs. Utama's financial statements were consolidated into Allianz's financial statements. As a result of the conduct described above, Allianz violated Section 13(b)(2)(A) of the Exchange Act, which requires issuers to keep accurate books, records and accounts. Further, as evidenced by the extent and duration of Utama's improper payments and their improper recordation, and the fact that Allianz was not aware that Utama's commission payment request process allowed funds to be diverted for improper payments, Allianz failed to recognize the compliance risks posed by Utama. Allianz also failed to devise and maintain an effective system of internal controls sufficient to provide reasonable assurances that improper payments were not being made by its subsidiary. As a result of the conduct described above, Allianz violated Section 13(b)(2)(B) of the Exchange Act, which requires issuers to devise and maintain a sufficient system of internal accounting controls.

Allianz's Cooperation and Remedial Efforts

26. In determining to accept the Offer, the Commission considered the cooperation afforded the Commission staff and certain remedial measures undertaken by Allianz including enhancements to its compliance program.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Allianz cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act;

B. Respondent shall, within 30 days of the entry of this Order, pay to the United States Treasury disgorgement of $5,315,649, prejudgment interest of $1,765,125 and a civil money penalty of $5,315,649. If timely payment of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If payment of a civil penalty is not timely made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[5]
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Allianz SE as a Respondent in these proceedings, and the file number of these proceedings; a copy

[5] The minimum threshold for transmission of payment electronically is $50,000.00 as of April 1, 2012. This threshold will be increased to $1,000,000 by December 31, 2012. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

of the cover letter and check or money order must be sent to Tracy L. Price, Assistant Director, FCPA Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Paredes, Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
December 17, 2012

IN THE MATTER OF **Spencer Pharmaceutical 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 Spencer Pharmaceutical Inc. ("Spencer") because of questions regarding the accuracy of publicly disseminated information, concerning, among other things: (1) the company's current financial condition; and (2) statements made by Spencer in press releases concerning, among other things, an unsolicited buyout offer of Spencer by a foreign company.

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, and any equity securities of any entity purporting to succeed to this issuer, is suspended for the period from 9:30 a.m. EST on Monday, December 17, 2012, through 11:59 p.m. EST on Monday, December 31, 2012.

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. 3516 / December 18, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15137

In the Matter of **NEW ENGLAND INVESTMENT AND RETIREMENT GROUP, INC., AND NICHOLAS JOHN GIACOUMAKIS,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against New England Investment and Retirement Group, Inc. ("NEINV") and Nicholas John Giacoumakis ("Giacoumakis") (collectively, "the Respondents").

II.

In anticipation of the institution of these proceedings, 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, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. From approximately 2007 through 2011, NEINV and Giacoumakis, on several occasions, provided clients or prospective clients with reports generated using Morningstar® Principia® ("Principia") software. The Principia reports were used to assess various financial metrics. Among other things, the Principia reports purport to compare the historical performance and risk of NEINV's equity and fixed income models to either an equity or fixed income benchmark ("NEINV Principia reports"). However, these NEINV Principia reports did not represent past performance of NEINV's models. Instead, NEINV generated the information in these reports by inputting in the Principia software the current investments of one of NEINV's models and analyzing how the model would have performed had the model held its current investments throughout the entire time period in the NEINV Principia report. In reality, the models did not exist throughout the entire time period in the report and the models' holdings changed over time during the period when they did exist. The NEINV model performance reports did not disclose that the model results portrayed were hypothetical, not actual, results. Giacoumakis was responsible for distributing and presenting the NEINV Principia reports to several clients and prospective clients of NEINV.

2. In addition, throughout the relevant time period, NEINV failed to implement written compliance policies and procedures reasonably designed to prevent its employees from presenting performance information to clients or prospective clients that did not violate the Advisers Act and its rules.

Respondents

3. **NEINV** (SEC File No. 801-67679), is a Massachusetts corporation headquartered in North Andover, Massachusetts that has been registered with the Commission as an investment adviser since 2007. NEINV has approximately 1,395 discretionary accounts and, as of September 2012, approximately $430 million in discretionary assets under management. Approximately 1,100 of NEINV's clients are individuals. NEINV also advises some corporate clients. Giacoumakis, the President of NEINV, formed NEINV in 1995 and owns the entire business. Giacoumakis was NEINV's Chief Compliance Officer ("CCO") from at least February 2007 until June 2011. NEINV has approximately 15 employees, and approximately five of these employees are investment adviser representatives.

4. **Nicholas John Giacoumakis**, age 45, resides in Windham, New Hampshire. Giacoumakis is the principal, President, and sole owner of NEINV. Giacoumakis formed NEINV in late 1995.

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

Background

5. At various times from approximately 2005 to the present, NEINV has used five equity-based models and three fixed income models to manage its clients' assets. Currently, the four equity models are called "Conservative," "Moderately Conservative," "Moderate," and "Moderately Aggressive." NEINV previously had an "Aggressive" equity model but no longer uses it with clients. NEINV has had investors invested in the "Moderate" model since approximately 2004 or 2005, the "Conservative" and "Moderately Conservative" models since approximately 2007 or 2008, and the "Moderately Aggressive model" since approximately 2006 or 2007. NEINV's three fixed income models are: (1) "Fixed Income 1," which holds municipal bonds; (2) "Fixed Income 2," which is roughly half municipal and half taxable bonds; and (3) "Fixed Income 3," which holds taxable bonds for investors with tax-deferred retirement accounts. NEINV has had investors in the "Fixed Income 1" and "Fixed Income 2" models since approximately 2007 or 2008, and NEINV has had investors in "Fixed Income 3" since approximately 2008 or 2009.

6. From at least 2007 to 2011, NEINV used Principia software to show how a hypothetical back-testing of the securities in one of its models measured against a benchmark or index such as the S&P 500®. The NEINV Principia reports showed a current portfolio value for an investment in the model for the preceding five to ten years and how such value grew over that period compared to a relevant benchmark. NEINV entered the current holdings of one of NEINV's models into Principia's software and the software did a hypothetical back-test to show how those holdings would have grown during the time period shown in the report.

7. Respondents on several occasions sent NEINV Principia reports to clients or prospective clients that purported to compare the performance of an NEINV model to a fixed income or equity benchmark. For example, NEINV sent a "NEINV RIA Models Moderately Aggressive" Principia report to a prospective client in May 2007. That report purported to portray the growth of an investment in the model from January 1, 2000 to March 31, 2007 compared to a custom benchmark. That report did not reflect the actual performance of the Moderately Aggressive model, but rather the back-tested performance of the group of securities held in the model in approximately May 2007. Moreover, NEINV's Moderately Aggressive model did not exist before 2006, so the reported performance presented model performance (including the three- and five-year returns of the model's "portfolio return" compared to the benchmark) for a time period in which the model did not exist. The report also compared the three- and five-year risk and return statistics of NEINV's model (as it existed in May 2007) to the benchmark without disclosing that the model's risk and return statistics were hypothetical.

8. In addition to other materials, Giacoumakis used the NEINV Principia reports in meetings with clients or prospective clients and also directed NEINV employees to send NEINV Principia reports to his clients or prospective clients. Giacoumakis and other NEINV employees distributed these NEINV Principia reports to clients and prospective clients both by email, and in hardcopy during in-person meetings.

9. NEINV's employees sometimes emailed the NEINV Principia reports to clients or prospective clients without disclosing that the model performance was hypothetical and not actual past performance.

10. In some instances, one former adviser of NEINV misrepresented to clients or prospective clients that the NEINV Principia reports reflected actual past performance of NEINV's models. In May 2010, this adviser emailed a prospective client comparing the historical performance and risk of her current portfolio to NEINV's models. In the email forwarding the report, the NEINV adviser stated: "Let me know if you have any questions, but as you can see we are taking less risk and getting better risk adjusted return on a 3 year and 5 year basis. Your one year number should be higher than ours for the risk you are taking." The prospective client ultimately became a client of NEINV. The same adviser sent other emails to prospective clients with no explanation that the results portrayed in the attached NEINV Principia report were hypothetical and not actual past performance. When this conduct was detected, this employee was terminated.

11. The NEINV Compliance and Procedures Manual contained a section on "Performance Advertising." That section described Rule 206(4)-1 promulgated under the Advisers Act and various staff statements regarding presentations of investment adviser performance but included no policies or procedures specifically addressing the presentation of performance information, especially performance of NEINV's models, in a manner designed to comply with the Advisers Act and rules thereunder. NEINV took no steps to implement that Manual or otherwise to prevent its employees from presenting performance to clients or prospective clients in a way that violated the Advisers Act and its rules.

Violations

12. As a result of the conduct described above, NEINV willfully violated[2] Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) promulgated thereunder. Section 206(2) of the Advisers Act prohibits an investment adviser from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Section 206(4) of the Advisers Act prohibits any investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and authorizes the Commission to prescribe rules designed to prevent such conduct. Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act for a registered investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading. By negligently circulating or distributing misleading performance reports to clients and prospective clients, NEINV willfully violated Section 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.

13. As a result of the conduct described above, NEINV also willfully violated Rule 206(4)-7 promulgated under the Advisers Act, which requires that registered advisers adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules that the Commission has adopted under the Act. By failing to adopt and implement such written policies or procedures reasonably designed to prevent violation of the

[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)).

Advisers Act and the rules promulgated thereunder regarding performance presentations to clients and prospective clients and requiring that NEINV's Principia reports distributed to prospective or actual clients comply with the Advisers Act and the rules promulgated thereunder, NEINV willfully violated Rule 206(4)-7.

14. As a result of the conduct described above, Giacoumakis caused NEINV's violation of Section 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 promulgated thereunder. By negligently using misleading NEINV Principia reports with clients and prospective clients and negligently directing NEINV's employees to use misleading NEINV Principia reports with clients and prospective clients, Giacoumakis caused NEINV to violate Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) promulgated thereunder. Also, as NEINV's CCO, Giacoumakis caused NEINV to violate Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder by failing to adopt and implement written policies or procedures reasonably designed to prevent violation of the Advisers Act and the rules promulgated thereunder regarding performance presentations to clients and prospective clients, and by failing to require that NEINV's performance reports distributed to prospective or actual clients comply with the Advisers Act and the rules promulgated thereunder.

NEINV's Remedial Acts

15. In determining to accept the Offers, the Commission considered remedial acts undertaken by NEINV.

Undertakings

16. Order Notification

a. Within thirty days of the issuance of this Order, NEINV undertakes to mail to each of its existing clients a copy of the Form ADV which incorporates the paragraphs contained in Section III of this Order, and which specifies that the entire Order will be posted on the homepage of NEINV's website.

b. Within thirty days of the issuance of this Order, NEINV also undertakes to post a copy of this Order on the homepage of NEINV's website and to maintain this copy of the Order on the homepage of NEINV's website for a period of six months.

17. Independent Compliance Consultant

a. NEINV shall retain, within 30 days of the date of the issuance of this Order, the services of an Independent Compliance Consultant not unacceptable to the staff of the Commission. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by NEINV. NEINV shall require the Independent Compliance Consultant to conduct one review of the NEINV compliance policies and procedures that the Independent Compliance Consultant deems relevant with respect to the publication, circulation, or distribution of performance reports;

b. At the end of the review, which in no event shall be more than three months after the date of the issuance of this Order, NEINV shall require the Independent Compliance Consultant to submit an Initial Report to NEINV and to the Commission staff. The Initial Report shall describe the review performed, the conclusions reached, and shall include any recommendations deemed necessary to make the policies and procedures adequate. NEINV may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Compliance Consultant. The Independent Compliance Consultant shall evaluate any alternative procedure proposed by NEINV. However, NEINV shall abide by the Independent Compliance Consultant's final recommendation;

c. Within six months after the date of issuance of this Order, NEINV shall, in writing, advise the Independent Compliance Consultant and the Commission staff of the recommendations it is adopting;

d. Within nine months after the date of issuance of this Order, NEINV shall require the Independent Compliance Consultant to complete its review and submit a written final report to Commission staff. The Final Report shall describe the review made of NEINV's compliance policies and procedures relating to the publication, circulation, or distribution of performance reports; set forth the conclusions reached and the recommendations made by the Independent Compliance Consultant, as well as any proposals made by NEINV; and describe how NEINV is implementing the Independent Compliance Consultant's final recommendations;

e. NEINV shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Independent Compliance Consultant's Final Report;

f. For good cause shown and upon timely application by the Independent Compliance Consultant or NEINV, the Commission's staff may extend any of the deadlines set forth in these undertakings;

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

18. NEINV shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission's staff may make reasonable requests for further evidence of compliance, and NEINV agrees to provide such evidence. The certification and supporting material shall be submitted to Kevin M. Kelcourse, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110, with a copy to the Office of the Chief Counsel of the Enforcement Division, no later than sixty days from the date of completion of the undertakings.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent NEINV cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 promulgated thereunder.

B. Respondent Giacoumakis cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 promulgated thereunder.

C. Respondent NEINV is censured.

D. Respondents shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $200,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Respondents are jointly and severally liable for all payments required to be made by this paragraph. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying New England Investment and Retirement Group, Inc. and Nicholas John Giacoumakis as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kevin M. Kelcourse, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68463 / December 18, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15138

In the Matter of **HearMe,** **Heratsi Pharmaceuticals, Inc.,** **Historic Housing for Seniors Limited Partnership,** **Historic Housing for Seniors II Limited Partnership,** **Historic Housing for Seniors III Limited Partnership,** **Homesmart.Com, Inc. (a/k/a Smart Truck Systems, Inc.), and** **House2Home, 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 HearMe, Heratsi Pharmaceuticals, Inc., Historic Housing for Seniors Limited Partnership, Historic Housing for Seniors II Limited Partnership, Historic Housing for Seniors III Limited Partnership, Homesmart.Com, Inc. (a/k/a Smart Truck Systems, Inc.), and House2Home, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. HearMe (CIK No. 1078693) is a dissolved Delaware corporation located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HearMe 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, 2010.

2. Heratsi Pharmaceuticals, Inc. (CIK No. 1363555) is a void Delaware corporation located in Foothill Ranch, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Heratsi 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, 2007, which reported a net loss of $27,026 for the prior nine months.

3. Historic Housing for Seniors Limited Partnership (CIK No. 820199) is a void Delaware corporation located in Berkeley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Historic Housing 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, which reported a net loss of over $1.6 million for the prior nine months.

4. Historic Housing for Seniors II Limited Partnership (CIK No. 835413) is a void Delaware corporation located in Berkeley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Historic Housing II 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, which reported a net loss of over $3.8 million for the prior nine months.

5. Historic Housing for Seniors III Limited Partnership (CIK No. 850961) is a void Delaware corporation located in Berkeley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Historic Housing III 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, which reported a net loss of over $2.26 million for the prior nine months.

6. Homesmart.Com, Inc. (a/k/a Smart Truck Systems, Inc.) (CIK No. 1122106) is a dissolved Colorado corporation located in Cameron Park, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Homesmart.Com 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 August 29, 2000, which reported a net loss of over $1.4 million for the year ended December 31, 1999.

7. House2Home, Inc. (CIK No. 850316) is a void Delaware corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). House2Home 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 27, 2001, which reported a net loss of over $187 million for the prior thirty-nine weeks. On November 7, 2001, the company filed a Chapter 11 petition

in the U.S. Bankruptcy Court for the Central District of California, which was terminated March 30, 2006.

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

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68456 / December 18, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15136

In the Matter of

Biremis Corporation,
Peter Beck, and
Charles Kim

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Biremis Corporation ("Biremis"), and public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Exchange Act against Peter Beck ("Beck") and Charles Kim ("Kim," and together with Biremis and Beck, the "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents Biremis, Beck, and Kim have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings[1] Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

[1] The Cease-and-Desist Proceedings are as to Biremis only.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[2] that:

Summary

1. From at least January 2007 through June 2010 (the "Relevant Period"), Respondent Biremis, a broker-dealer registered with the Commission, and Respondents Beck and Kim, Biremis' co-founders and co-owners, failed reasonably to supervise certain associated persons who were day traders and who repeatedly used Biremis' order management system to engage in a manipulative trading practice known as "layering" on U.S. securities markets. Contrary to their supervisory obligations and despite repeated indications of this practice, Biremis and its President and Chief Executive Officer Beck failed to establish procedures or a system for applying procedures that would reasonably be expected to prevent and detect the traders' manipulative trading. In addition, Beck and Biremis Vice President Kim, who had supervisory authority over the traders, both failed to respond to repeated red flags indicative of layering. Finally, Biremis failed to file Suspicious Activity Reports regarding the manipulative trading and failed to retain instant messages related to its broker-dealer business.

2. Beck and Kim operated a worldwide day trading business that contained 4,000 to 5,000 day traders in over 30 different nations (the "Overseas Traders"). The Overseas Traders were given access to many nations' securities markets, including the U.S. securities markets. Beck and Kim operated this business through Biremis and multiple affiliated corporations, all of which functioned in practice as one business (collectively, the "Biremis Business").

3. The Biremis Business exercised control over the Overseas Traders and their activities. In particular, the Biremis Business backed the Overseas Traders' trading with its own capital; determined the amount of its capital available to each individual Overseas Trader as buying power[3]; enforced daily loss limits on each Overseas Trader; monitored each Overseas Trader's profit and loss performance; and had the ability to reprimand, restrict, suspend, or terminate the Overseas Traders. The Overseas Traders were controlled by or under

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[2] 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.

[3] Within the Biremis Business, the term "buying power" was used to mean the maximum amount of the Biremis Business' capital which any given Overseas Trader could commit for orders to buy or short sell stocks at any given instant, plus the total value of long and short positions held by that Overseas Trader at that instant (marked to market in real time).

common control with the firm, and accordingly, were associated persons of a broker or dealer (*i.e.*, Biremis) within the meaning of Section 3(a)(18) of the Exchange Act.[4]

4. The Overseas Traders served as a proprietary trading force of the Biremis Business. Among other things, their trading was funded by the Biremis Business; they traded through the proprietary high-speed order management system of the Biremis Business; and they traded subject to restrictions established and enforced by the Biremis Business. Moreover, the Biremis Business received a share, generally 17%, of the profits earned by the Overseas Traders.

5. During the Relevant Period, certain of these Overseas Traders engaged in a manipulative trading strategy typically known as "layering," "spoofing," or "gaming" (hereinafter, collectively, "layering"). In general, layering occurs when a trader creates a false appearance of market activity by entering multiple non-*bona fide* orders on one side of the market, at generally increasing (or decreasing) prices, in order to move that stock's price in a direction where the trader intends to induce others to buy (or sell) at a price altered by the non-*bona fide* orders. The layering was widespread and pervasive throughout the Biremis Business. This trading by the Overseas Traders violated Exchange Act Section 9(a)(2), which at the time of the misconduct, prohibited effecting a series of transactions in any security registered on a national securities exchange with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, when done for the purpose of inducing the purchase or sale of such security by others.

6. Biremis, Beck, and Kim all failed reasonably to supervise those Overseas Traders who engaged in layering and violated Exchange Act Section 9(a)(2). Beck was responsible for establishing procedures reasonably designed to prevent and detect manipulative trading and a system for their implementation. Beck and Biremis failed to establish such procedures and systems to prevent and detect manipulative trading by the Overseas Traders. In addition, both Beck and Kim had the authority to affect the conduct of the Overseas Traders, including the authority to reduce or take away their buying power or to reprimand, restrict, suspend and terminate them. Throughout the Relevant Period, both Kim and Beck were aware of repeated red flags indicative of the manipulative trading, yet they failed to respond to those red flags. Their failure to respond to these red flags allowed the illegal conduct to continue.

7. During the Relevant Period, Biremis also failed to file Suspicious Activity Reports regarding the manipulative trading, and failed to retain instant messages related to its business as such. Accordingly, Biremis also willfully violated Exchange Act Section 17(a), which requires registered broker-dealers to make and keep certain records; Rule 17a-4(b)(4) thereunder, which requires registered broker-dealers to preserve electronic communications relating to their business as such; and Rule 17a-8 thereunder, which

[4] In relevant part, Section 3(a)(18) of the Exchange Act defines an *associated person of a broker or dealer* to mean "any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer."

requires registered broker-dealers to comply with the recordkeeping, retention, and reporting obligations of the regulations under the Bank Secrecy Act, including the requirement to file Suspicious Activity Reports to report suspicious activity conducted or attempted by, at, or through that broker-dealer.

Respondents

8. Respondent Biremis Corporation, a wholly-owned subsidiary of BRMS Holdings, Inc., a holding company, was formed as a Massachusetts corporation in 2003 and became a Canadian corporation in 2011, and an Anguillan corporation in 2012. Since 2004, it has been registered with the Commission as a U.S. broker-dealer pursuant to Section 15(b) of the Exchange Act. Biremis was run from an office located at 55 St. Clair Avenue West, 9th Floor, in Toronto, Canada. In filings with the Commission and FINRA, it listed its principal place of business at an address in Boston, but that address was a commercial business service which received and forwarded Biremis' mail to Toronto. Biremis had no employees, operations, or books or records in the United States. Through their ownership of BRMS Holdings, Inc., Peter Beck and Charles Kim owned 75% and 25% respectively of Biremis.

9. In 2008, 2010 and 2011, FINRA fined Biremis $5,000, $20,000 and $25,000 respectively (and censured it in 2010 and 2011) for failing to properly transmit order data to FINRA's Order Audit Trail System ("OATS"). In 2010, Nasdaq censured Biremis and fined it $10,000 for supervisory deficiencies concerning the prevention of erroneous orders and transactions. Also in 2010, FINRA censured Biremis and fined it $50,000 for failing to establish, maintain and enforce supervisory procedures which would have prevented it from employing for over a year and a half a Controller who was statutorily disqualified from the securities industry as a result of a Canadian criminal conviction for embezzlement. In 2011, the United Kingdom Financial Services Authority found Biremis affiliate Swift Trade, Inc. to have committed market abuse through layering on the London Stock Exchange and fined it GBP 8 million. In 2012, the Ontario Securities Commission ("OSC") found Biremis, Swift Trade, Inc. and four other securities businesses affiliated with Biremis, Beck or Beck's family trust jointly and severally liable for financial management deficiencies, trade review deficiencies, books and records violations, and non-compliance with dealer registration requirements under the Ontario Securities Act. The OSC also barred Biremis and Swift Trade from trading or acquiring securities in Ontario for six years.

10. Respondent Peter Beck is the co-founder, President, and sole director of Biremis and affiliated companies. During the Relevant Period, Beck owned 75% of BRMS Holdings, Inc., the holding company which wholly owns Biremis. Beck holds Series 24, 55, and 63 licenses. Beck, age 57, resides in Toronto, Ontario, Canada and San Jose, Costa Rica.

11. In 2002, NASD censured Beck, suspended him for 30 days, and fined him $101,000 for placing "wash" trades in the over-the-counter equities market in violation of NASD rules and Exchange Act Section 10(b) and Rule 10b-5 thereunder. In 2010, FINRA fined Beck $10,000 and suspended him for six weeks for failing to establish, maintain and enforce

supervisory procedures which would have prevented Biremis from employing for over a year and a half a Controller who was statutorily disqualified from the securities industry as a result of a Canadian criminal conviction for embezzlement. In 2009, the OSC reprimanded Beck and ordered him to pay $20,000 in costs for his acknowledgement that his non-willful lack of disclosure in OSC testimony about the beneficial ownership and effective control of Barka Co. Limited – then Swift Trade's largest customer – resulted in the OSC being misled about the actual beneficial ownership and effective control of Barka. In 2012 the OSC reprimanded Beck, barred him for two years from acting as an officer or director of a registrant, and found him jointly and severally liable with Biremis, Swift Trade, Inc. and four other securities businesses affiliated with Biremis, Beck or Beck's family trust for CAD 400,000 as a consequence of failing to supervise adequately his Chief Compliance Officer and authorizing, permitting or acquiescing in his securities-related companies' non-compliance with Ontario securities law.

12. Respondent Charles Kim is the co-founder and Vice President of Biremis and affiliated companies. During the Relevant Period, Kim owned 25% of BRMS Holdings, Inc., the holding company which wholly owns Biremis. Kim holds a Series 7 license. Kim has no prior disciplinary history. Kim, age 40, resides in Toronto, Ontario, Canada.

Background

Overview of the Biremis Business

13. During the Relevant Period, Beck and Kim ran a day-trading business, in which sole proprietors, corporations, or partnerships could open and operate trading floors with access to securities markets worldwide, including in the United States. At various times, the Biremis Business had as many as 200 different trading floors (the "Trading Floors") in over 30 nations, including Canada, Russia, Bangladesh, Nigeria, Venezuela, and Uzbekistan, with the majority of the Trading Floors located in China. None of the Trading Floors were located in the United States. Some of the individuals who owned or managed these Trading Floors ("Trading Floor Operators") had previously worked for Beck and Kim in Canada. The Trading Floor Operators recruited Overseas Traders who traded on the Trading Floors.

14. The Biremis Business was headquartered in Toronto and operated through a complex structure of multiple companies affiliated with Biremis, Beck, or Beck's family trust. Biremis served as the registered U.S. broker-dealer arm of this business through which the Overseas Traders placed orders on U.S. markets. An Ontario corporation, Swift Trade, Inc., recruited and trained the Trading Floor Operators. Another Ontario corporation, Orbixa Management Services Inc., owned and supported ProsperPro, the Biremis Business' proprietary order management system, and employed a Toronto-based staff who worked for all three companies. A Costa Rican corporation, Omira Corporation S.A., provided further software and technical support from a satellite office in San Jose, Costa Rica under the supervision of the Toronto-based staff. Although each was separately incorporated, these entities functioned as one business.

15. To open a Trading Floor, the Trading Floor Operator entered into a market access agreement with Opal Stone Financial Services, S.A., a corporation incorporated in Uruguay and domiciled in Costa Rica. In testimony before the Commission Staff, Beck, Kim, and Biremis' general counsel testified that Opal Stone was Biremis' "customer" and described Opal Stone as the broker-dealer which serviced and maintained the accounts of the Trading Floors, and held the books and records relating to the Overseas Traders. Thus, according to Biremis, the Overseas Traders were customers of Opal Stone and Opal Stone was a customer of Biremis. During the Relevant Period, Biremis routinely responded to regulatory inquiries regarding the layering activity by attributing the trading to Opal Stone and describing it as a Costa Rica based "customer" of Biremis.

16. Opal Stone, however, was incorporated at Beck's direction and was owned by a Bermuda family trust established and controlled by Beck, who was a beneficiary of the trust. Opal Stone had no employees or office of its own; its address of record was actually the address of Omira Corporation.

17. The Biremis Business, the Trading Floors, and the Overseas Traders operated as one integrated business. For example, the Trading Floor Operators as well as the staff and management of the Biremis Business frequently referred to the Trading Floors as "offices," "branches," "affiliates" or "affiliated trading floors" of the Biremis Business; the Toronto headquarters was called the "head office." They also frequently referred to themselves collectively as "the company." In correspondence with one U.S. exchange, the Biremis Business characterized the Overseas Traders as "employees" of the Biremis Business.

Biremis Controlled the Overseas Traders Who Therefore Were Associated Persons

18. Once a Trading Floor was opened, the Overseas Traders received buying power and assistance from the Biremis Business. First, although the Trading Floor Operators were required to deposit $10,000 with the Biremis Business to protect against losses, the Biremis Business provided the Trading Floors millions of dollars in buying power for U.S. markets alone. In February 2009, for example, 187 then-active Trading Floors had an aggregate buying power of $2.48 billion on U.S. markets alone.

19. Second, the Biremis Business provided the Overseas Traders with access to ProsperPro, the Biremis Business' proprietary order management system that allowed the Overseas Traders to quickly access markets in the U.S. as well as in Canada, the United Kingdom, Europe and Japan.

20. Third, the speed with which the Overseas Traders were able to trade in the U.S. markets was enhanced by means of the direct market access[5] that Biremis received from U.S. broker-dealers.

[5] Broker-dealers provide access to the trading markets in a number of ways. One way is through a "sponsored" access arrangement whereby a broker-dealer permits customers to enter orders into a trading center that bypass the broker-dealer's trading system and are routed directly to the trading center. Another way is through "direct market" access, which is an arrangement whereby a broker-dealer permits customers to enter orders into a trading center but such orders flow through the broker-dealer's trading systems prior

21. In addition, the Biremis Business worked closely with the Trading Floors in many other respects. For example, when new Trading Floors were established, Kim personally trained the Trading Floor Operators and the Biremis Business provided them a template for the layout and operation of a Trading Floor.

22. Once established, the Trading Floors received continuous support from the Biremis Business, which advised them on methods of recruiting traders, incorporated them into the Biremis Business' internal telephone, e-mail, and instant messaging systems, provided real-time technical assistance during trading sessions, communicated updates on system and market developments via instant messages, conference calls, and written "trader alerts," and periodically conducted office visits and regional conferences of Trading Floor Operators.

23. As part of this arrangement, the Biremis Business received a share – generally 17% – of the profits earned by each Trading Floor, with the remainder being divided between that floor's Trading Floor Operators and the Overseas Traders. Based on all of the above, the Overseas Traders were a proprietary trading force of the Biremis Business: they traded using capital provided by Beck and Kim; traded for the benefit of the Biremis Business; used the order management system and direct market access relationships of the Biremis Business; and were subject to the Biremis Business' rules and monitoring.

24. The Biremis Business exercised substantial, additional control over the Overseas Traders. As a condition of trading on the Trading Floors, the Biremis Business prohibited the Overseas Traders from trading for other accounts or through other order management systems. For each Overseas Trader, the Biremis Business established a unique user identification, which it used to grant, supervise and control that trader's market access, loss limits, and buying power.

25. The Biremis Business provided each Overseas Trader with buying power, often in substantial amounts. Kim determined the amount of buying power granted to each Overseas Trader, and set those amounts in ProsperPro. As a general matter, larger amounts of buying power were provided to those Overseas Traders who were most profitable, and lesser amounts to those who were not. Large amounts of buying power could facilitate layering by allowing traders to submit many non *bona fide* orders for stocks.

26. Moreover, the Biremis Business set daily loss limits for each individual Overseas Trader. Biremis Business employees, using guidelines set and enforced by Beck and Kim, determined the loss limits set for each Overseas Trader, and entered those limits into

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to reaching the trading center. On November 3, 2010, the Commission adopted Rule 15c3-5 to require brokers and dealers to utilize risk controls in connection with market access thereby eliminating the practice known as "unfiltered" access to an exchange or an ATS. See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010).

ProsperPro. The Biremis Business maintained the ability to terminate the market access of any Overseas Trader who exceeded his or her limits on any day. For example, when an Overseas Trader reached 125% of his/her loss limits, the Biremis Business began sending warnings for the trader to reduce his/her exposure; when the Overseas Trader reached 200% of his or her loss limits, the Biremis Business remotely closed out his/her trading positions.

27. Beck and Kim had final authority over Biremis Business policies regarding buying power and loss limits as well as over the buying power levels and loss limits of individual Overseas Traders. Beck and Kim also strictly enforced a policy prohibiting any Overseas Trader from holding a stock overnight. Moreover, throughout the Relevant Period, Beck, Kim, and other Biremis Business employees had the authority to reprimand, restrict, suspend or terminate Overseas Traders or entire Trading Floors for a variety of reasons.

28. Based on all of the above, the Overseas Traders were controlled by, or under common control with, Biremis, and therefore were associated persons of a broker or dealer, as defined in Section 3(a)(18) of the Exchange Act.

The Manipulative Trading

29. During the Relevant Period, certain Overseas Traders manipulated the markets for U.S. listed stocks by engaging in the practice of layering.

30. Layering uses non-*bona fide* orders (*i.e.*, orders that the trader does not intend to execute) to induce others to buy or sell a security at a price not representative of prices set by actual supply and demand.

31. Specifically, a layering trader places a *bona fide* buy (or sell) order that he/she desires to be executed at an advantageous price, and also enters multiple non-*bona fide* limit sell (or buy) orders for the purpose of attracting interest to the *bona fide* order. The non-*bona fide* orders are placed on the opposite side of the market at decreasing (or increasing) prices with the intent of lowering (or raising) the price at which the layering trader buys (or sells).

32. Thus, this strategy creates a false picture of the pricing of, and/or demand for, a stock in order to induce, or trick, other market participants, often those using algorithmic[6] trading platforms, to execute against the layering trader's *bona fide* order. Immediately after the

[6] A trading algorithm is a set of computer instructions incorporating steps required to trade according to a certain strategy or to execute orders according to certain guidelines. Trading algorithms function by interpreting near-instantaneous streams of trading data – including the prices and quantities of bids, asks, and executions for stocks. Using pre-programmed criteria, algorithms evaluate such data within fractions of a second in order to ascertain market trends. Some algorithms are programmed to identify market trends and immediately submit orders designed to profit from those trends before the algorithm's time advantage over other market participants disappears. Other algorithms are programmed to identify a means for executing orders within optimal price ranges or timeframes. The specific workings of each algorithm differ according to the criteria and objectives dictated by its programmer. Orders submitted by algorithms are often known as "programmed orders."

execution of the *bona fide* order, the layering trader cancels the open, non-*bona fide* orders, which were intended only to temporarily alter the market prices and/or displayed liquidity for the stock. Often, the layering trader then repeats this strategy on the opposite side of the market to close out the position.

33. Throughout the Relevant Period, hundreds of Overseas Traders on at least ten different Trading Floors associated with Biremis engaged repeatedly in layering manipulations on U.S. securities markets. Such traders induced other market participants to trade in certain securities by placing layers of orders in those securities with the purpose of having those non-*bona fide* orders alter the national best bid and offer ("NBBO") of the securities and alter the displayed liquidity in the securities. These orders sent false signals regarding the supply and demand for such securities, which other market participants misinterpreted as reflecting true supply and demand. Thus, the Overseas Traders' deceptive orders were intended to induce, and did induce, other market participants into buying (or selling) stocks from (or to) the Overseas Traders at prices that had been artificially raised (or lowered) to the advantage of the Overseas traders.

Example of Layering by an Overseas Trader

34. The layering activity is illustrated by the activity of an Overseas Trader, who traded using the Biremis Business user identification "FUFUZENG." This individual traded on one of three Trading Floors established in Asia by a Trading Floor Operator who had previously traded for Beck and Kim in Canada. These Trading Floors were among the most profitable in the Biremis Business and repeatedly engaged in layering throughout the Relevant Period. On September 4, 2008, this trader layered the stock of Colonial Properties Trust (NYSE: "CLP").

35. That day, as of 11:00:58 a.m., the National Best Offer ("inside ask") for CLP was $19.19 and the National Best Bid ("inside bid") was $19.15. At that moment, the trader began placing orders to sell CLP shares. Over the next 31 seconds, the trader submitted 28 consecutive orders to NASDAQ (OUCH), NASDAQ (RASH), a dark pool operated by a broker-dealer, and NYSE, each to sell 100 shares of CLP at prices successively decreasing from $19.21 to $19.13. In addition, the trader periodically interspersed the 100-share orders with seven other sell orders submitted to NASDAQ (RASH), each for 14,000 shares at several cents above the prevailing inside ask. These 14,000-share "pressure orders" falsely signaled to the marketplace that – in addition to the 100-share sell orders near the prevailing inside ask – there was additional and substantial interest in selling the stock at price levels above the prevailing inside ask. When viewed in combination with other displayed orders, the "pressure orders" created the appearance of a liquidity imbalance, *i.e.*, a substantial difference between the quantities of shares demanded for purchase and the quantities offered for sale

36. By 11:01:29 a.m., as a result of these orders, the inside ask declined seven cents to $19.12. Then the trader switched sides, placing a buy order on NYSE for 3,800 CLP shares at $19.12. After receiving an execution for this order, the trader then cancelled all 35 of the

sell orders within eleven seconds. By 11:01:42 a.m., the inside bid reverted to $19.14 and the inside ask reverted to $19.17.

37. Less than a second after submitting his last cancellation, the trader switched sides, conducting the manipulation in reverse. At 11:01:42 a.m., with the inside bid for CLP at $19.14 and the inside ask at $19.17, the trader submitted 57 buy orders, each for 100 shares, at prices that successively rose from $19.08 to $19.19 over the course of 47 seconds. As before, the trader submitted these orders among NASDAQ (OUCH), NASDAQ (RASH), a dark pool operated by a broker-dealer, and NYSE. Again, as the trader pushed the inside bid up, he also interspersed his 100-share buy orders with nine pressure orders each to buy 10,200 or 10,300 shares, each at a price several cents below the prevailing inside bid.

38. As the trader submitted the last of these orders, the inside bid for CLP had risen to $19.19 and the inside ask stood at $19.22. Then, within four seconds, the trader entered an order to sell 3,800 shares of CLP at the elevated price of $19.19, which immediately executed. Within twenty-two seconds of this sale, the trader then cancelled the open buy orders that were still outstanding. Twenty seconds later, the inside bid reverted to $19.08 and the inside ask reverted to $19.13.

39. In total, the trader submitted 35 sell orders, demonstrating substantial selling interest and depressing CLP's price from $19.19 to $19.12, before buying 3,800 shares of CLP and cancelling all of his non-*bona fide* sell orders. Then the trader submitted 57 buy orders while inflating CLP's price from $19.14 to $19.19 before selling 3,800 shares, and cancelling his open non-*bona fide* buy orders. For this series of transactions, the trader made $266 of illicit profits (excluding commissions or fees) in two minutes and 35 seconds.

40. Over the next few minutes, the trader repeated this process several more times. In each instance, the trader submitted a series of non-*bona fide* orders at ascending (or descending) prices on one side of the market, causing the stock's price to move in the direction of the non-*bona fide* orders. In each instance, the trader then obtained an execution on the opposite side of the market at the altered price, before cancelling the initial market-moving orders.

41. Notably, each time the trader submitted a series of non-*bona fide* orders on one side of the market, the trader drove the inside bid up (or the inside ask down). In addition, when viewed in combination with other displayed orders, the pressure orders created the appearance of a liquidity imbalance. Market participants that use trading algorithms often program their algorithms to react to such market signals.

The Overseas Traders' Layering Violated Exchange Act Section 9(a)(2)

42. The Layering by the Overseas Traders violated Section 9(a)(2) of the Exchange Act, which forbids any person "[t]o effect, alone or with one or more other persons, a series of transactions in any security . . . creating actual or apparent active trading in such security,

or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

43. In the example above, the Overseas Trader's non-*bona fide* orders created actual or apparent active trading in the security. For example, in the first instance, the trader submitted and cancelled 35 sell orders within 42 seconds, representing non-*bona fide* offers to sell 86,900 shares. In the second instance, the trader submitted 66 buy orders within 58 seconds, representing non-*bona fide* offers to buy 95,500 shares. The trader's non-*bona fide* orders also altered the price of the security, first depressing its inside ask from $19.19 to $19.12, and then inflating its inside bid from $19.14 to $19.19.

44. The Overseas Trader's intent to induce others to trade at disadvantaged prices is evident from his repeated submission of orders at rising (or declining) prices, his opportunistic executions on the opposite side of the market after these non-*bona fide* orders had altered the stock's price to his advantage, and his prompt cancellation of the non-*bona fide* orders before they could be executed. The trader's intent to induce market participants using algorithmic platforms is also evident in his usage of 100-share orders interspersed with pressure orders for much higher share quantities at prices several cents away from the inside bid or inside ask in order to induce the purchase or sale of securities by others who used trading algorithms that focus on changes to the NBBO or liquidity imbalances.

Biremis, Peter Beck, and Charles Kim Failed Reasonably to Supervise the Overseas Traders' With a View to Preventing the Layering Manipulations

45. Although the Biremis Business was capable of monitoring the trading of each Overseas Trader, it generally lacked adequate anti-manipulation surveillance systems or procedures, and specifically lacked any systems or procedures to detect or prevent the layering trading on U.S. markets, which violated Section 9(a)(2) of the Exchange Act. Moreover, the compliance staff of the Biremis Business lacked the training or experience to identify manipulative trading patterns and was ineffective in detecting or investigating instances of suspected manipulation.

46. For example, the Biremis Business had several automated trading reports purportedly intended to detect illegal trading, such as wash trading or collusive trading. In practice, however, review of such reports was not consistently conducted, and was assigned to junior personnel who lacked the training or experience to understand the trading patterns they reviewed, and were ineffective in following up on their findings.

47. In 2009, the Biremis Business implemented a surveillance system for the purpose of detecting layering by reviewing for excessive quantities of cancelled orders. However, this system was implemented only for orders that the Biremis Business submitted to non-U.S. exchanges, such as Toronto, London or Tokyo. Biremis did not use this system to monitor for layering on U.S. markets until mid-2010, despite the fact that trades on U.S. markets accounted for approximately two-thirds of its gross trading revenues.

48. Beck was responsible for establishing supervisory procedures and systems for their implementation that were reasonably designed to prevent and detect manipulative layering on U.S. markets. Beck failed reasonably to establish such procedures and systems. If he had developed such supervisory procedures and systems, it is likely that Biremis and Beck would have prevented and detected the violations of Section 9(a)(2) by the Overseas Traders.

49. Beck and Kim also had the authority to affect the conduct of the Overseas Traders, including the authority to reprimand, restrict, suspend and terminate the Overseas Traders. For example, Kim was responsible for determining the amount of buying power allocated to each Overseas Trader, based on factors such as that trader's profitability. Moreover, as described below, Kim frequently communicated with the Trading Floor Operators concerning the Overseas Traders' activities and provided instruction to them concerning their trading activities.

50. Throughout the Relevant Period, Beck and Kim were aware of repeated red flags indicating that certain of the Overseas Traders were engaged in layering in securities on U.S. markets and that such trading might violate the federal securities laws. Notwithstanding their awareness of these red flags, Beck and Kim did not respond adequately to them.

51. For example, as early as September 2006, a U.S. broker-dealer which provided direct market access to Biremis explicitly informed Beck in writing that an Overseas Trader was layering on U.S. markets and that such trading violated anti-manipulation provisions of the federal securities laws.

52. In response to this broker-dealer's complaints, the Biremis Business prepared in September 2006 a "Trader Alert" entitled "Price Manipulation," which advised that orders intended to "influence other market participants to buy or sell" and "posting orders with no intent of having them filled constitutes market manipulation." However, the Biremis Business only disseminated this Trader Alert among its personnel in its Toronto head office, and not to the Trading Floor Operators or Overseas Traders.

53. Beck and Kim were aware that certain of the Overseas Traders used a strategy that involved submitting non-*bona fide* orders (and subsequently cancelling them) in order to induce market participants who operated algorithmic trading platforms to trade. In testimony before the Commission Staff, Kim admitted that he had been aware that Overseas Traders associated with Biremis submitted orders in order to get other market participants using trading algorithms to react to those orders.

54. In April and May 2007, the Trading Floor Operator who owned three frequently layering Trading Floors (including the Trading Floor described in paragraph 34), sent Beck and Kim multiple e-mails in which he described how certain Overseas Traders on those Trading Floors traded against orders (commonly called "programmed orders") submitted by market participants using trading algorithms.

55. In particular, this Trading Floor Operator wrote of the traders' strategy to "make money from those stupid programmed orders." The Trading Floor Operator admitted that many of the traders on his Trading Floors "place orders to close the spread," meaning that they placed orders to raise the inside bid or lower the inside ask, thereby narrowing (or "closing") the spread between the bid and ask prices.

56. This Trading Floor Operator further explained that the traders "use[d] small-size orders . . . to test the programmed orders" and described the importance of using a computer keyboard shortcut to immediately cancel non-*bona fide* orders before those orders could be executed. This "mass cancellation" function was a feature of ProsperPro, the Biremis Business' proprietary order management system.

57. Beck and Kim were also aware that certain Overseas Traders searched for "hidden liquidity" - *i.e.*, stocks that other parties sought to trade in dark pools[7] – using a feature of the ProsperPro system known as the "Scanner." The Scanner automatically submitted orders sequentially for each of hundreds of stock ticker symbols until an execution for one of those symbols signaled another party's interest in that stock.

58. On three occasions over the course of 2007, a second U.S. broker-dealer explicitly warned Beck that the broker-dealer's internal surveillance tool had detected suspicious trading activity from Biremis. Specifically, the broker-dealer's "anti-gaming" tool had detected instances in which orders from Biremis obtained executions in that broker-dealer's dark pool at prices favorable to Biremis shortly after the stock price had abruptly risen or declined in the open market. After the third such instance, the broker-dealer terminated Biremis' access to its dark pool.

59. In January 2008, Biremis admitted to this broker-dealer that operators of other U.S. trading facilities (*i.e.*, exchanges, dark pools, or electronic communications networks) had previously conveyed to Beck that certain of the Overseas Traders used trading strategies deemed unsuitable by those facilities.

60. Over the course of the spring of 2008, a third U.S. broker-dealer warned Beck and Kim that certain of the Overseas Traders were "gaming" U.S. stocks by moving those stocks' "NBBO up or down" in order to "buy or sell the stock at the disadvantaged price." This broker-dealer provided Biremis with access to multiple dark pools, which Biremis made available to its Overseas Traders. As a result of complaints from other U.S. trading facilities, this broker-dealer attempted to implement several restrictions intended specifically for Biremis' Overseas Traders. These restrictions included minimum share quantities for orders, as well as restrictions on the Overseas Traders' access to the complaining trading facilities. This broker-dealer informed Beck and Kim of these restrictions and the reasons for imposing them.

[7] Dark pools are a type of alternative trading system. They are essentially private trading systems in which participants can transact their trades without displaying quotations to the public. The largest dark pools are sponsored by securities firms often to execute the orders of customers as well as proprietary orders of the firms.

61. Notwithstanding these restrictions, the layering manipulations by the Overseas Traders continued. In July 2008, this broker-dealer made additional complaints in an e-mail to Kim and Biremis' trade desk director, noting that Overseas Traders associated with Biremis would frequently "[r]un up the stock, then short it in the DarkPool, then let it roll over." Kim relayed these complaints to Beck.

62. Some of these complaints related to another frequently layering Trading Floor. This Trading Floor was also among the most profitable in the Biremis Business and was established by another individual who had formerly traded for Beck and Kim in Canada. In response to these complaints, that Trading Floor Operator e-mailed Kim and Biremis' trade desk director, noting that the trader "started buying the stock at around 7.39/7.40 and raised the stock until 7.49 where he sold." Kim relayed this information to Beck.

63. Despite these red flags, Kim e-mailed Trading Floor Operators, relaying the view that, although layering was illegal on certain foreign markets, it was legal on U.S. markets. For example, in September 2008, Kim e-mailed one Trading Floor Operator, writing, "the [London Stock Exchange] laws are very strict about any type of gaming on their markets. For example, you cannot put in bids/offers and cancel them like we do on U.S. markets."

64. In March 2009, Biremis' trade desk director prepared a "Compliance Guide Book" and shared it with Kim. The Guide Book expressly: described the layering strategy used by certain of the Overseas Traders to "influence or trick computer programs into taking action"; noted these strategies were "manipulative in nature"; and further noted that this conduct constituted market manipulation in violation of U.S. securities laws.

65. In August 2009, Biremis' newly-installed Chief Compliance Officer prepared and shared with Beck a proposal for Biremis to filter its trading data for suspicious trading patterns, including layering. This document again described the layering conduct and identified several "high risk" Trading Floors frequently engaging in layering (including the Trading Floors described in paragraphs 34 and 62).

66. Also in August 2009, that Chief Compliance Officer requested a meeting with Beck and Kim to discuss several frequently layering Trading Floors, warning Beck and Kim that "most [Trading Floor Operators] seem to think we pay [compliance] only lip service." About three hours later, the Chief Compliance Officer e-mailed Beck a list of Trading Floors that frequently engaged in layering (including the Trading Floors described in paragraph 34). About one hour later, Kim e-mailed the Trading Floor Operators, informing them that their access to numerous non-U.S. markets was immediately terminated as a result of regulatory complaints. Nonetheless, Kim's e-mail specifically told these Trading Floors that they would be able to continue trading on U.S. markets. Consequently, Overseas Traders continued to layer on U.S. markets until June 2010.

67. In September 2009, Kim again e-mailed a Trading Floor Operator telling him that layering was legal on U.S. markets by saying "[t]here are many things that you can do on American

markets that you CANNOT do on the [Toronto Stock Exchange]. For example, pushing stocks or bidding and offering stocks and canceling your orders is a no-no."

68. As noted herein, Beck and Kim had the authority to restrict or terminate the access of the Overseas Traders to U.S. markets for, among other things, regulatory infractions. However, notwithstanding the above-discussed red flags, Beck and Kim failed to follow-up on these red flags and failed to take any steps to prevent and detect manipulative layering by the Overseas Traders in securities on U.S. markets. In addition, Beck established neither any procedures nor any system to implement procedures reasonably designed to prevent and detect the manipulative layering by the Overseas Traders on U.S. markets between January 2007 and June 2010. If Beck and Kim had followed-up on the red flags of suspicious trading by the Overseas Traders and if Beck had established reasonable procedures and systems, it is likely that Biremis, Beck and Kim would have prevented and detected the violations of Section 9(a)(2) by the Overseas Traders.

Biremis Failed to File Suspicious Activity Reports for Any of the Layering Incidents

69. In April 2002, Congress passed and President Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act" or "Patriot Act"). The Patriot Act amended provisions of the Bank Secrecy Act[8] ("BSA") and substantially expanded a broker-dealer's obligations to detect and prevent money laundering. Exchange Act Section 17 and Rule 17a-8 thereunder require broker-dealers to comply with the recordkeeping, record retention, and reporting obligations of the BSA and the regulations thereunder. These regulations mandate, among other things, that broker-dealers report suspicious transactions by filing a Suspicious Activity Report ("SAR") with the Financial Crimes Enforcement Network ("FinCEN") to report any transaction (or a pattern of transactions of which the transaction is a part) involving or aggregating funds or other assets of at least $5,000 that it "knows, suspects, or has reason to suspect": (1) involves funds derived from illegal activity or is conducted to disguise funds derived from illegal activities; (2) is designed to evade any requirements of the BSA; (3) has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity. [9]

70. The failure to file a SAR as required by these regulations is a violation of Exchange Act Section 17(a) and Rule 17a-8 thereunder. Despite red flags alerting Biremis personnel that the layering activity lacked an apparent lawful purpose, Biremis failed to file a single SAR for the layering activity during the Relevant Period, thereby contravening its own written compliance policies.

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[8] The Bank Secrecy Act is the name commonly used for the Currency and Financial Transactions Reporting Act of 1970, 12 U.S.C. § 1829b, 12 U.S.C. §§ 1951-1959, and 31 U.S.C. §§ 5311-5330.

[9] 31 C.F.R. 1023.320(a)(2).

71. In addition, on at least three instances in 2008, Biremis failed to report that certain Overseas Traders engaged in apparent wash trades and/or matched orders involving shares valued at millions of dollars. On February 13, 2008, certain Overseas Traders transacted over 60 percent of that day's volume in Papa John's International Inc. (NASDAQ: "PZZA"), including 404 trades between certain Overseas Traders. Using PZZA's lowest share price that day, the aggregate value of this activity was $16.8 million. Also, on April 2, 2008, the Biremis Business accounted for 63 percent of that day's volume in Associated Estates Realty Corp. (NYSE: "AEC"), including 865 trades solely between Overseas Traders. The value of AEC shares traded by the Overseas Traders that day was approximately $7.9 million. Likewise, on June 5, 2008, certain Overseas Traders transacted over 16 percent of that day's volume in Jo-Ann Stores, Inc. (NYSE: "JAS"), including 236 trades between certain Overseas Traders, representing approximately $57.2 million. No SAR was filed in any of these in instances, a violation of Exchange Act Section 17(a) and Rule 17a-8 thereunder.

72. Moreover, Biremis' "Anti-Money Laundering Compliance Program," dated July 1, 2004 and in effect throughout the Relevant Period, called for Biremis to "monitor account activity for unusual size, volume, pattern or type of transactions" and to file a SAR for any suspicious activity conducted or attempted through the Biremis Business and involving or aggregating $5,000 or more if the activity lacked a "business or apparent lawful purpose." By failing to do so, Biremis failed to document accurately its Anti-Money Laundering Compliance Program in violation of Exchange Act Section 17(a) and Rule 17a-8 thereunder.

Biremis Failed to Preserve Instant Message Communications Related to its Business As Such

73. Under Exchange Act Rule 17a-4(b)(4), registered broker-dealers are required to preserve "originals of all communications received and copies of all communications sent (and any approvals thereof) by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the member, broker or dealer is a member regarding communications with the public."

74. In April 2010 and February 2011, Biremis received subpoenas from the Commission Staff requiring the firm to produce instant messages of persons associated with Biremis, including Trading Floor Operators and Biremis Business officers and employees during the Relevant Period. Apart from incomplete instant message collections backed up by a handful of persons on their own initiative, Biremis was unable to produce the required records because it had never configured its instant messaging system to preserve instant messages.

75. The instant message system played a central role in the operation of the Biremis Business. Each Trading Floor received access to it, enabling instant communications with the Biremis Business head office as well as with the other Trading Floors. The Biremis Business required Trading Floor Operators to monitor this system throughout trading

sessions, including so that they could be alerted of any Overseas Trader who exceeded his/her daily loss limits. The Trading Floors used the instant message system to ask questions of the Biremis Business head office or to inform it of system problems, such as outages, stock quotations that were not updating, or orders that were not being filled.

76. The instant message system enabled the Biremis Business head office to promptly support, and to simultaneously communicate with, all the Trading Floors. One former Biremis Business officer estimated that ninety percent of all Biremis Business communications took place on this system. Another stated that without the system, the Biremis Business could never have grown as it did to approximately 200 Trading Floors worldwide.

77. The few instant messages produced to the Commission Staff confirm that Biremis used this instant message system to communicate with the Trading Floors about its operations on U.S. markets. For example, Biremis used instant messaging to address technical problems affecting the traders' ability to trade (*e.g.*, slow execution speeds, outages, or inability to view quotations). Biremis also used instant messaging to update the Trading Floors regarding market developments such as U.S. markets declaring self-help under Regulation NMS or issues affecting specific U.S. stocks. Thus, the instant message communications related to Biremis' broker-dealer business as such.

<u>Violations</u>

78. Exchange Act Section 15(b)(4)(E) provides for the imposition of sanctions against a broker or dealer who "has failed reasonably to supervise, with a view to preventing violations of the [federal securities laws], another person who commits such a violation, if such other person is subject to his supervision." Section 15(b)(6) incorporates by reference Section 15(b)(4)(E) and allows for the imposition of sanctions against persons associated with a broker or dealer for failing reasonably to supervise.

79. Biremis was responsible for supervising the Overseas Traders, who were directly or indirectly controlled by, or under common control with, Biremis, and thus were associated persons of the firm. The Commission has emphasized that a broker-dealer's responsibility to supervise persons subject to its supervision by means of effective, established procedures "is a critical component in the federal investor protection scheme regulating the securities markets." *See e.g.*, *Dean Witter Reynolds, Inc.*, Exchange Act Release No. 46578 (October 1, 2002).

80. Notwithstanding its obligation to supervise the Overseas Traders and despite repeated red flags indicating that certain Overseas Traders were engaged in manipulative layering trades, Biremis failed throughout the Relevant Period to implement procedures, or a system for applying procedures, to detect and prevent the Overseas Traders' violations of Exchange Act Section 9(a)(2). Thus, Biremis failed reasonably to supervise the Overseas Traders with a view to preventing their market manipulation.

81. Beck had the authority and responsibility for developing Biremis' supervisory procedures and a system to implement such procedures. Beck failed reasonably to supervise the

Overseas Traders because he failed to ensure that Biremis had procedures, as well as a system to implement procedures, to prevent and detect manipulative trading by the Overseas Traders in violation of Exchange Act Section 9(a)(2).

82. Beck had the responsibility, ability, and authority to affect the conduct of the Overseas Traders, including the authority to reprimand, restrict, suspend, and terminate them. He also failed reasonably to supervise the Overseas Traders because he failed to respond to red flags, as described above, that should have alerted him to the Overseas Traders' repeated layering manipulations in violation of Section 9(a)(2) of the Exchange Act. "The supervisory obligations imposed by the federal securities laws require a vigorous response even to indications of wrongdoing." *In the Matter of John H. Gutfreund, et al.*, 51 S.E.C. 93, 108, Exchange Act Release No. 31554 (Dec. 3, 1992). "In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention . . . Red flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review. When indications of impropriety reach the attention of those in authority, they must act decisively to detect and prevent violations of the federal securities laws." *See, e.g., In the Matter of Edwin Kantor*, 51 S.E.C. 440, 447 Exchange Act Release No. 32341 (May 20, 1993) (internal quotations omitted). If Beck had responded reasonably to the red flags of layering by the Overseas Traders, he could have prevented and detected the Overseas Traders' violations of Section 9(a)(2) of the Exchange Act.

83. Kim possessed and exercised supervisory authority over the Overseas Traders in his conduct of his duties at Biremis Business. "[D]etermining if a particular person is a 'supervisor' depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." *Gutfreund* at 113, Exchange Act Release No. 31554 (Dec. 3, 1992).

84. Kim had the responsibility, ability or authority to affect the conduct of the Overseas Traders in that he had final discretion over each Overseas Trader's amount of buying power, as well as the power to terminate or restrict their access to Biremis' order management system. Kim also had the authority to restrict, suspend and terminate the access of the Overseas Traders. Kim also helped establish the Trading Floors on which the Overseas Traders traded, trained the Trading Floor Operators using the Biremis Business' template for trading floor setup and operation, and misinformed those Trading Floor Operators that layering strategies were legal on U.S. markets. Kim failed reasonably to supervise the Overseas Traders, in that he failed to respond to the red flags that should have alerted him to the Overseas Traders' repeated layering manipulations in violation of Section 9(a)(2) of the Exchange Act.

85. Biremis also willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder which require registered brokers and dealers to comply with the reporting, recordkeeping and record retention requirements of the rules promulgated under the BSA, by failing to file Suspicious Activity Reports reporting the Overseas Traders' layering manipulations and the wash trades and/or matched orders among certain of the Overseas

Traders, and by failing to document accurately its Anti-Money Laundering Compliance Program.

86. Biremis also willfully violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder which require registered brokers and dealers to make, keep current, and furnish to the Commission such records as the Commission proscribes by rule, by failing to retain instant messages relating to its business as such.

IV.

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

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

A. Pursuant to Section 21C of the Exchange Act, Respondent Biremis shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rules 17a-4(b)(4) and 17a-8 thereunder.

B. Pursuant to Section 15(b)(4) of the Exchange Act, the broker-dealer registration of Respondent Biremis shall be, and hereby is, revoked.

C. Pursuant to Section 15(b)(6) of the Exchange Act, Respondents Beck and Kim shall be, and hereby are:

> 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.

D. Any reapplication for association by a 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 Peter Beck shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $250,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

> (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
> (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
> (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
>
> > Enterprise Services Center
> > Accounts Receivable Branch
> > HQ Bldg., Room 181, AMZ-341
> > 6500 South MacArthur Boulevard
> > Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Peter Beck as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Ms. Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5720.

F. Respondent Charles Kim shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $250,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

> (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
> (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
> (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
>
> > Enterprise Services Center
> > Accounts Receivable Branch
> > HQ Bldg., Room 181, AMZ-341
> > 6500 South MacArthur Boulevard
> > Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Charles Kim as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Ms. Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5720.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3519 / December 19, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30308 / December 19, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15139

In the Matter of **CLAYMORE ADVISORS, LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 9(f) 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 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Claymore Advisors, LLC ("Respondent" or "Claymore").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940 and Section 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise from the collapse of the Fiduciary/Claymore Dynamic Equity Fund ("HCE" or "the Fund"), a registered closed-end investment company. From April 2007 through October 2008, HCE engaged in derivative strategies to supplement the Fund's covered call investment strategy. Specifically, HCE wrote out-of-the-money S&P 500 put options and entered into short variance swaps, which exposed the Fund to substantial losses in the event of a steep market decline or spikes in market volatility. HCE failed to include adequate disclosure about the principal risks to the Fund arising from the Fund's use of written put options and variance swaps, either in its annual report or in an amended Fund registration statement. In September and October 2008, HCE realized an approximately $45.4 million loss, or 45% of the Fund's net assets as of the end of August 2008, on five written put options and variance swaps, contributing to a 72.4% two-month decline in the Fund's net asset value ("NAV"). In its role as HCE's investment adviser and fund administrator, Claymore failed reasonably to supervise the Fund's sub-adviser, Fiduciary Asset Management, LLC ("FAMCO"), which utilized strategies and exposed the Fund to risks that were not adequately disclosed.

Respondent

2. Claymore Advisors, LLC is a Delaware limited liability company based in Lisle, Illinois which provides portfolio management services to investment companies. Claymore, which has been registered with the Commission as an investment adviser since 2003, served as HCE's investment adviser from the Fund's inception in April 2005 until its liquidation in 2009 and as HCE's fund administrator from 2006 through 2009. In October 2009, after the conduct at issue and described in this Order, Claymore was acquired by a third party and, in September 2010, changed its name to Guggenheim Funds Investment Advisors, LLC.

Other Relevant Entities

3. Fiduciary/Claymore Dynamic Equity Fund was a closed-end investment company organized in April 2005. HCE's shares were offered to the investing public pursuant to a registration statement filed with the Commission in April 2005. HCE regularly filed periodic reports with the Commission pursuant to the requirements of the Investment Company Act. The Fund was liquidated in May 2009.

4. Fiduciary Asset Management, LLC was a Missouri limited liability company based in St. Louis, Missouri, and is now a Delaware entity based in St. Louis. FAMCO has been registered with the Commission as an investment adviser since 1994, and provides portfolio management services for individuals, businesses, institutional clients, and investment

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

companies. FAMCO served as sub-adviser to HCE from the Fund's inception in April 2005 until its liquidation in 2009.

Background

5. HCE informed investors in its April 2005 registration statement that its primary investment strategy was to invest in equities and write call options on a substantial portion of those equities. This strategy is commonly referred to as a covered call strategy. Covered call strategies trade upside potential in the equities held in the portfolio for current income from option premiums received. HCE informed investors in its periodic reports that HCE's covered call strategy had the potential to protect the Fund in a downward trending market. Claymore marketed HCE as a high income fund and the Fund disclosed to investors a goal of paying an annual dividend equal to an 8.5% yield on the Fund's initial public offering price.

6. Claymore provided advisory services to HCE pursuant to an investment advisory agreement. Claymore was responsible for, among other things, supervising and managing the investment of HCE's assets, investment program, and portfolio composition. The advisory agreement permitted delegation of Claymore's duties, but stated that "no such delegation shall relieve the Adviser from its duties and obligations of management and supervision of the management of [HCE's] assets . . . ." Claymore's fund policies and procedures manual also required Claymore to oversee and monitor the services of sub-advisers, including those affecting the Fund's portfolio management and compliance with the securities laws. Claymore's advisory policies and procedures stated that Claymore was also responsible for other Fund-wide investment management decisions such as those involving the use of leverage and hedging strategies.

7. Claymore also served as HCE's fund administrator and was responsible for managing the preparation, filing, and distribution of HCE's periodic reports and for monitoring HCE's portfolio on a post-trade basis for compliance with HCE's registration statement.

8. According to Claymore's fund policies and procedures manual, Claymore, in conjunction with HCE's counsel, was responsible for preparing and filing HCE's registration statement. Claymore, in consultation with outside counsel, also was charged with ensuring that HCE's registration statement was supplemented with additional disclosure as necessary if there were material changes to the Fund's investment policies and principal risks.

9. Claymore delegated certain of its advisory responsibilities to FAMCO through a sub-advisory agreement. The sub-advisory agreement provided that FAMCO would manage HCE's investment portfolio, subject to Claymore's oversight and supervision. The sub-advisory agreement required FAMCO to manage the Fund in accordance with HCE's investment objective, policies, and restrictions as stated in the Fund's registration statement. FAMCO designated two of its employees as co-portfolio managers.

HCE's Put Option and Variance Swap Strategies

10. Beginning in April 2007 and continuing through October 2008, FAMCO employed two new strategies to supplement HCE's income and support the Fund's dividend.

During this period, HCE wrote short-duration, out-of-the-money S&P 500 put options and entered into short variance swaps.

11. When HCE wrote put options, it collected a premium from the purchaser of the option, and in exchange agreed to compensate the purchaser for any declines in the S&P 500 beyond the "strike price" of the option. HCE typically wrote put options with one- or two-month expirations, and with strike prices between 6% and 10% below the S&P 500's level at the time the options were written.[2] As a result, HCE would profit most of the time with this strategy by the amount of its premium and would lose money on its options when the S&P 500 declined past the option strike price in the one- or two-month option period.

12. Throughout 2008, the notional exposures on put options that HCE wrote ranged from 60% to 140% of the Fund's NAV.[3] Each month HCE wrote put options during 2008, the Fund collected between $500,000 to $1.4 million in premiums, which significantly increased the Fund's return each time the options expired out-of-the-money. Between April 2007 and August 2008, HCE collected $9.6 million in premiums from written put options.

13. Variance swaps are essentially wagers on whether actual or realized market volatility will be higher or lower than the market's expectation for volatility (or "implied volatility"). A party with a "long variance" position profits if realized volatility for the contract period is more than implied volatility. A party with a "short variance" position profits if realized volatility is less than implied volatility.

14. HCE began trading short variance swaps in July 2007. HCE had written put options and short variance swaps in its portfolio at nearly all times from July 2007 through October 2008. The only significant hiatus from using those products was a two-month period from April to June 2008.

15. In 2007 and/or early 2008, FAMCO had discussions with Claymore regarding its intended use of written put options and variance swaps, and Claymore personnel were aware that FAMCO was trading those products. Claymore also monitored HCE's portfolio on a daily basis and saw FAMCO's trading activity in those strategies.

16. FAMCO's use of written put options and variance swaps was of a magnitude and frequency that significantly affected HCE's performance and changed the Fund's risk profile. FAMCO's internal documents projected that writing put options and trading short variance swaps each could add hundreds of basis points to return each year, so long as there were no significant market disruptions. On the other hand, HCE had leveraged exposure to market declines and volatility and was exposed to massive potential losses if the S&P 500 declined rapidly or became very volatile. By engaging in these strategies, FAMCO changed HCE from a fund that provided some downside protection, to one with magnified downside exposure.

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[2] The amount by which the option's strike price is below the current price is commonly referred to as the amount by which the option is "out-of-the-money."

[3] An option's notional exposure is the amount of maximum loss exposure on the option that would be realized in the event that the underlying referenced security or index, in this case the S&P 500, were to decline to 0.

17. HCE's written put options and variance swaps were profitable in 2007 and through August 2008. For HCE's fiscal year ended November 30, 2007, written put options added approximately 2.0% to HCE's NAV growth, while short variance swaps affected NAV growth by approximately -0.4%. For the six months ending May 31, 2008, written put options and short variance swaps added approximately 2.1% and 0.8% to the Fund's return, respectively.

HCE's Collapse in the Fall of 2008

18. FAMCO continued to write put options and enter into short variance swaps throughout the summer of 2008. In late August 2008, HCE wrote two two-month, 10% out-of-the-money put options with a $139 million total notional exposure, which equated to 136% of the Fund's NAV, as of August 28, 2008. HCE also entered into one one-month short variance swap in August 2008, further exposing the Fund to a market shock. FAMCO internally estimated HCE's August 2008 written put option position to have a loss exposure of $17,630,000, or approximately 17.5% of the Fund's value, as of the end of August.

19. Beginning in early September 2008, the financial markets began declining rapidly and became very volatile. On September 19, 2008, HCE settled its expiring one-month variance swap position at a $7,025,454 loss.

20. As of September 19, HCE also had an unrealized $1.25 million loss on its written put options, and FAMCO's internal estimate of HCE's exposure on those options had grown to $39.7 million, or 44% of the Fund's NAV as of September 19, 2008. FAMCO subsequently entered into two additional one-month short variance swaps on September 19, 2008. During this period of time, the marketplace became increasingly volatile and these positions suffered additional losses.

21. In mid-September, Claymore became aware of the losses in HCE's portfolio and of the new variance swap trades on September 19 through its monitoring of the portfolio. At that time, Claymore did not take sufficient actions to assess the risks to the portfolio going forward, or to understand the significance of those positions to HCE's portfolio.

22. The markets continued to decline with increased volatility in late September and October 2008. Claymore continued monitoring HCE's portfolio on a daily basis as losses increased throughout September and October, but did not take sufficient action to limit the risks or losses from put options and variance swaps. HCE covered its two written put positions in early October at a $15,527,300 loss. HCE lost $22,844,124 on its two variance swaps that expired in October 2008, in addition to its $7,025,454 loss on its variance swap position that expired in September 2008, for an aggregate loss of $29,869,578.

23. HCE's total losses on its five written put options and short variance swaps from September through October 2008 were $45,396,878, or 45% of the Fund's NAV.

HCE's Failure to Disclose Its Put Option and Variance Swap Strategies

24. Commission Form N-2 requires a registered investment company to describe in its registration statement the types of investments, investment policies, practices, and

techniques that the investment company employs or intends to employ, the extent to which it may engage in investment policies, and the risks inherent in such policies. Form N-2 also requires a registered investment company to discuss the principal risk factors associated with investment in the investment company.

25. Investment Company Act Rule 8b-16 requires that a registered investment company amend its registration statement annually. Rule 8b-16 provides that a closed-end fund need not amend its registration statement provided that it includes certain information in its annual reports, including any material changes in the fund's investment objectives or policies that have not been approved by shareholders, and any material changes in the principal risk factors associated with investment in the fund.

26. Neither HCE's registration statement nor any of its annual reports disclosed writing index put options or trading variance swaps as principal fund strategies. Neither strategy received any mention in the registration statement's sections entitled "Fund Investments" and "Portfolio Contents," where HCE described the types of investments in which the Fund would invest under normal market conditions. HCE's registration statement disclosed in a separate section entitled "Strategic Transactions" that the Fund may utilize a variety of derivative strategies, including "purchas[ing] and sell[ing] exchange-listed and over-the-counter put and call options on securities, equity and fixed-income indices and other instruments, purchas[ing] and sell[ing] futures contracts and options thereon and enter[ing] into various transactions such as swaps, caps, floors or collars." HCE included in its statement of additional information disclosure about some additional investments the Fund may make, including the Fund's potential use of index options, but did not describe the extent to which the Fund may use index options. HCE's statement of additional information also indicated that index options would possibly be used to hedge other portfolio securities. The registration statement did not provide any disclosure about the Fund's use of variance swaps beyond the more general disclosures about using derivatives.

27. The registration statement's "Risks" section also did not discuss the risks associated with HCE's put writing or variance swap strategies. There was no mention of the downside risks the Fund could face by trading index put options and variance swaps, including the Fund's leveraged exposure to market declines and to spikes in market volatility. While the registration statement included a generic warning that the use of derivatives could leave the Fund worse off, depending on the adviser's ability to correctly predict movements in the securities and interest rate markets, it did not include anything specific regarding the types of market movements that could harm the Fund or the particular risks associated with writing index put options and trading variance swaps. Most of the risk discussion about using index options related to the risk that such options may be imperfect hedges for HCE's portfolio securities.

28. FAMCO used put options and variance swaps in HCE to such a degree that those strategies became primary drivers of the Fund's performance and added additional principal risks to the Fund. Neither FAMCO nor Claymore took steps to ensure that those strategies and their risks were sufficiently disclosed to investors in HCE's registration statement or annual report. FAMCO instead engaged in strategies and exposed the Fund to risks that were inadequately disclosed. HCE never amended its registration statement to include sufficient disclosure of its put-

writing and variance swap strategies and the risks associated with those strategies, nor did HCE include sufficient information about those strategies and risks in its 2007 annual report.

29. FAMCO informed Claymore that it intended to trade put options and variance swaps in the portfolio. Claymore regularly monitored the portfolio and could see each trade as it was made. Yet Claymore did not take action to evaluate the significance of FAMCO's new strategies to the Fund and the Fund's registration statement disclosures. Claymore also did not take sufficient steps to evaluate whether FAMCO's regular use of written put options and variance swaps necessitated additional disclosure about the strategies and their associated risks.

HCE's 2007 Annual Report and 2008 Semi-Annual Report

30. HCE's annual report for the twelve months ending November 30, 2007 reported a return of 12.87% on a NAV basis, and compared that return to the S&P 500, which returned 7.72% for the period, and the BuyWrite Index ("BXM"), an index simulating a S&P 500 covered call strategy, which returned 5.54% for the period. HCE's semi-annual report for the six months ending May 31, 2008 reported a return of 0.37% on a NAV basis, and compared that return to the S&P 500, which returned -4.50% for the period, and the BXM, which returned 2.00% for the period.

31. The Questions and Answers section of HCE's 2007 annual report and 2008 semi-annual report, which purported to be an interview with FAMCO's co-portfolio managers, contained misleading statements and omissions regarding the drivers of performance and the Fund's exposure to downside risk.

32. For example, in the Questions and Answers section of the 2007 annual report, the portfolio managers answered the question "Which investment decisions most helped the Fund's performance?" by attributing HCE's strong performance to stock selection and the covered call strategy and highlighting particular sector and single stock investments that contributed to return, including eleven individual stock investments which contributed between approximately $(20,000) and $1 million each (net of covered call option positions) to HCE's NAV growth. The portfolio managers failed to disclose that the Fund generated significant income from alternative investment strategies outside of its primary covered call strategy, including writing S&P 500 put options, writing S&P 500 call options, and purchasing S&P 500 put options, which contributed approximately $2.2 million (2.0%), $1.9 million (1.7%), and $1.9 million (1.7%) to HCE's NAV growth, respectively. Also, the portfolio managers did not discuss HCE's put-write and variance swap strategies when they explained the Fund's hedging strategies in the Questions and Answers section. The portfolio managers stated that the Fund's covered call option strategy had the potential to protect the Fund in a downward trending market, and further stated that at times during 2007 when the portfolio managers were concerned about the market, they bought index put options and wrote index call options for protection. The portfolio managers failed to mention the written put options or the variance swaps, which exposed the Fund to losses during declining or volatile markets.

33. During the six months ended May 31, 2008, option premiums collected on writing put options were a major contributor to HCE's NAV growth, generating approximately

$2.4 million of income and increasing HCE's NAV by approximately 2.1%, and were a close second to HCE's entire portfolio of covered call options as a positive contributor to performance. HCE also increased NAV by $801,212 (0.7%) by writing S&P 500 call options, and by $917,289 (0.8%) from short variance swaps. In the Questions and Answers section of the 2008 semi-annual report, the portfolio managers answered the question "Which investment decisions or strategies most helped the Fund's performance?" by stating that HCE's performance benefited from "industry and stock selection, the covered call strategy, and the hedge program" and that "[d]uring most of this period, the portfolio was strategically hedged for additional downside protection, and that proved to be a good decision as equity markets trended downward." The portfolio managers failed to disclose that the Fund generated significant income from its written S&P 500 put and call options and from its short variance swaps. In addition, the portfolio managers' statement that the portfolio was hedged for downside protection inaccurately portrayed HCE's exposure to downside market risk. FAMCO had written put options and short variance positions in the portfolio during approximately 65% of the period, while it maintained long put options and long variance positions for less than 40% of the period. The S&P 500 actually increased during most of the period that FAMCO hedged the portfolio with long put options and long variance, causing HCE to lose approximately $1.5 million on those positions during the period. HCE profited on its written put options and short variance swaps, but those profits had nothing to do with equity markets trending downward. HCE profited on these strategies because the markets declined only slightly during this period. If the markets had declined more steeply, HCE would have been exposed to significant loss.

34. Pursuant to Claymore's investment advisory agreement with HCE and Claymore's fund policies and procedures manual, Claymore was responsible for supervising its sub-adviser FAMCO. Claymore also was responsible for the preparation and filing of HCE's 2007 annual report and 2008 semi-annual report, including reviewing and approving the portfolio managers' comments in the Questions and Answers section. Even though Claymore had the information necessary to verify the portfolio managers' commentary in the Questions and Answers section, Claymore failed to ensure that the commentary fully disclosed the drivers of HCE's performance and appropriately described the Fund's exposure to downside risk.

Violations

35. As a result of the conduct described above, Claymore caused HCE's violations of Investment Company Act Rule 8b-16, which requires registered investment companies to amend their registration statements to include changes to the fund that are required to be disclosed in the registration statement.

36. As a result of the conduct described above, FAMCO violated Section 34(b) of the Investment Company Act, which prohibits any person from omitting from any report or other document filed or transmitted pursuant to the Act any fact necessary to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading.

37. As a result of the conduct described above, Claymore failed reasonably to supervise FAMCO, with a view to preventing FAMCO's violations of the federal securities laws.

Respondent's Remedial Efforts

38. In determining to accept Respondent's Offer, the Commission has considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff. Respondent has taken the following steps to strengthen its compliance function. Respondent has: (1) enhanced its Chief Investment Office; (2) hired outside counsel to help identify, review, and, when necessary, revise policies and procedures consistent with best practices for its funds; (3) worked to identify and address operational risks in its various funds; (4) hired a third party to review and expand its legal and compliance functions; and (5) enhanced the requirement that its funds make regular reports to their boards of directors about trading activity, performance, and risk analyses in the various funds' portfolios. The Commission also considered the Undertakings described below.

Undertakings

39. Respondent has undertaken the following actions:

a. Compensate Investors. Immediately preceding the entry of this Order, Respondent established a plan (the "Plan") for a distribution, managed by an independent third-party administrator, to reimburse former shareholders in HCE for losses up to the amount of $45,396,878 from the five derivative transactions in September and October 2008 described in this Order, which represents 100% of the loss attributable to those transactions. Respondent has committed to implement the distribution to investors in accordance with the Plan. The distribution was established by and will be managed by Respondent and is not a Commission-ordered distribution plan. Members of the SEC's staff have reviewed the Plan and the methodology it uses to determine an investor's loss. Details of the distribution to compensate shareholders, include, but are not limited to:

   i. Claymore's distribution will be managed by The Garden City Group, Inc. (the "Plan Administrator"). Claymore will compensate the Plan Administrator for its services and reimburse the Plan Administrator for reasonable expenses. The compensation paid to the Plan Administrator and expenses incurred will not reduce the total amount of reimbursement to be paid to shareholders.

   ii. The Plan Administrator will make reasonable efforts to identify and provide notice to all shareholders potentially eligible to be compensated, as provided for in the Plan.

   iii. Any investor who owned one or more common shares of HCE during the period August 19, 2008 through October 20, 2008 may have suffered losses attributed to the five derivative transactions and are thus eligible for reimbursement of those losses.

iv. Eligible losses for reimbursement will be calculated based on the effect the five derivative transactions had on HCE's NAV during the period August 19, 2008 through October 20, 2008, as provided for in the Plan.

v. The Plan Administrator will provide all identified investors with notice and a claim form, as provided for in the Plan.

vi. Investors who are not identified by the Plan Administrator will be able to obtain a claim form via the internet or the mails and make a claim by providing the Plan Administrator with evidence of their share ownership.

vii. The Plan Administrator will evaluate all claims, apply the loss calculation methodology in the Plan, make decisions about the amount to pay each claimant, and make final payments to claimants consistent with the terms of the Plan.

viii. Investors who do not accept a payment under the Plan retain all rights and remedies that are available to them under the law.

b. Provide Ongoing Cooperation. Respondent agrees to cooperate fully with the Commission with respect to this action and any judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party relating to the matters in this Order. Respondent's cooperation shall include, but is not limited to:

i. Production of Information. At the Commission's request on reasonable notice and without a subpoena, Respondent shall truthfully and completely disclose information and documents reasonably requested by Commission staff in connection with the Commission's related investigation, litigation, or other proceedings. Respondent will have no obligation to provide information voluntarily that it is not able to provide without a subpoena.

ii. Production of Cooperative Personnel. At the Commission's request on reasonable notice, and without a subpoena, Respondent shall use reasonable efforts to secure the attendance and truthful statements or testimony of any current partner, principal, officer, agent, or employee of Respondent, at any meeting, interview, testimony, deposition, trial, or other legal proceeding.

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

IV.

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

Accordingly, pursuant to Section 203(e) of the Advisers Act and Section 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Claymore cease and desist from committing or causing any violations and any future violations of Investment Company Act Rule 8b-16.

B. Respondent Claymore is censured.

C. Respondent Claymore shall report to the Commission staff the final results of its distribution once it is completed. The report shall include a report detailing the investors who were reimbursed under the distribution, the percentage of total investors who were reimbursed, and the total amount of funds distributed. Respondent shall report this information to Robert J. Burson, Senior Associate Regional Director, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604 within 90 days of termination of the Plan.

D. Respondent Claymore acknowledges that the Commission is not imposing disgorgement, prejudgment interest, or a civil penalty based upon its undertakings and its agreement to cooperate in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, or did not implement the undertakings described above, including making the distribution to former HCE shareholders, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter to seek an order directing that the Respondent pay appropriate disgorgement, prejudgment interest, and a civil money penalty. Respondent may contest in any resulting hearing whether it knowingly provided materially false or misleading information or did not implement the above undertakings, but may not, by way of defense, contest the findings in the Order or assert a defense based on the statute of limitations that relies in any way on the period from the date of this Order through one year from the date the Respondent notifies the Commission that the distribution has been completed.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68467 / December 19, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3521 / December 19, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30310 / December 19, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15141

In the Matter of **MOHAMMED RIAD AND KEVIN TIMOTHY SWANSON** **Respondents.**	**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 SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 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 Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Mohammed Riad ("Riad") and Kevin Timothy Swanson ("Swanson") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

Respondents

1. Mohammed Riad, age 43, resides in Clayton, Missouri. During 2007 and 2008, Riad was Managing Director and Senior Portfolio Manager at Fiduciary Asset Management, LLC ("FAMCO"). Riad was portfolio manager of

Fiduciary/Claymore Dynamic Equity Fund ("HCE") from its inception until October 2008. Riad also became a Vice President of HCE in 2007. Currently, Riad is the Chief Executive Officer of a Missouri-registered investment advisory firm located in St. Louis, Missouri. Riad holds Series 7, 8, 63, and 65 licenses.

2. Kevin Timothy Swanson, age 45, resides in St. Louis, Missouri. During 2007 and 2008, Swanson was a portfolio manager at FAMCO and served as a co-portfolio manager of HCE with Riad. Between 2011 and 2012, Swanson served as the Chief Investment Officer for an investment adviser located in St. Louis, Missouri. Swanson is a Chartered Financial Analyst and formerly held a Series 7 license.

Other Relevant Entities

3. Fiduciary Asset Management, LLC is a Delaware limited liability company based in St. Louis, Missouri. FAMCO has been registered with the Commission as an investment adviser since 1994. FAMCO is a wholly-owned subsidiary of the Piper Jaffray Companies. FAMCO was the sub-adviser to HCE. FAMCO received an annual sub-advisory fee of .5% of the Fund's net assets. On December 19, 2012, the Commission instituted settled administrative proceedings in In the Matter of Fiduciary Asset Management, LLC, in which the Commission found that FAMCO willfully violated Section 34(b) of the Investment Company Act and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. FAMCO consented to the issuance of the Commission's order without admitting or denying the Commission's findings.

4. Fiduciary/Claymore Dynamic Equity Fund was a closed-end investment company organized in April 2005. HCE's shares were offered to the investing public pursuant to a registration statement filed with the Commission. HCE's investors included asset managers, retirement plans and individual retirement account holders. HCE regularly filed periodic reports with the Commission as required by the Investment Company Act. The Fund was liquidated in May 2009.

5. Claymore Advisors, LLC ("Claymore") is a Delaware limited liability company based in Lisle, Illinois. Claymore has been registered with the Commission as an investment adviser since 2003, and provides portfolio management services for investment companies. Claymore served as investment adviser to HCE from the Fund's inception in April 2005 until its liquidation in 2009. Claymore also served as HCE's fund administrator from 2006 through 2009. On December 19, 2012, the Commission instituted settled administrative proceedings in In the Matter of Claymore Advisors, LLC, in which the Commission found that Claymore failed reasonably to supervise FAMCO with a view to preventing its violations of the securities laws within the meaning of Section 203(e)(6) of the Advisers Act, and caused HCE's violations of Investment Company Act Rule 8b-16. Claymore consented to the issuance of the Commission's order without admitting or denying the Commission's findings.

Background

6. According to HCE's April 2005 registration statement, the Fund's primary investment strategy was to invest in equities and write call options on a substantial portion of those equities. This strategy is commonly referred to as a covered call strategy. Covered call strategies trade upside potential in the equities held in the portfolio for current income from option premiums received.

7. HCE informed investors in its periodic reports that this covered call strategy had the potential to protect the Fund in a downward trending market. The Fund also disclosed to investors that it had a goal of paying an annual dividend equal to an 8.5% yield on the Fund's initial public offering price.

8. Claymore provided advisory services to HCE pursuant to an investment advisory agreement, and delegated certain of its responsibilities to FAMCO through a sub-advisory agreement. Under the sub-advisory agreement, FAMCO acted as a fiduciary and was responsible for the management of HCE's portfolio.

9. FAMCO was required to manage the Fund in accordance with HCE's investment objective, policies, and restrictions as stated in the Fund's registration statement. FAMCO's engagement as sub-adviser was subject to annual review by HCE's Board of Directors. FAMCO initially designated Riad as HCE's portfolio manager and later in 2005 added Swanson as co-portfolio manager. Riad was the senior portfolio manager, and Swanson reported to him.

10. FAMCO was involved in HCE's periodic reporting. For each HCE annual and semi-annual report, Riad provided Claymore with a signed certification that: (1) he had reviewed the portfolio of investments contained in HCE's report and that, to the best of his knowledge, the portfolio of investments was complete and accurate; and (2) to the best of his knowledge, the securities in the portfolio were purchased in compliance with the investment parameters set forth in the prospectus.

11. Each HCE annual and semi-annual report also contained a Questions and Answers discussion with Riad and Swanson (also referred to as the portfolio manager commentary). A Claymore consultant interviewed Swanson for each periodic report and then, after the interview, drafted the Questions and Answers section based on Swanson's statements during the interview. Once the initial draft was completed, Riad, Swanson, and others at FAMCO and Claymore reviewed and edited the Questions and Answers before it was included in the report.

12. For each HCE annual and semi-annual report, Swanson provided Claymore with a signed certification that he had reviewed the portfolio manager commentary contained in the report and that, to the best of his knowledge, it did not contain any material misstatement or omission that would make the report inaccurate or misleading.

HCE'S Put Option And Variance Swap Strategies

13. Beginning in April 2007 and continuing through October 2008, FAMCO implemented two new strategies intended to supplement HCE's income and to help meet the Fund's dividend objective. More specifically, during this period HCE regularly wrote short duration, out-of-the-money S&P 500 put options and also entered into short variance swaps.

14. Riad was primarily responsible for managing these new strategies, although Swanson assisted and advised Riad. Swanson described these strategies as allowing FAMCO to "do more with less."

15. Prior to April 2007, HCE purchased S&P 500 put options and wrote S&P 500 call options as protection for the portfolio. Beginning in April 2007, HCE began writing S&P 500 put options as well, at times holding long and written put options simultaneously and at other times holding only written put options. Beginning in November 2007, HCE ceased holding long and written put options together and began consistently holding only written put options in its portfolio with no corresponding long position.

16. When FAMCO wrote put options for HCE's portfolio, HCE collected a premium from the purchaser of the option, and agreed to compensate the purchaser for any declines in the S&P 500 beyond the "strike price" of the option. HCE typically wrote put options with one- or two-month expirations, and with strike prices that were between 6% and 10% below the S&P 500's level at the time the options were written.[1] Usually, this strategy was profitable. But HCE stood to lose money on a written put position if the S&P 500 approached or declined below the option strike price during the option period.

17. Throughout 2008, the notional exposures to potential losses on put options that HCE wrote ranged from 60% to 140% of the Fund's net asset value ("NAV").[2] Each month HCE wrote put options during 2008, the Fund collected between $500,000 to $1.4 million in premiums, which significantly increased the Fund's return each time the options expired out-of-the-money. Between April 2007 and August 2008, HCE collected $9.6 million in premiums from written put options.

18. Variance swaps are essentially a bet on whether the actual or realized market volatility will be higher or lower than the market's expectation for volatility ("implied volatility"). A party with a "long variance" position profits when realized volatility for the contract period is greater than the implied volatility. A party with

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[1] The amount by which the option's strike price is below the current price is commonly referred to as the amount by which the option is "out-of-the-money."

[2] An option's notional exposure is the amount of maximum loss exposure on the option that would be realized in the event that the underlying referenced security or index, in this case the S&P 500, were to decline to 0.

a "short variance" position profits whenever realized volatility is less than the implied volatility.

19. FAMCO began regularly trading short variance swaps in HCE's portfolio in July 2007. HCE maintained written put options and short variance swaps in its portfolio at nearly all times from July 2007 through October 2008, with the only significant exception being a two-month period from April to June 2008.

20. FAMCO's use of written put options and variance swaps significantly affected HCE's performance and changed the Fund's risk profile. FAMCO's internal documents projected writing put options and trading short variance swap could potentially add hundreds of basis points to HCE's return each year, so long as there were no significant market disruptions. However, by using these strategies, FAMCO leveraged HCE's exposure to market declines and volatility, which exposed the Fund to massive potential losses if the S&P 500 declined rapidly or became very volatile. In so doing, FAMCO changed HCE from a fund that provided some downside protection to a fund that magnified downside exposure.

21. In connection with these new strategies, FAMCO maintained research files with a variety of materials, including research reports which analogized short variance swaps to selling insurance. One report noted that such an approach was "potentially very risky" and required enough capital "to absorb the occasional inevitable losses." The same report also noted that while short positions usually result in "modest gains," they can be exposed to "very large losses if volatility spikes up significantly."

22. When FAMCO began writing put options in HCE without any corresponding long positions, a FAMCO accountant with options trading experience warned Riad that the risks associated with this strategy outweighed the benefit received from the option premiums. However, Riad dismissed this warning because he did not believe the stock market would decline far enough during the life of the put options to generate significant losses.

23. Subsequently, the FAMCO accountant raised his concerns about excessive risk to FAMCO's compliance department. In response, FAMCO consulted with Claymore regarding whether writing put options was permissible in the Fund. However, FAMCO did not fully explain to Claymore or HCE the nature of its short strategies and the associated risks. The accountant continued to raise his concerns about risk to Riad as FAMCO continued to trade written put options.

<u>Riad's Characterization Of These Strategies To HCE</u>

24. As HCE's sub-adviser, FAMCO was subject to the supervision of Claymore and HCE's Board of Directors. On several occasions during 2007 and 2008, Riad misled Claymore and HCE's Board of Directors regarding the purpose behind the put option and variance swap strategies, as well as the risk associated with those strategies.

25. For example, in December 2007, Riad described the put-writing strategy to Claymore as a "conservative high yielding strategy," and in March 2008 told

Claymore he was using put options and variance swaps to hedge the portfolio against declines in market volatility and to "lock in" high market volatility levels. This was not true, and Riad subsequently admitted that locking in volatility was not a reason for writing put options and trading variance swaps. Swanson was aware of Riad's misrepresentation to Claymore and HCE regarding the reasons for implementing these new strategies.

26. On several occasions between October 2007 and July 2008, Riad also described his put option and variance swap trading to Claymore and HCE's Board as a means to mitigate downside risks to the investment portfolio or to augment downside protection in adverse markets. This was not true either.

27. The first time Riad maintained a written put option position in HCE without a corresponding long put position, Swanson asked if such a position was permissible, and suggested that a naked short option position might raise questions. Riad responded that he was "stalling" and hoped that the short position would expire profitably before he needed to have "that discussion."

Put Option And Variance Swap Performance

28. HCE's written put options and variance swaps materially affected HCE's return in 2007 and 2008. During this period, HCE also purchased S&P 500 put options, wrote S&P 500 call options, and entered into long variance swaps.

29. During HCE's fiscal year ending November 30, 2007, HCE's NAV increased 12.87%, compared to the S&P 500's 7.72% return and a 5.54% return for the CBOE Buywrite Monthly Index ("BXM"), an index that simulates an S&P 500 covered call strategy. HCE's written put options, long put options, and written S&P 500 call options contributed approximately 2.0%, 1.7%, and 1.7% respectively to HCE's NAV growth; these strategies accounted for more than 40% of the Fund's NAV growth for the period, and nearly all of HCE's excess return above the S&P 500. HCE's short variance swaps were one of HCE's worst performing investments for the period, reducing the Fund's return by .4% in four months of trading the products.

30. HCE's derivative strategies continued to boost return during the first half of 2008. For the six-month period ending May 31, 2008, HCE's return was .37% of NAV, compared to -4.50% for the S&P 500 and 2.00% for the BXM. HCE's written put options, short variance swaps, and written call options contributed approximately 2.1%, .8%, and .7% respectively to the Fund's return. By contrast, HCE's long put options and long variance swaps decreased the Fund's return by .6% and .8%, respectively.

HCE's Collapse During The Fall Of 2008

31. FAMCO continued to write put options and trade short variance swaps throughout the summer of 2008. In late August 2008, FAMCO wrote two-month, 10% out-of-the-money S&P 500 put options in HCE with a $139 million notional exposure, which equated to 136% of the Fund's NAV, as of August 28, 2008.

32. FAMCO estimated this position to have a potential loss exposure of $17,630,000, or approximately 17.5% of the Fund's value, as of the end of August. FAMCO also caused HCE to enter into a one-month short variance swap in August 2008, further exposing the Fund to market declines and volatility.

33. In August and early September 2008, Riad made similar put option and variance swap trades in a hedge fund that he managed for himself and other principals at FAMCO.

34. Beginning in early September 2008, the financial markets began declining rapidly and became very volatile. On September 10, 2008, Riad stated in an internal FAMCO email that "[A FAMCO research analyst] told me this would happen. Never sell variance in front of a broker/dealer disaster." The day after Lehman Brothers filed for bankruptcy, Riad closed out the written put position in the hedge fund he managed for himself and other principals at FAMCO, but left HCE's put position open.

35. On September 18, 2008, the same FAMCO accountant who previously had expressed concerns about the risks of writing put options met with FAMCO's compliance department. Once again, the accountant expressed his concern that the Fund was taking on too much risk with the put option and variance swap strategies.

36. On September 19, 2008, FAMCO settled HCE's expiring one-month variance swap position for a loss of $7,025,454. As of September 19, HCE also had an unrealized $1.25 million loss on its written put options, and FAMCO's estimate of HCE's exposure or potential losses on those options had grown to $39.7 million, or 44% of the Fund's NAV. Nevertheless, Riad caused HCE to enter into two new, one-month short variance swaps that same day, despite the possibility of suffering significant losses on the outstanding put option positions if the S&P 500 continued to decline.

37. The S&P 500 continued to decline with increased volatility in late September and October 2008. FAMCO covered HCE's written put positions in early October and realized a loss of $15,527,300. HCE also lost an additional $22,844,124 on the two variance swaps entered into in September, for an aggregate loss of $29,869,578 million from both its August and September variance swaps.

38. In September and October 2008, HCE lost approximately $73.4 million, or 72.8% of its NAV. By comparison, the S&P 500 index declined 24.5%, and the BXM declined 19.9%. Approximately $45.4 million of HCE's losses during this two-month period were directly attributable to HCE's use of written put options and short variance swaps.

39. HCE's Board met in early October 2008 to discuss the Fund's performance. Riad told the Board that he had implemented a strategy of purchasing put options, and he was using written put options to offset the cost of FAMCO's long put strategy. He also said that the Fund's long option position had expired or was offset during the summer, but that he had intended to reinstate it after the November 2008 election. Riad

said that he decided to maintain the written put option exposure in the portfolio in the meantime.

40. Riad's description of his strategy to the Board was not true. Between November 2007 and August 2008, Riad purchased put options in HCE just once, and held a long position for less than three months. By contrast, Riad wrote put options on fifteen different occasions during that period and maintained a short position for more than eight of those ten months. Riad's use of written put options far exceeded that which was necessary to offset the cost of HCE's long put options.

41. Before HCE's collapse, Riad's written put option strategy had generated $7.6 million in option premiums and profits of $3.85 million for the Fund. Riad caused FAMCO to continue writing put options as part of a principal fund strategy, and not merely to offset the cost of long put option positions.

HCE's Failure To Disclose Its Put Option And Variance Swap Strategies

42. Commission Form N-2 requires a registered investment company to describe in its registration statement the types of investments, investment policies, practices, and techniques that the investment company employs or intends to employ, the extent to which it may engage in investment policies, and the risks inherent in such policies. Form N-2 also requires a registered investment company to discuss the principal risk factors associated with investment in the investment company.

43. Investment Company Act Rule 8b-16 requires that a registered investment company amend its registration statement annually. Rule 8b-16 provides that a closed-end fund need not amend its registration statement provided that it includes certain information in its annual reports, including any material changes in the fund's investment objectives or policies that have not been approved by shareholders, and any material changes in the principal risk factors associated with investment in the fund.

44. Neither HCE's registration statement nor any of its annual reports disclosed writing index put options or trading variance swaps as principal fund strategies. Neither strategy received any mention in the registration statement's sections entitled "Fund Investments" and "Portfolio Contents," where HCE described the types of investments in which the Fund would invest under normal market conditions.

45. In fact, HCE's registration statement disclosed that the Fund would pursue primarily a covered call strategy. HCE never disclosed that put options and variance swaps were primary drivers of fund performance, or that the use of those products might alter the Fund's risk profile.

46. HCE's prospectus, which was part of HCE's registration statement, disclosed in a separate section entitled "Strategic Transactions" the fact that the Fund may utilize a variety of derivative strategies, including "purchas[ing] and sell[ing] exchange-listed and over-the-counter put and call options on securities, equity and fixed-income indices and other instruments, purchas[ing] and sell[ing] futures contracts and options thereon and enter[ing] into various transactions such as swaps, caps, floors or collars."

HCE's Statement of Additional Investment ("SAI"), also part of HCE's registration statement, disclosed that the Fund might purchase or sell index options, but described those products as potential hedges against other portfolio securities. The registration statement did not provide any specific disclosure about the use of variance swaps beyond the more general disclosures about using derivatives.

47. Further, the "Risks" section in HCE's registration statement did not discuss the risks associated with put writing or variance swaps, including leveraged exposure to market declines or exposure to spikes in market volatility. Instead, HCE's risk disclosures relating to its use of derivatives merely contained a warning that the use of derivatives could leave the Fund worse off, depending on the adviser's ability to correctly predict movements in the securities and interest rate markets.

48. FAMCO used put options and variance swaps in HCE's portfolio to such a degree that those strategies became an integral part of how HCE sought to achieve its investment objective and exposed the Fund to new and material risks. In so doing, FAMCO engaged in strategies and exposed the Fund to risks that were not adequately disclosed.

49. Although FAMCO informed Claymore that it intended to trade put options and variance swaps in HCE's portfolio, Riad did not adequately explain to Claymore or HCE's Board of Directors the risks associated with the written put option and variance swap strategies or take adequate steps to ensure that the strategies were consistent with HCE's registration statement disclosures regarding the Fund's investments, strategies, and risks.

50. As a consequence, HCE never amended its registration statement to include sufficient disclosure of its put-writing and variance swap strategies and the risks associated with those strategies, nor did HCE include sufficient information about those strategies and risks in its 2007 annual report.

HCE's Misleading 2007 Annual Report

51. HCE's annual report for the period ended November 30, 2007 omitted material information necessary to make the statements contained therein not misleading. The Questions and Answers section of the annual report, which purported to be an interview with Riad and Swanson as FAMCO's co-portfolio managers, contained misleading statements and omissions regarding the drivers of Fund performance and the Fund's exposure to downside risk.

52. In the Questions and Answers section, Riad and Swanson answered the question "Which investment decisions most helped the Fund's performance?" by attributing HCE's strong performance to stock selection and the covered call strategy. The portfolio managers highlighted particular sector and single stock investments that contributed to return, including eleven individual stock investments which contributed between approximately \$(20,000) and \$1 million each (net of covered call option positions) to HCE's NAV growth.

53. However, Riad and Swanson failed to disclose that the Fund had generated significant income from alternative investment strategies outside of its covered call strategy, including writing S&P 500 put options, writing S&P 500 call options, and purchasing S&P 500 put options, which contributed approximately $2.2 million (2.0%), $1.9 million (1.7%), and $1.9 million (1.7%) respectively to HCE's NAV growth.

54. In fact, contrary to Riad's and Swanson's commentary, stock selection accounted for a relatively small amount of the Fund's outperformance. HCE's equity portfolio outperformed the S&P 500 by 1.25%, which was only slightly more than the 1% advisory fee charged by the Fund. As a result, Riad's and Swanson's commentary was materially misleading, and created a distorted picture of what was driving HCE's performance by omitting discussion of HCE's profits from S&P 500 put options and call options during the period.

55. In the Questions and Answers section, Riad and Swanson also failed to mention that HCE lost $400,509 on its variance swap positions when discussing which holdings most hurt performance in 2007. Instead, Riad and Swanson highlighted four individual stock investments, three of which lost less than $100,000 (net of covered call option positions). Omitting any discussion of the short variance swaps rendered the disclosure misleading.

56. Riad and Swanson also failed to discuss HCE's written put option and variance swap strategies when explaining the Fund's hedging strategies in the Questions and Answers section. Instead, Riad and Swanson noted that the Fund's covered call option strategy had the potential to protect the Fund in a downward trending market and, at times during 2007 when they were concerned about the market, they bought index put options and wrote index call options for protection. Riad and Swanson never mentioned the written put options or the variance swaps, which exposed the Fund to losses in periods of significant market decline or volatility. Without mention of the written put options or variance swaps and the Fund's exposure to downside risk from those positions, this disclosure was misleading.

57. Further, in the interview that served as the basis for the Questions and Answers section, Swanson told Claymore's consultant that HCE appropriately hedged the portfolio to take advantage of spikes in market volatility, when the Fund actually had lost money on its short variance swaps during the period.

58. HCE's 2007 annual report also contained a risks disclosure section, which listed the risks associated with investing in the Fund. The risks disclosure stated that the views expressed "reflect those of the portfolio managers and Claymore only." The risks disclosure omitted discussion of any of the risks associated with writing put options and trading variance swaps, and therefore misled investors regarding the risks of investing in HCE.

59. Riad and Swanson regularly received portfolio attribution reports prepared internally at FAMCO that showed how the various investments in HCE's portfolio had performed, and they followed the performance of the various investments and

strategies. Therefore, Riad and Swanson knowingly, recklessly, and negligently made misleading statements and omissions in HCE's 2007 annual report regarding the contributors to the Fund's performance. Riad and Swanson also knowingly, recklessly, and negligently made misleading statements and omissions regarding their actions to protect the Fund against declining markets, and omitted from discussion of the Fund's risks any of the risks associated with writing put options and trading short variance swaps.

HCE's Misleading 2008 Semi-Annual Report

60. HCE's semi-annual report for the six months ended May 31, 2008 contained many of the same deficiencies as the 2007 annual report. The Questions and Answers section attributed to Riad and Swanson again mischaracterized the primary drivers of performance and misled investors about the Fund's exposure to downside risk. The semi-annual report's risks disclosure again omitted any discussion of the risks associated with written put options and variance swaps in periods of significant market decline or volatility.

61. In response to a question in the Questions and Answers section asking what investment decisions most helped the Fund's performance, Riad and Swanson stated that HCE's performance benefited from "industry and stock selection, the covered call strategy, and the hedge program." Riad and Swanson noted that HCE's equity portfolio lost only 3%, outperforming the S&P 500, and touted the Fund's covered call strategy by noting that the call options offset 2/3 of the 3% loss on HCE's equity portfolio. Riad and Swanson also claimed that "[d]uring most of this period, the portfolio was strategically hedged for additional downside protection, and that proved to be a good decision as equity markets trended downward."

62. In fact, FAMCO had written put options and short variance positions in the portfolio during approximately 65% of the period, while it maintained long put option and long variance positions for less than 40% of the period. The S&P 500 actually increased during most of the period that FAMCO hedged the portfolio with long put options and long variance swaps, causing HCE to lose approximately $1.5 million on those positions during the same period.

63. HCE earned profits on its written put options and short variance swaps, but those profits had nothing to do with equity markets trending downward. HCE profited because the markets declined only slightly, and was exposed to significant losses if the markets had declined more steeply. Accordingly, this disclosure was misleading in light of HCE's exposure to downside risk in periods of significant market decline or volatility.

64. The option premiums that HCE collected on written put options were a major contributor to the Fund's NAV growth, generating approximately $2.4 million of income and boosting NAV growth by approximately 2.1%. HCE also profited by approximately $801,212, or .7%, from writing S&P 500 call options, and by approximately $917,289, or .8%, from short variance positions.

65. These strategies significantly increased HCE's return, while exposing HCE to significant loss in periods of significant market decline or volatility. Yet Riad and Swanson did not mention the strategies when discussing the Fund's performance. Accordingly, Riad's and Swanson's discussion regarding what most helped HCE's performance was materially misleading.

66. Riad and Swanson also failed to identify HCE's long put options or long variance swaps in response to a question about which holdings most hurt performance, even though those positions constituted some of the worst performers in the Fund's portfolio. Instead, Riad and Swanson highlighted an underweight position in the energy equity sector and investments in two broker/dealers. Accordingly, these omissions caused the Questions and Answers section regarding the drivers of performance to be materially misleading.

67. Like HCE's annual report, the Fund's semi-annual report did not discuss any of the specific risks associated with trading put options and variance swaps in its risks disclosure section, which stated that it reflected the views of the portfolio managers and Claymore. The risk disclosures were misleading as a result of those omissions.

68. Riad and Swanson regularly received portfolio attribution reports prepared internally at FAMCO that showed how the various investments in HCE's portfolio had performed, and they followed the performance of the various investments and strategies. Therefore, Riad and Swanson knowingly, recklessly, and negligently made misleading statements and omissions in HCE's 2008 semi-annual report regarding the contributors to the Fund's performance. Riad and Swanson also knowingly, recklessly, and negligently made misleading statements and omissions regarding the portfolio being strategically hedged for downside protection, and excluded from discussion of the Fund's risks the specific risks associated with writing put options and trading short variance swaps in periods of significant market decline or volatility.

Violations

69. As a result of the conduct described above, Riad and Swanson 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.

70. As a result of the conduct described above, Riad and Swanson willfully aided and abetted and caused FAMCO's violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit fraudulent conduct by an investment adviser.

71. As a result of the conduct described above, Riad and Swanson willfully violated Section 34(b) of the Investment Company Act, which prohibits untrue statements of material fact or omissions of any fact necessary in order to prevent the statements made, in the light of the circumstances under which they were made, from being materially misleading, in any registration statement, report or other document filed under the Investment Company Act.

72. As a result of the conduct described above, Riad and Swanson willfully aided and abetted and caused HCE's violations of Section 34(b) of the Investment Company Act, which prohibits untrue statements of material fact or omissions of any fact necessary in order to prevent the statements made, in the light of the circumstances under which they were made, from being materially misleading, in any registration statement, report or other document filed under the Investment Company Act.

73. As a result of the conduct described above, Riad caused HCE's violations of Investment Company Act Rule 8b-16, which requires registered closed-end investment companies to amend their registration statements to include changes to the fund that are required to be disclosed in the registration statement, or to include such information in their annual reports.

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 Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents Riad and Swanson pursuant to Section 21C of the Exchange Act, including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

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

D. What, if any, remedial action is appropriate in the public interest against Respondents Riad and Swanson pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

E. Whether, pursuant to Section 21C of the Exchange Act, Section 203(k) of the Advisers Act, and Section 9(f) of the Investment Company Act, Respondent Riad should be ordered to cease and desist from committing or causing violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, Section 34(b) of the Investment Company Act, and Investment Company Act Rule 8b-16.

F. Whether, pursuant to Section 21C of the Exchange Act, Section 203(k) of the Advisers Act, and Section 9(f) of the Investment Company Act, Respondent Swanson should be ordered to cease and desist from committing or causing violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and Section 34(b) of the Investment Company Act.

IV.

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

IT IS FURTHER ORDERED that Respondents shall file 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 a Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it/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 Respondents personally or by certified mail.

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

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

By the Commission.

Elizabeth M. Murphy
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. 68499 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15147

In the Matter of **David E. Ruskjer,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From about September 2004 to December 2008, Ruskjer, individually and doing business as Ruskjer & Associates, raised approximately $16 million from at least 140 investors nationwide by selling and offering to sell securities in the form of promissory notes purportedly paying fixed monthly interest rates ranging from 3% to 5%, and making various fraudulent representations about the notes, as set forth below. No registration statement was ever filed or in effect with the Commission for the offering of the notes. During the period in which he engaged in the conduct underlying the conviction and injunction described below, Respondent was also acting as an unregistered broker-dealer. Respondent, 60 years old, was a resident of Koloa, Hawaii, during the period of the relevant conduct; he is currently incarcerated in federal prison in Sheridan, Oregon, serving a 120 month prison sentence as a result of his conviction described below.

B. RESPONDENT'S CRIMINAL CONVICTION AND ENTRY OF THE INJUNCTION

2. On, September 26, 2011, Ruskjer was found guilty in a jury trial of sixteen counts of mail fraud in violation of Title 18 United States Code, Sections 1341 and 1343, two counts of structuring financial transactions in violation of Title 31 United States Code, Sections 5324(a)(3) and (d)(2), and twenty-two counts of money laundering in violation of Title 18 United States Code, Section 1957, before the United States District Court for the District of Hawaii, in United States v. David E. Ruskjer, Case No. 1:09-CR-249-HG. On January 11, 2012, a judgment in the criminal case was entered against Ruskjer. He was sentenced to a prison term of 120 months followed by three years of supervised release and ordered to make restitution in the amount of $11,586,334.85.

3. The counts of the criminal indictment as to which Ruskjer was found guilty, alleged, among other things, that Ruskjer defrauded investors and obtained money and property by means of materially false and misleading statements in connection with the fraudulent sale of notes underlying the Commission's complaint described in Paragraph 5 below.

4. On September 28, 2012, a final judgment was entered following the Court granting the Commission's motion for summary judgment against Ruskjer, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. David E. Ruskjer, Civil Action Number 1:09-CV-00237-HG, in the United States District Court for the District of Hawaii.

5. The Commission's complaint alleged that, from about September 2004 to December 2008, Ruskjer, individually and doing business as Ruskjer & Associates, raised approximately $16 million from at least 140 investors nationwide by selling and offering to sell securities in the form of promissory notes purportedly paying fixed monthly interest rates ranging from 3% to 5%. No registration statement was ever filed or in effect with the Commission for the offering of the notes. Ruskjer personally solicited prospective investors at presentations at places like coffee shops, hotel lounges, and private residences. Ruskjer represented to investors that he had a lucrative investment strategy for selling call options that emphasized "safety first" and "doesn't rely on speculation." He also told investors that he used their funds to operate his trading strategy, made 5% to 5.5% per month from such trading, and used these profits to pay investors their returns. Contrary to Ruskjer's representations, from September 2004 through December 2008, Ruskjer used only $7.9 million (or about half of the $16 million raised) to trade securities and incurred $2.6 million in trading losses for a cumulative loss of 95% and an average thirty-day return of negative 5.8%. Ruskjer used about $5.5 million to pay purported returns to investors and misappropriated the remaining investor funds for personal expenses, including $523,466 to purchase a condominium. During the period in which he engaged in the conduct underlying the conviction and injunction described above, Respondent was also acting as an unregistered broker-dealer.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened 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 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURTIES EXCHANGE ACT OF 1934
Release No. 68501 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15149

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

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 Carl N. Duncan ("Respondent" or "Duncan") 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 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 Public Administrative Proceedings

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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.

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. Carl N. Duncan, age 66, is an attorney licensed to practice in the District of Columbia.

2. On September 27, 2012, the Commission filed a complaint against Duncan in the U.S. District Court for the Southern District of New York, alleging that Duncan violated Sections 5(a), 5(c), and 17(a)(2) of the Securities Act of 1933 (the "Securities Act") [15 U.S.C.§§ 77e(a), 77e(c), and 77q(a)(2)]. *See SEC v. Duncan*, Civil Action No. 12 CV 7261.

3. On December 7, 2012, the U.S. District Court for the Southern District of New York entered a final judgment by consent against Duncan permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a)(2) of the Securities Act. Additionally, the order: (a) prohibits Duncan from participating in the preparation or issuance of any opinion letter in connection with the offer or sale of securities pursuant to, or claiming an exemption under Section 4(1) of the Securities Act [15 U.S.C. § 77d(1)] and Rule 144 or Rule 802 under the Securities Act [17 C.F.R. §§ 230.144 and 230.802], including without limitation, signing an opinion letter or preparing an opinion letter to be signed by another person, related to such offering; (b) permanently bars Duncan from participating in an offering of penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock; and (c) requires Duncan to pay disgorgement and prejudgment interest thereon in the amount of $16,094.98, and a civil money penalty in the amount of $25,000.00.

4. The Commission's complaint alleged, among other things, that Duncan prepared and issued false legal opinions and letters to the transfer agent, OTC Markets Group, Inc., and the Depository Trust and Clearing Corporation in connection with a scheme to inflate trading volume in the common shares of 8000, Inc. and the company's stock price.

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, effectively immediately that Duncan 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. 68500 / December 20, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3523 / December 20, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3433 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15148

In the Matter of **STEVEN A. GOULD CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND 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 pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 102(e)(3)(i) of the Commission's Rules of Practice against Steven A. Gould ("Respondent" or "Gould").[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

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 and 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. Gould, age 48, is a certified public accountant currently licensed in New York. Gould was the chief financial officer of West End Financial Advisors ("West End") from September 2006 to May 11, 2009. West End is a New York-based, unregistered investment adviser to a collection of hedge funds (the "West End funds"). West End is affiliated with Sentinel Investment Management Corporation, which has been registered with the Commission since 1986. Gould's responsibilities at West End included overseeing West End's accounting department, maintaining financial records for the West End funds, and preparing monthly account statements sent to West End investors.

2. On September 25, 2012, the U.S. District Court for the Southern District of New York entered a final judgment against Gould, permanently enjoining him from future violations, direct or indirect, of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Landberg, et al., 11-CV-0404 (PKC). Gould was also ordered to pay a $130,000 civil money penalty.

3. The Commission's amended complaint alleged that between at least January 2008 and May 2009 Gould knew, or was reckless in not knowing, that the returns West End funds were generating were not adequate to meet the funds' obligations. Account statements that Gould prepared misrepresented the returns of the West End funds. Gould was aware of the extensive commingling of assets among West End funds. Gould also facilitated the misuse of funds from a reserve account that was to be maintained on behalf of a lender to a West End fund and devised an accounting mechanism to disguise at least one instance where money was improperly taken from the account. Gould was also aware that investments were being used in ways that were inconsistent with what had been represented to West End's investors.

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the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

IV.

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

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

(i) pursuant to Section 203(f) of the Advisers Act that Respondent Gould be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.

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.

(ii) pursuant to Rule 102(e)(3) of the Commission's Rules of Practice, Gould 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

Commissioner Paredes
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3524 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15150

In the Matter of

STEVEN B. HART,

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 Steven B. Hart ("Hart").

II.

In anticipation of the institution of these proceedings, Hart 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, Hart 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 (the "Order"), as set forth below.

III.

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

1. Hart is the president, investment manager, portfolio manager, and sole owner and employee of Octagon Capital LLC, which is the general partner and manager of Octagon Capital Partners, LP ("Octagon Capital Partners"), an investment fund. Octagon Capital LLC and Octagon Capital Partners have never been registered with the Commission in any capacity. Hart was also employed as a portfolio manager from January 2006 to April 2011, providing investment advice for various investment funds (the "employer's funds"). Hart previously held Series 7 and 63 licenses and was associated with two broker-dealers that were registered with the Commission. Hart is 40 years old and is a resident of New York, New York.

2. On December 13, 2012, a final judgment was entered by consent against Hart in the civil action entitled Securities and Exchange Commission v. Steven B. Hart, Civil Action Number 12-CV-8986 (JPO), in the United States District Court for the Southern District of New York, permanently enjoining Hart from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act. Under the final judgment, Hart is liable to pay disgorgement in the amount of $831,071, plus prejudgment interest thereon in the amount of $103,424, and a civil penalty in the amount of $394,733.

3. The Commission's complaint against Hart alleged that, in connection with Hart's management of Octagon Capital Partners and the provision of investment advice to one of his employer's funds, Hart engaged in two fraudulent trading schemes, one involving matched trading and the other involving insider trading ahead of certain confidentially marketed offerings. As to the matched trading, the complaint further alleged that, from January 17, 2008 to June 4, 2009, Hart directed thirty-one matched trades in the securities of certain thinly traded issuers, intentionally causing his employer's fund to pay inflated prices for the securities to Octagon Capital Partners. Through this scheme, Hart benefitted Octagon Capital Partners at the expense of his employer's fund. The complaint further alleged that, from June 19, 2007 through March 15, 2011, Hart, on behalf of Octagon Capital Partners, traded the securities of nineteen issuers while in the possession of material nonpublic information. Generally, as to these issuers, Hart had been solicited to invest in their private investments in public equity (PIPEs), registered direct offerings, or confidentially marketed public offerings, and had agreed to keep confidential the information related to these offerings and not trade the issuers' securities until the offerings were publicly announced. Additionally, the complaint alleged that in two instances, Hart had signed a securities purchase agreement in which he falsely represented that, after being solicited, he had not traded the issuer's securities in the days leading up to the public announcement of the transaction.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Hart be, and hereby is:

> barred from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Hart 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 Hart, 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 Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 30313 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15146

In the Matter of **The New America High Income Fund, Inc.; Robert F. Birch; and Ellen E. Terry,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO 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**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against The New America High Income Fund, Inc., Robert F. Birch, and Ellen E. Terry (collectively "Respondents").

II.

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

III.

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

Summary

These proceedings arise out of actions by a registered closed-end investment company, The New America High Income Fund, Inc. ("New America" or "the Fund"), and its two executives, Robert F. Birch ("Birch") and Ellen E. Terry ("Terry"), concerning New America's preferred stock called Auction Term Preferred Stock ("ATP"). ATP is a type of auction rate security ("ARS").

In January 2008, during the ARS market crisis, New America, acting through Birch and Terry, repurchased $15 million of its own ATP from an ATP broker-dealer to avoid a failed auction. Although the repurchase also was intended to preserve ATP liquidity, it was inconsistent with the ATP terms and conditions, which prohibited the Fund from submitting an order or otherwise acquiring ATP in an ATP auction. The repurchase also unfairly discriminated against other ATP holders, and was contrary to the Fund's prior statements in shareholder reports that the Fund would redeem or repurchase ATP to the extent necessary to maintain applicable asset coverage requirements. The repurchase was not intended to maintain asset coverage requirements; it was designed to avoid a failed auction.

Also, in September 2008, when the broker-dealer for the majority of New America's ATP became subject to liquidation and resigned as an ATP broker-dealer, New America, acting through Birch and Terry, improperly lowered the dividend rate on the majority of its ATP from the Maximum Applicable Rate to the Minimum Applicable Rate. This reduction in the dividend rate also was inconsistent with the ATP terms and conditions, and resulted in an underpayment of dividends from September 2008 to December 2010 by 70% for a total amount of $410,594.08.

Respondents

1. **<u>The New America High Income Fund, Inc. ("New America" or "the Fund")</u>**, is organized as a Maryland corporation located in Boston, Massachusetts, and is registered with the Commission as a diversified, closed-end management investment company under the Investment Company Act.

2. **<u>Robert F. Birch ("Birch")</u>**, age 76, of Dover, Massachusetts, has been a Director and the President of New America since 1992.

3. **<u>Ellen E. Terry ("Terry")</u>**, age 53, of Reading, Massachusetts, is the Vice President and Treasurer (since 1992), Chief Compliance Officer (since 2004), and Secretary (since 2010) of New America.

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

Other Relevant Entities

4. **Lehman Brothers Inc. ("Lehman")**, a Delaware corporation with its principal offices in New York, New York, was a broker-dealer registered with the Commission under Section 15(b) of the Securities Exchange Act of 1934. On September 19, 2008, Lehman became subject to liquidation under the Securities Investor Protection Act after Lehman's parent company, Lehman Brothers Holdings Inc., filed a voluntary petition for bankruptcy on September 15, 2008. Lehman was the exclusive broker-dealer for New America's ATP Series A, B, and C.

Background

5. New America is a closed-end fund with a leveraged capital structure. The Fund's investment objective is to provide high current income, while seeking to preserve common stockholders' capital, through investment in a professionally managed, diversified portfolio of high-yield bonds. The Fund is managed under the direction of the Fund's Board of Directors and by its two officers, Birch and Terry. Birch, Terry, and another person who handles administrative matters are the Fund's only employees. The Fund's bond portfolio is managed by an external investment adviser.

6. The Fund's capital structure consists of two classes of securities—common and preferred stock. Its common stock is listed on the New York Stock Exchange under the symbol "HYB." As of January 2008 the Fund had issued and outstanding 5,200 shares of ATP in four Series (A, B, C, and D) for a total value of $130 million, based on a liquidation value of $25,000 per share.[2] The four ATP Series were issued under registration statements filed with the Commission and have nearly identical terms and conditions, including auction procedures.

7. ATP allowed the Fund to borrow for the long-term at short-term interest rates. ATP are essentially perpetual preferred stock because they do not have a maturity date. The Fund uses ATP proceeds to invest in high-yield bonds to increase the Fund's net asset value ("NAV") and to contribute to common stock dividends. Under the Investment Company Act and in order to maintain Aaa/AAA credit ratings, the Fund must comply with asset coverage requirements obligating the Fund to hold a certain percentage of assets in its bond portfolio in excess of the ATP liquidation value.

8. Like many ARS, each ATP Series may be traded every twenty-eight days through a Dutch auction in which the ATP dividend would be reset. The auctions for New America's four ATP Series were staggered so that there was one auction for one Series approximately every week. ATP auction dividends typically cleared or reset at or just below the 30-day, AA Composite Commercial Paper Rate (the "Benchmark Rate" which is similar to 1-Month LIBOR).

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2 Auction rate securities, such as New America's ATP, are bonds or preferred stock with interest rates or dividend yields that are periodically reset through Dutch auctions, typically held every seven, twenty-eight, or thirty-five days. ARS were usually issued with variable maturity dates from five to thirty years, but can be issued with no maturity date. ATP were often sold to investors by broker-dealers as a "cash management alternative" in light of their short-term dividend periods. General information about ARS is available at http://www.sec.gov/investor/ars.htm.

9. For an ATP auction to occur on a scheduled auction date, at least one broker-dealer must gather and submit orders to the auction agent appointed by the Fund. If a scheduled auction was not held for any reason, or if an auction "failed" due to insufficient clearing or buy orders to cover sell orders, the ATP dividend was automatically reset at the "Maximum Applicable Rate" (150% of the Benchmark Rate), until the next auction. If all holders submitted (or were "deemed" to have submitted) hold orders in any auction, the auction was an "all-hold" auction and the ATP dividend was automatically reset at the "Minimum Applicable Rate" (80% of the Benchmark Rate), until the next auction.

10. Under ATP auction procedures set forth in the Fund's ATP registration statements, the Fund may not submit an order or otherwise acquire ATP in any ATP auction. The Fund's ATP broker-dealers, however, routinely placed buy orders ("support bids") in ATP auctions to prevent failed auctions. If an auction had insufficient buy orders, the broker-dealers' support bids were partially filled, and they purchased ATP for their own accounts or inventory. The broker-dealers also routinely placed sell orders in every auction (for which they held ATP in inventory) to prevent all-hold auctions.

11. The Fund's ATP registration statements permit the Fund to redeem or repurchase ATP outside of an auction under certain circumstances, such as when the Fund's assets and NAV are in decline and the Fund needs to reduce leverage. The Fund may redeem or repurchase ATP by (1) a mandatory redemption; (2) an optional redemption; or (3) a repurchase in market or other transactions. Any redemption or repurchase also must comply with Section 23(c) of the Investment Company Act and rules thereunder, which prohibit a closed-end fund from purchasing its own securities except under limited conditions. The Fund's shareholder reports filed with the Commission from 1996 to 2008 stated that the Fund "intends to effect such redemptions and/or repurchases to the extent necessary to maintain applicable asset coverage requirements." In the past, the Fund had repurchased ATP when its assets and NAV were declining to decrease leverage and maintain asset coverage requirements.

Facts

New America's Repurchase of ATP to Avoid a Failed Auction

12. Beginning in August 2007, as the subprime mortgage market crisis spread to the ARS market, demand for ARS plummeted, causing some ARS auctions to fail. The contagion effect of these failures quickly spread to New America's ATP. Lehman, as the exclusive broker-dealer for New America's ATP Series A, B, and C, bought increasing amounts of ATP as the buyer of last resort to prevent ATP auctions from failing. By the end of August, Lehman had bought more than $37 million (of $105 million) of Series A, B, and C at auctions. By mid-September, Lehman owned more than $57 million.

13. The ARS market crisis also caused a spike in ATP auction dividend rates. Before August 2007, ATP auction dividends usually had cleared at or just below the Benchmark Rate. But the ARS market crisis caused ATP dividends from August to September 2007 to clear 15-30% higher than the Benchmark Rate. For example, on July 30, 2007, the Series A auction cleared at

5.28% (or just 0.75% below the Benchmark Rate). The next Series A auction on August 27, however, cleared at 6.90% (or 25.39% above the Benchmark Rate).

14. On September 12, 2007, the ATP troubles caused the Fund to issue a press release announcing that "as a result of turmoil in the commercial paper markets and its effect on investor demand, there has been a significant increase in the dividend rates for the four series of the Fund's [ATP]." The release also warned that "[u]nder current market conditions, there is no assurance that future auctions of the Fund's ATP will be successful."

15. From September to December 2007, Lehman continued to place support bids in Series A, B, and C auctions and bought even more ATP even though the ATP market remained troubled. By the end of December, Lehman had bought more than $84 million (or 80%) of New America's Series A, B and C, and ATP dividend rates continued to clear well above historic levels and the Benchmark Rate.

16. Late in the week of January 7, 2008, Lehman's head ARS trader informed Birch and Terry that Lehman—which by then owned more than $91 million of ATP—would no longer be the buyer of last resort at ATP auctions, and that, unless the Fund repurchased some ATP from Lehman's inventory, the next ATP auction (of Series A) on Monday, January 14, could fail due to approximately $15 million (or 600 shares) of expected sell orders from other holders.

17. On or around Friday, January 11, Birch authorized the Fund to repurchase $15 million of ATP from Lehman after separate discussions with certain Fund directors. Birch authorized this repurchase with the understanding that Lehman would in turn place a support bid in the January 14th auction of Series A and buy whatever amount was necessary to prevent a failed auction. At the time, Birch and Terry believed that even one failed auction could cause all future ATP auctions to fail. A failed auction also would deprive existing ATP shareholders of liquidity, and could prevent the Fund from replacing Lehman with another ATP broker-dealer.

18. Birch and Terry understood that, under the Fund's ATP registration statements, the Fund could not submit an order or acquire ATP in ATP auctions. Thus, they decided that the Fund should not repurchase any Series A from Lehman, as that Series was scheduled to auction on January 14th. Birch and Terry agreed with the Lehman trader's suggestion that the Fund repurchase $15 million of non-Series A-ATP. The Fund repurchased $15 million of Series C ATP, of which Lehman by then had owned nearly $42 million out of $45 million outstanding. The Series A auction on Monday, January 14th was successful, with Lehman placing a support bid and purchasing an additional $12.5 million into its inventory.

19. By repurchasing $15 million of Series C as a means to maintain Lehman's support of the January 14th Series A auction and thereby avoid an auction failure, the Fund indirectly submitted an order or acquired ATP in the Series A auction, which was inconsistent with the ATP terms and conditions. The repurchase also was contrary to the Fund's disclosures in shareholder reports, which stated that the Fund intended to repurchase ATP "to the extent necessary to maintain asset coverage requirements." The repurchase from Lehman was not driven by any concern with the asset coverage requirements.

20. Later in January 2008, Birch and Terry negotiated with another broker-dealer to replace Lehman as the Series A, B, and C broker-dealer. This prospective broker-dealer began to purchase most of the ATP from Lehman's inventory, and Lehman continued to place support bids in ATP auctions to prevent auction failures while the Fund and the prospective broker-dealer were negotiating a written broker-dealer agreement. However, on February 13, 2008, before the agreement could be executed, the ARS market collapsed and all ATP auctions began to fail.

21. In New America's 2008 Semi-Annual Report filed with the Commission on Form N-CSRS (Sept. 4, 2008), the Fund reported a change in the number of outstanding ATP shares from 5,200 to 4,600. The report did not explain that the Fund had repurchased 600 shares ($15 million) of ATP from Lehman in January 2008 to avoid a failed auction. With the assistance of the Fund's counsel, Birch and Terry drafted, signed, and filed the 2008 Semi-Annual Report on Form N-CSRS.

New America's Failure to Pay the Correct ATP Dividend After Lehman's Demise

22. The Fund's ATP auction procedures set forth in ATP registration statements require the ATP dividend to be automatically reset at the Maximum Applicable Rate (1) if sufficient clearing or buy orders do not exist in an auction (*i.e.*, auction failure), or (2) if an auction is not held for any reason. The only applicable exception to this procedure is when all holders submit or are "deemed" to have submitted a hold order for a given auction. In that situation, the resulting auction is an "all-hold" auction with the ATP dividend resetting at the Minimum Applicable Rate. For this exception to apply, however, there must be a duly appointed broker-dealer that can participate in the auction. If no such broker-dealer exists, then the auction cannot be held, and the ATP dividend must be automatically reset at the Maximum Applicable Rate as described above. Also, Lehman's routine practice was to submit a sell order (when it was holding ATP in inventory) in every ATP auction to prevent an all-hold auction, thus preventing the ATP dividend from resetting at the Minimum Applicable Rate.

23. Since February 13, 2008, ATP dividends had been resetting at the Maximum Applicable Rate because of failed auctions as a result of insufficient clearing or buy orders. On September 15, 2008, Lehman's parent holding company filed a voluntary bankruptcy petition. On September 19, 2008, Lehman was subject to liquidation proceedings under the Securities Investor Protection Act. Lehman began to shut down most of its broker-dealer operations, including the ARS trading desk, and laid off thousands of employees. On the same day, a Lehman ARS trader e-mailed the ATP auction agent stating that, due to the liquidation Lehman was resigning as the broker-dealer for all ARS, including New America's ATP Series A, B, and C. Beginning on September 22nd, Series A, B, and C auctions were not held because of Lehman's resignation.

24. Shortly after Lehman's liquidation commenced, an auction agent called Terry to seek her guidance on the appropriate dividend rate for Series A, B, and C. The auction agent was unclear whether the Series A, B, and C auction dividends should continue to reset at the Maximum Applicable Rate, as Lehman was not submitting any orders. Before its liquidation, Lehman had been submitting sell orders in Series A, B, and C auctions to prevent all-hold auctions and the application of the Minimum Applicable Rate. After consulting with Birch and Fund counsel, Terry told the auction agent that, if there was no order submitted on behalf of any ATP holder, the Fund

would deem all holders to have submitted hold orders, resulting in an all-hold auction with dividends resetting at the Minimum Applicable Rate. Following this conversation, the auction agent reset the Series A, B, and C dividends at the Minimum Applicable Rate. As a result, the Fund began to pay dividends to Series A, B, and C holders at the Minimum Applicable Rate in September 2008.

25. Under ATP auction procedures, the Maximum Applicable Rate should have applied for Series A, B, and C dividends when Lehman, the exclusive Series A, B, and C broker-dealer, resigned due to its liquidation. As noted above, the auction procedures require ATP dividends to be automatically reset at the Maximum Applicable Rate in the event an auction is not held for any reason. After Lehman's resignation, Series A, B, and C auctions could not be held because there was no broker-dealer. Without a broker-dealer, the exception permitting the Fund to deem all holders as having submitted hold orders should not have applied. Because Series A, B, and C holders could not submit orders directly to the auction agent, it was not possible to hold auctions after Lehman's resignation, and the dividend rate should have been automatically reset at the Maximum Applicable Rate.

26. The Fund's 2008 Semi-Annual Report filed with the Commission on Form N-CSRS (Sept. 4, 2008) contained the following statement on ATP auction failures beginning in February 2008:

> [S]ince February the auctions for most auction rate securities, including the Fund's ATP have failed. As a result of the auction failures, the holders of the Fund's ATP have not been able to sell the ATP. In a failed auction, the ATP dividend is set according to the terms of the ATP prospectus at 150% of the [Benchmark Rate].

27. After the Fund began paying the Minimum Applicable Rate for Series A, B, and C dividends in the wake of Lehman's liquidation in September 2008, the Fund's 2008 Annual Shareholder Report filed on Form N-CSR (Mar. 6, 2009) contained the following revised disclosure:

> As a result of the auction failures, holders of the Fund's ATP have not been able to sell their ATP in monthly auctions. Because of these auction failures, the dividend rate for each series of the ATP *has been, and will continue to be so long as the auctions are not successful, automatically set at each auction using a formula* dictated by the terms of the ATP. This formula is based on [the Benchmark Rate] as described in the ATP prospectus. [Emphasis added.]

The 2008 Annual Shareholder Report did not disclose that the Fund had determined that the Minimum Applicable Rate would apply to Series A, B, and C dividends beginning in September 2008, even though auctions for those ATP were not being held. To date, there is no Series A, B, or C broker-dealer, and auctions for those ATP are not being held. With the assistance of the Fund's counsel, Birch and Terry drafted, signed, and filed the Fund's 2008 Annual Shareholder Report.

28. On December 27, 2010, after Commission staff commenced an examination and investigation of matters relating to the Fund's ATP, the Fund announced that the Fund's Board

had authorized the Fund to pay a "Supplemental Dividend" in the amount of $413,399.57 to Series A, B, and C holders. This Supplemental Dividend is the difference between the Minimum Applicable Rate that was paid and the Maximum Applicable Rate that would have been paid as Series A, B, and C dividends from September 2008 through October 2010, plus interest. The Board also authorized the Fund to pay the Maximum Applicable Rate for Series A, B, and C dividends on scheduled auction dates from October 2010 forward.

Violations

29. As a result of the conduct described above, Respondent New America willfully[3] violated Section 23(c) of the Investment Company Act and Rule 23c-1 thereunder. Section 23(c) states that "[n]o registered closed-end company shall purchase any securities of any class of which it is the issuer except" under limited conditions. Rule 23c-1(a) enumerates eleven such conditions, including the following: "The purchase is not made in a manner or on a basis which discriminates unfairly against any holders of the class of securities purchased," and "the issuer has, within the preceding six months, informed stockholders of its intention to purchase stock of such class by letter or report addressed to all the stockholders of such class." Rule 23c-1(a)(9) & (10).

30. New America's repurchase of ATP in January 2008 from Lehman outside of an auction and at the liquidation value was made in a manner or on a basis which discriminated unfairly against other ATP holders. New America also did not adequately notify ATP holders of its intention to repurchase ATP because it had only informed investors that it would repurchase ATP "to the extent necessary to maintain applicable asset coverage requirements." The January 2008 repurchase, however, was not made for this purpose, but rather to prevent an auction failure. By authorizing and executing the repurchase for the Fund, Respondents Birch and Terry caused New America's violations of Section 23(c) and Rule 23c-1.

31. Respondents also willfully violated Section 34(b) of the Investment Company Act, which states: "It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to [the Investment Company Act,]" and "[i]t shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading."

32. New America's repurchase of its ATP in January 2008 was inconsistent with the Fund's ATP terms and conditions, which prohibited the Fund from submitting an order or otherwise acquiring ATP in ATP auctions. New America disclosed in the 2008 Semi-Annual Report filed on Form N-CSRS the reduction in the number of outstanding ATP shares. Because that disclosure did not specify that New America had repurchased ATP from Lehman to avoid a

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[3] 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)).

failed auction, the 2008 Semi-Annual Report was materially misleading at the time of filing. As a result, Respondents violated Section 34(b).

33. New America's payment of the Minimum Applicable Rate for Series A, B, and C dividends from September 2008 to December 2010 was also inconsistent with the ATP terms and conditions, which prescribed that the Maximum Applicable Rate would apply automatically in the event an ATP auction was not held for any reason. Because New America failed to disclose in the 2008 Annual Report filed on Form N-CSR that the Minimum Applicable Rate would be applied for Series A, B, and C dividends even though no auctions were being held for those ATP beginning in September 2008, the 2008 Annual Report was materially misleading at the time of filing. As a result, Respondents violated Section 34(b).

IV.

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

Accordingly, pursuant to Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent New America cease and desist from committing or causing any violations and any future violations of Sections 23(c) and 34(b) of the Investment Company Act and Rule 23c-1 promulgated thereunder.

B. Respondents Birch and Terry cease and desist from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act, and from causing any violations and any future violations of Section 23(c) of the Investment Company Act and Rule 23c-1 promulgated thereunder.

C. Respondent New America is ordered to pay disgorgement in the amount of $410,594.08 and prejudgment interest of $2,805.49. This order to pay disgorgement and prejudgment interest shall be deemed satisfied by New America's voluntary payment of the Supplemental Dividend to ATP Series A, B, and C holders in the amount of $413,399.57 on December 27, 2010.

D. Respondents Birch and Terry each shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $10,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the United States Treasury and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Birch and Terry as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Conway T. Dodge, Jr., Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Mail Stop 6561-A, Washington, DC 20549.

E. To preserve the deterrent effect of the civil penalty, Birch and Terry 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 their payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Birch and Terry 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 Respondents by or on behalf of one or more investors based on substantially the same findings in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 20, 2012

In the Matter of **IAS Energy, Inc.,** **IB3 Networks, Inc.,** **IBroadband, Inc.,** **ICP Solar Technologies, Inc.,** **IdentiPHI, Inc.,** **iDNA, Inc.,** **Immune Network Ltd.,** **Inca Designs, Inc.,** **Indico Technologies, Inc. (n/k/a Indico Resources Ltd.),** **Infopage, Inc. (a/k/a Tamija Gold & Diamond Exploration, Inc.),** **Innofone.com, Inc. (n/k/a Goldstar Global Minerals Corp.),** **Instachem Systems, Inc. (n/k/a CH Lighting International Corp.),** **Interlink-US-Network, Ltd., and** **International Aerospace Enterprises, 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 IAS Energy, Inc. because it has not filed any periodic reports since the period ended January 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of IB3 Networks, Inc. because it has not filed any periodic reports since the period ended September 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of IBroadband, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ICP Solar Technologies, Inc. because it has not filed any periodic reports since the period ended October 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of IdentiPHI, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of iDNA, Inc. because it has not filed any periodic reports since the period ended October 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Immune Network Ltd. because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Inca Designs, Inc. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Indico Technologies, Inc. (n/k/a Indico Resources Ltd.) because it has not filed any periodic reports since the period ended November 30, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Infopage, Inc. (a/k/a Tamija Gold & Diamond Exploration, Inc.) because it has not filed any periodic reports since the period ended September 30, 1993.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Innofone.com, Inc. (n/k/a Goldstar Global Minerals Corp.) 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 Instachem Systems, Inc. (n/k/a CH Lighting International Corp.) because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Interlink-US-Network, Ltd. because it has not filed any periodic reports since the period ended September 30, 2010.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on December 20, 2012, through 11:59 p.m. EST on January 4, 2013.

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. 68486 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15145

In the Matter of	
IAS Energy, Inc., IB3 Networks, Inc., Immune Network Ltd., Indico Technologies, Inc. (n/k/a Indico Resources Ltd.), Innofone.com, Inc. (n/k/a Goldstar Global Minerals Corp.), and International Aerospace Enterprises, 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 IAS Energy, Inc., IB3 Networks, Inc., Immune Network Ltd., Indico Technologies, Inc. (n/k/a Indico Resources Ltd.), Innofone.com, Inc. (n/k/a Goldstar Global Minerals Corp.), and International Aerospace Enterprises, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. IAS Energy, Inc. (CIK No. 945641) is an Oregon corporation located in Richmond, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IAS Energy is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a

Form 10-Q for the period ended January 31, 2011, which reported a net loss of $179,072 for the prior nine months, and was not reviewed by an auditor as required by Reg. S-X of the Securities Act of 1933 ("Securities Act"). IAS Energy's Form 10-Q for the period ended October 31, 2010 was also not reviewed by an auditor. Thus, the Forms 10-Q for the periods ended January 31, 2011 and October 31, 2010 were materially deficient. As of December 14, 2012, the company's stock (symbol "IASCA") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. IB3 Networks, Inc. (CIK No. 1350962) is a defaulted Nevada corporation located in Columbus, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IB3 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, 2009, which reported a net loss of over $1.68 million for the prior nine months. As of December 14, 2012, the company's stock (symbol "IBNW") 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. Immune Network Ltd. (CIK No. 1097907) 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). Immune Network is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a loss of over $16 million for the prior twelve months. As of December 14, 2012, the company's stock (symbol "IMMFF") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Indico Technologies, Inc. (n/k/a Indico Resources Ltd.) (CIK No. 1079155) is an Alberta corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Indico Technologies 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, 1999. As of December 14, 2012, the company's stock (symbol "IDIFF") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Innofone.com, Inc. (n/k/a Goldstar Global Minerals Corp.) (CIK No. 1100364) is a Nevada corporation located in Santa Monica, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Innofone.com 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, 2007, which reported a net loss of over $33 million for the prior nine months. As of December 14, 2012, the company's stock (symbol "IMEN") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. International Aerospace Enterprises, Inc. (CIK No. 1156293) is a defaulted Nevada corporation located in Carson City, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Aerospace 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, 2010, which reported a net loss of $538,500 for the prior three months. As of December 14, 2012, the company's stock (symbol "IARO") 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

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.

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

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68484 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15143

In the Matter of IBroadband, Inc., IdentiPHI, Inc., Inca Designs, Inc., and Instachem Systems, Inc. (n/k/a CH Lighting International Corp.), Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents IBroadband, Inc., IdentiPHI, Inc., Inca Designs, Inc., and Instachem Systems, Inc. (n/k/a CH Lighting International Corp.)

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. IBroadband, Inc. (CIK No. 1358700) is a revoked Nevada corporation located in Farmer's Branch, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IBroadband is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for period ended September 30, 2007, which reported a net loss of over $2.23 million for the year ended September 30, 2006. As of December 14, 2012, the company's stock (symbol "IBBD") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. IdentiPHI, Inc. (CIK No. 847555) is a void Delaware corporation located in Austin, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IdentiPHI 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 over $5.9 million for the prior nine months. On February 11, 2009, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Texas, which was terminated on March 29, 2010. As of December 14, 2012, the company's stock (symbol "IDPIQ") 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. Inca Designs, Inc. (CIK No. 1084702) is a defaulted Nevada corporation located in Miami Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Inca Designs 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, 2010, which reported a net loss of $603,516 for the prior nine months. As of December 14, 2012, the company's stock (symbol "IDGI") was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Instachem Systems, Inc. (n/k/a CH Lighting International Corp.) (CIK No. 1110396) is a void Delaware corporation located in Shangyu City, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Instachem 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, 2010. As of December 14, 2012, the company's stock (symbol "CHHN") 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

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68485 / December 20, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15144

In the Matter of ICP Solar Technologies, Inc., iDNA, Inc., Infopage, Inc. (a/k/a Tamija Gold & Diamond Exploration, Inc.), and Interlink-US-Network, Ltd., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents ICP Solar Technologies, Inc., iDNA, Inc., Infopage, Inc. (a/k/a Tamija Gold & Diamond Exploration, Inc.), and Interlink-US-Network, Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. ICP Solar Technologies, Inc. (CIK No. 1281872) is a revoked Nevada corporation located in Montreal, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ICP Solar 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, 2009, which reported a net loss of over $8.5 million for the prior nine months. As of December 14, 2012, the company's stock (symbol "ICPR") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC

Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. iDNA, Inc. (CIK No. 1004981) 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). iDNA 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, 2008, which reported a net loss of over $5.9 million for the prior nine months. As of December 14, 2012, the company's stock (symbol "IDAI") 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. Infopage, Inc. (a/k/a Tamija Gold & Diamond Exploration, Inc.) (CIK No. 716944) is a void Delaware corporation located in Edison, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Infopage 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, which reported a net loss of over $2 million for the prior nine months. As of December 14, 2012, the company's stock (symbol "TMJG") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Interlink-US-Network, Ltd. (CIK No. 1144347) is a suspended California corporation located in Syosset, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Interlink 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, 2010. As of December 5, 2012, the company's stock (symbol "IUSN") was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 68525 / December 21, 2012

Admin. Proc. File No. 3-14786

In the Matter of TOOLEX INTERNATIONAL N.V., *et al.*

ORDER DISMISSING WITH RESPECT TO TRIBRIDGE ENTERPRISES CORP., n/k/a NORTHERN LION GOLD CORP.

On March 6, 2012, an administrative proceeding was instituted against Tribridge Enterprises Corp., now known as Northern Lion Gold Corp., along with six other issuers under § 12(j) of the Securities Exchange Act of 1934.[1] The Order Instituting Proceedings alleged that Tribridge violated periodic reporting requirements; it ordered a hearing to determine whether these allegations were true and, if so, whether suspension or revocation of the registration of Tribridge's securities was necessary and appropriate for the protection of investors.

On March 22, 2012, after these proceedings were instituted against it, Tribridge filed a Form 15, pursuant to Exchange Act Rule 12g-4(a),[2] to voluntarily terminate the registration of its securities under Exchange Act § 12(g).[3] Under Rule 12g-4(a), an issuer's registration is terminated ninety days after filing Form 15, which in this case was June 20, 2012. As a result, the Division of Enforcement filed a motion to dismiss the proceeding against Tribridge, based on the deregistration of its securities; Tribridge has not responded to the Division's motion.

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1 15 U.S.C. § 78l(j). All of the other respondents' registrations have been revoked as part of this proceeding. *See Toolex Int'l N.V.*, Exchange Act Release No. 66899, 2012 SEC LEXIS 1381 (May 2, 2012) (revoking registration of Toolex); *Toolex Int'l N.V.*, Exchange Act Release No. 66694, 2012 SEC LEXIS 1022 (Mar. 30, 2012) (revoking registrations of topjobs.net PLC, Tropika International Ltd., Tsunami Media Corp., T.Z.F. International Investments, Inc., and Vantage Enterprises Corp. (n/k/a African Gemstones Ltd.)).

2 17 C.F.R. § 240.12g-4(a) (certification of termination of registration under § 12(g)).

3 15 U.S.C. § 78l(g).

It is appropriate to grant the Division's motion because the respondent does not now have a class of registered securities and because revocation or suspension of registration is the only remedy available in a proceeding instituted under Exchange Act § 12(j).[4]

Accordingly, IT IS ORDERED that this proceeding be dismissed with respect to Tribridge Enterprises Corp., now known as Northern Lion Gold Corp.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

4 *See, e.g., Aegis Assessments, Inc.*, Exchange Act Release No. 68379, 2012 SEC LEXIS 3762, at *2 (Dec. 6, 2012) (granting motion to dismiss Exchange Act § 12(j) proceeding against respondent where respondent no longer had a class of securities registered with the Commission).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68509 / December 21, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15152

In the Matter of **David C. Lin, Esq.** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to issue an order of forthwith suspension against David C. Lin ("Lin") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].[1]

II.

The Commission finds that:

1. Lin is an attorney, whom the State of California admitted to practice law in 1994.

2. On September 26, 2012, a judgment of conviction was entered against Lin in United States v. Lin, No. CR-11-00393-004 TEH, in the United States District Court for the Northern District of California, finding him guilty of one count of conspiracy to commit mail fraud or wire fraud in violation of Title 18 U.S.C. Section 1349, one count of wire fraud in violation of Title 18 U.S.C. Section 1343, and sixteen counts of mail fraud in violation of Title 18 U.S.C. Section 1341.

3. As a result of this conviction, Lin was sentenced to 28 months in federal prison followed by three years of supervised release.

4. On November 5, 2012, the District Court for the Northern District of California ordered Lin to pay restitution, on a joint-and-several basis with other defendants in the criminal

[1] Rule 102(e)(2) provides, in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission." See 17 C.F.R. § 201.102(e)(2).

ection, in an amount to be determined after a restitution hearing, which was held on December 3, 2012.

III.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3525 / December 21, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15153

In the Matter of **James S. Ward,** **Edward G. Locker,** **Richard F. Tipton, and** **David C. Lin,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING**

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 James S. Ward, Edward G. Locker, Richard F. Tipton, and David C. Lin ("Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Respondent Ward was co-owner of Jim Ward & Associates ("JWA") and operated JWA from 2001 until at least 2006. From 2003 to 2006, JWA was investment adviser to Blue Chip Realty Fund LLC ("Blue Chip"), and Ward was associated with JWA. Ward also was an owner of JSW Financial Inc. ("JSW"), which stood for "James Stanley Ward," and continued to participate in JSW's operations from 2006 until at least 2008 in the same manner as he had with JWA. Ward was responsible for, among other duties at JWA and JSW, investor relations, loan decisions, project management, and property acquisitions. From 2006 until at least 2008, JSW was investment adviser to Blue Chip and Shoreline Investment Fund, LLC ("Shoreline"), and Ward was associated with JSW. Ward, age 66, is a resident of Delaware, Ohio.

2. Respondent Locker was employed at JWA beginning in or about October 2002 and thereafter at JSW until it ceased operations. From 2003 to 2006, JWA was investment adviser to Blue Chip and Locker was associated with JWA. Locker became President and a one-third owner of JSW in or about January 2006. Locker was responsible for, among other duties at

JWA and JSW, investor relations, loan decisions, project management, and property acquisitions. Locker also directly supervised employees who handled accounting and bookkeeping for JWA and JSW. From 2006 until at least 2008, JSW was investment adviser to Blue Chip and Shoreline and Locker was associated with JSW. Locker, age 37, is a resident of Highland Heights, Ohio.

3. Respondent Tipton was employed at JWA beginning in or about March 2005 and thereafter at JSW until it ceased operations. Tipton became Vice President and a one-third owner of JSW in or about January 2006. Tipton was responsible for, among other duties at JWA and JSW, investor relations and strategic planning. From 2006 until at least 2008, JSW was investment adviser to Blue Chip and Shoreline and Tipton was associated with JSW. Tipton, age 62, is a resident of Palo Alto, California.

4. Respondent Lin was employed at JWA beginning in or about December 2004 and thereafter at JSW until it ceased operations. Lin became Secretary and Counsel, and a one-third owner of JSW, in or about January 2006. Lin was responsible for, among other duties at JWA and JSW, legal compliance matters and documentation. From 2006 until at least 2008, JSW was investment adviser to Blue Chip and Shoreline and Lin was associated with JSW. Lin, age 45, is a resident of Sunnyvale, California.

B. RESPONDENTS' CRIMINAL CONVICTIONS

5. On December 6, 2011, Ward pled guilty to one count of conspiracy to commit mail and wire fraud in violation of Title 18 United States Code, Section 1349, before the United States District Court for the Northern District of California, in United States v. Ward, Case Number CR-11-00393-001 TEH. On August 23, 2012, a judgment in the criminal case was entered against Ward. He was sentenced to a prison term of 60 months followed by three years of supervised release.

6. On December 7, 2011, Locker pled guilty to one count of conspiracy to commit mail and wire fraud in violation of Title 18 United States Code, Section 1349, before the United States District Court for the Northern District of California, in United States v. Locker, Case Number CR-11-00393-002 TEH. On October 16, 2012, a judgment in the criminal case was entered against Locker. He was sentenced to a prison term of 30 months followed by three years of supervised release.

7. On December 7, 2011, Tipton pled guilty to one count of conspiracy to commit mail and wire fraud in violation of Title 18 United States Code, Section 1349, before the United States District Court for the Northern District of California, in United States v. Tipton, Case Number CR-11-00393-003 TEH. On September 26, 2012, a judgment in the criminal case was entered against Tipton. He was sentenced to a prison term of 18 months followed by three years of supervised release.

8. On May 15, 2012, a jury found Lin guilty of one count of conspiracy to commit mail fraud or wire fraud in violation of Title 18 United States Code, Section 1349; one count of wire fraud in violation of Title 18 United States Code, Section 1343; and sixteen counts of mail fraud in violation of Title 18 United States Code, Section 1341, before the United States District Court for the Northern District of California, in United States v. Lin, Case Number CR-

11-00393-004 TEH. On September 26, 2012, a judgment in the criminal case was entered against Lin. He was sentenced to a prison term of 28 months followed by three years of supervised release.

9. On November 5, 2012, the District Court for the Northern District of California ordered Ward, Locker, Tipton, and Lin to pay restitution, on a joint-and-several basis, in an amount to be determined after a restitution hearing, which was held on December 3, 2012.

10. The count of the criminal indictment to which Respondents Ward, Locker, and Tipton pled guilty, and the counts of which Respondent Lin was found guilty, alleged, *inter alia*, that Respondents engaged in a scheme to defraud investors in Blue Chip and Shoreline by misrepresenting that investors' money would be and was being used to make loans secured by deeds of trust on real estate. The indictment further alleged that Respondents knew that, at least from September 2005 through October 2008, almost none of the money invested in Blue Chip and Shoreline was used for loans secured by deeds of trust, but rather was used to make purported interest payments to earlier investors and for other business expenses. According to the indictment, Respondents thereby knowingly and intentionally conspired to and did devise a material scheme and artifice to defraud and to obtain money and property from investors through JWA and JSW by means of materially false and fraudulent pretenses, representations, and promises, and statements containing material omissions, and for the purpose of executing such scheme and artifice to defraud, knowingly and intentionally caused matter to be delivered by the United States Postal Service and private and commercial interstate carriers and transmitted writings and other matter by means of wire in interstate commerce. The conduct that is the basis of Respondents' criminal convictions arises out of the conduct of the business of an investment adviser and occurred while Respondents were associated with an investment adviser.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 203(f) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that Respondents each 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 any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that 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 Respondents personally, by certified mail, or as otherwise provided by Rule 141 of the Commission's Rules of Practice, 17 C.F.R. § 201.141.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 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

Lynn M. Powalski

By: Lynn M. Powalski
Deputy 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 **December 2012**, 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.

Elisse B. Walter, SEC Chairman
December 15, 2012 to Present

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

ELISSE B. WALTER, CHAIRMAN

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(16 Documents)

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68453; File No. PCAOB-2012-01)

December 17, 2012

Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules on Auditing Standard No. 16, Communications with Audit Committees, and Related and Transitional Amendments to PCAOB Standards

I. Introduction

On August 28, 2012, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 107(b)[1] of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and Section 19(b)[2] of the Securities Exchange Act of 1934 (the "Exchange Act"), proposed rules to adopt PCAOB Auditing Standard No. 16, "Communications with Audit Committees," and related and transitional amendments to PCAOB standards (collectively, the "Proposed Rules"). The Proposed Rules were published for comment in the Federal Register on September 17, 2012.[3] At the time the notice was issued, the Commission designated a longer period to act on the Proposed Rules, until December 17, 2012.[4] The Commission received five comment letters in response to the notice.[5] On November 9, 2012, the PCAOB submitted a letter addressing certain comments received by the Commission.[6] This order approves the Proposed Rules.

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[1] 15 U.S.C. 7217(b).

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

[3] See Release No. 34-67804 (September 10, 2012), 77 FR 57408 (September 17, 2012).

[4] Ibid.

[5] See letters to the Commission from Howard B. Levy, Principal and Director, Technical Services, Piercy Bowler Taylor & Kern, dated September 28, 2012 ("Piercy Letter"); Robert L. Leclerc, Chairman, Quest Rare Minerals Ltd., dated September 30, 2012 ("Quest Letter"); Tom Quaadman, Vice President, Center for Capital Markets

II. Description of the Proposed Rules

Auditing Standard No. 16 will supersede PCAOB interim auditing standard AU section 380, "Communication with Audit Committees" ("AU sec. 380"), and interim auditing standard AU section 310, "Appointment of the Independent Auditor" ("AU sec. 310"). Auditing Standard No. 16 retains or enhances existing audit committee communication requirements, incorporates SEC auditor communication requirements set forth in Rule 2-07 of Regulation S-X,[7] provides a definition of the term 'audit committee' for issuers and non-issuers, and adds new communication requirements that are generally linked to performance requirements set forth in other PCAOB auditing standards.

Auditing Standard No. 16 requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee. This requirement aligns the auditing standard with the provision of the Exchange Act, as amended by the Sarbanes-Oxley Act, that requires the audit committee of listed companies to be responsible for the appointment of the external auditor.[8] Additionally, Auditing Standard No. 16 requires the auditor to record the terms of the engagement in an engagement letter and to have the engagement letter executed by the appropriate party or parties on behalf of the company and determine that the audit committee has acknowledged and agreed to the terms.

Competitiveness, U.S. Chamber of Commerce, dated October 5, 2012 ("Chamber Letter"); Deloitte & Touche LLP, dated October 5, 2012 ("Deloitte Letter"); and Cindy M. Fornelli, Executive Director of the Center for Audit Quality, dated October 9, 2012 ("CAQ Letter").

[6] See letter to the Commission from the PCAOB, dated November 9, 2012.

[7] 17 CFR 210.2-07.

[8] See Section 10A(m) of the Exchange Act, as added by Section 301 of the Sarbanes-Oxley Act.

Auditing Standard No. 16 requires the communications with the audit committee to occur before the issuance of the audit report. The standard requires auditors to communicate, among other matters, the following to audit committees:

- Certain matters regarding the company's accounting policies, practices, and estimates (consistent with Rule 2-07 of Regulation S-X);
- The auditor's evaluation of the quality of the company's financial reporting;
- Information related to significant unusual transactions, including the business rationale for such transactions;
- An overview of the overall audit strategy, including timing of the audit, significant risks the auditor identified, and significant changes to the planned audit strategy or identified risks;
- Information about the nature and extent of specialized skill or knowledge needed in the audit, the extent of the planned use of internal auditors, company personnel or other third parties, and other independent public accounting firms, or other persons not employed by the auditor that are involved in the audit;
- Difficult or contentious matters for which the auditor consulted outside the engagement team;
- The auditor's evaluation of going concern;
- Expected departures from the auditor's standard report; and
- Other matters arising from the audit that are significant to the oversight of the company's financial reporting process, including complaints or concerns regarding

accounting or auditing matters that have come to the auditor's attention during the audit.

Auditing Standard No. 16 retains from AU sec. 380 the option for auditors to communicate to audit committees either orally or in writing, unless otherwise specified in the standard. The auditor is required to document the communications in the work papers, regardless of whether the communications take place orally or in writing.

As part of the Proposed Rules, the Board adopted conforming amendments to several PCAOB standards, including PCAOB interim auditing standard AU sec. 722, "Interim Financial Information." In addition to the conforming amendments, the Board adopted transitional amendments to AU sec. 380 so that audit committee communications would continue to be required in audits of all SEC-registered broker-dealers in the event PCAOB standards become applicable to broker-dealer audits prior to the effective date of Auditing Standard No. 16.

The PCAOB has proposed application of its Proposed Rules to audits of all issuers, including audits of emerging growth companies ("EGCs"),[9] and the Proposed Rules also would apply to audits of SEC-registered brokers and dealers if the Commission subsequently determines to make PCAOB standards applicable to such audits.[10] The Proposed Rules would be effective for audits of financial statements with fiscal years beginning on or after December 15, 2012. The transitional amendments to AU sec. 380 would be effective for the periods that PCAOB standards become applicable to audits of SEC-registered brokers and dealers, as

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[9] The term "emerging growth company" is defined in Section 3(a)(80) of the Exchange Act.

[10] The Commission proposed requiring application of PCAOB standards to audits for brokers and dealers in Release No. 34-64676 (June 15, 2011).

designated by the Commission, if the effective date of the application of PCAOB standards occurs prior to the effective date of Auditing Standard No. 16.

III. Comment Letters and the PCAOB's Responses

As noted above, the Commission received five comment letters concerning the Proposed Rules. Two commenters expressed unqualified support for the Proposed Rules, and cited a link between Auditing Standard No. 16 and investor protection.[11] One of these commenters expressed its view that the matters Auditing Standard No. 16 requires auditors to communicate to audit committees are commensurate with, and supportive of, the important role audit committees have in serving the interests of investors through oversight of financial reporting and the audit process.[12] The other commenter cited its belief that adoption of Auditing Standard No. 16 is in the public interest and contributes to investor protection because it establishes requirements that enhance the relevance, timeliness, and quality of communications between auditors and audit committees.[13]

One of these commenters also expressed unqualified support for the application of the proposed rules to audits of EGCs and stated its belief that investors in public companies of all sizes are entitled to the same level of protection, including the protection provided by improved communications between auditors and audit committees.[14] This commenter also cited the following points in support of its view:

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[11] See CAQ Letter and Deloitte Letter.

[12] See Deloitte Letter.

[13] See CAQ Letter.

[14] See CAQ Letter.

- *Auditing Standard No. 16 will foster improved financial reporting.* The commenter believes improved financial reporting reduces information asymmetry and should increase the efficiency of capital allocation, thereby fostering capital formation. The commenter also believes this may be particularly important for EGCs, which may need to access the capital markets more regularly than more established companies.
- *Bifurcation of the requirements would be confusing as to the level of investor protection an investor is receiving.* The commenter believes that applying Auditing Standard No. 16 to audits of EGCs would avoid bifurcation of the rules applied to the preparation and audit of public company financial statements. The commenter also believes that having different sets of rules for different categories of public companies makes it more difficult for investors to know what rules governed the preparation and audit of a given set of financial statements.

Three commenters raised questions and concerns about the Proposed Rules and their proposed application. These matters relate to: (1) application of the Proposed Rules to audits of foreign private issuers ("FPIs");[15] (2) application of Auditing Standard No. 16 to audits of broker-dealers; (3) the role of management in communicating matters to the audit committee that are also the subject of Auditing Standard No. 16; (4) the specificity of the requirements in Auditing Standard No. 16; (5) potential regulatory conflicts; (6) convergence of auditing

[15] The term "foreign private issuer" is defined in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer means any foreign issuer other than a foreign government except an issuer that meets the following conditions: (1) more than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States.

standards; and (7) the PCAOB's analysis supporting its proposal that the Proposed Rules apply to audits of EGCs (the "PCAOB's EGC analysis").

1. Audits of FPIs

One commenter requested clarification as to whether or not the Proposed Rules would apply to audits of issuers that are FPIs.[16] The commenter stated that it was not seeking relief, solely clarity. In response to the commenter's request, the Commission notes that under the Sarbanes-Oxley Act, the PCAOB's auditing and other professional standards apply to audits of issuers.[17] There is no exception for issuers that are FPIs, and the PCAOB did not propose to create an exclusion. Accordingly, the Proposed Rules, consistent with other auditing standards adopted by the PCAOB, will apply to audits of FPIs.

2. Audits of broker-dealers

One commenter requested more clarity about to whom the required Auditing Standard No. 16 audit committee communications should be made in situations when a broker-dealer does not have a board of directors or audit committee.[18] The commenter also recommended that the PCAOB make clear that the required communications should not be made to a chief financial officer or similar officer, but rather a chief executive officer. The commenter raised similar comments in connection with the PCAOB's own solicitation for comments on the Proposed Rules. The PCAOB revised Auditing Standard No. 16 in response to this comment, which was also raised by other commenters. The PCAOB revised the definition of audit committee with

[16] See Quest Letter.

[17] See Sections 101(c)(2) and 103(a)(1) of the Sarbanes-Oxley Act.

[18] See Chamber Letter.

respect to non-issuers such that, if a non-issuer broker-dealer did not have a board of directors or audit committee, the required communications would be directed to the person(s) identified by the auditor as responsible for overseeing the accounting and financial reporting processes of the company.

However, the definition was not revised to exclude from the definition of audit committee those persons with oversight responsibility who also have management responsibilities for the preparation of the financial statements of the company. In its adopting release, the PCAOB stated that for non-issuers with no existing audit committee or board of directors (or equivalent body), the auditor would be expected to identify senior persons at the company who have decision-making authority and responsibility to oversee the accounting and financial reporting processes of the company and audits of the financial statements, and to make the required communications to those persons.[19] The PCAOB provided examples and stated that if all persons identified by the auditor as having responsibility for oversight of the company's accounting and financial reporting processes and audits also have management responsibilities for the preparation of the financial statements, then the auditor could also make the communications specified in the standard to other individuals at the company (e.g., the chief executive officer or others in charge of the company's operations and performance, who may benefit from the communications). The Commission does not find the PCAOB's response to be unreasonable.

The commenter also requested that the PCAOB clarify to whom audit committee communications should be made when a broker-dealer is a subsidiary of an entity that has an

[19] See PCAOB Release No. 2012-004 (August 15, 2012), pg. A4-3.

audit committee.[20] The PCAOB addressed this comment in its adopting release as well. In that release, the PCAOB observed that some commenters suggested that the standard should clarify to whom the auditor should communicate when the company is a subsidiary of another entity. The PCAOB stated that Auditing Standard No. 16 does not require communication outside the governance structure of the audited entity because the standard designates the appropriate party to receive the auditor communications within the audited entity.[21] The PCAOB also stated that if directed by the audit client, or if the auditor otherwise deems it appropriate, the auditor could also communicate to a parent company audit committee or equivalent body. The Commission does not find the PCAOB's response to be unreasonable.

3. <u>The role of management in communicating matters to the audit committee</u>

One commenter repeated concerns expressed in letters to the PCAOB during the PCAOB's proposal stages that Auditing Standard No. 16 appears to shift inappropriately from management to auditors the primary responsibility to communicate to audit committees about matters of the selection and identification of significant and critical accounting policies, estimates and significant unusual transactions.[22] The commenter acknowledged that the PCAOB revised Auditing Standard No. 16 in response to this comment, and observed that Auditing Standard No. 16 is not intended to change the requirements of Rule 2-07 of Regulation S-X. However, the commenter believes the Commission should give consideration to its concerns and

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[20] See Chamber Letter.

[21] See PCAOB Release No. 202-004 (August 15, 2012), pg. A4-4.

[22] See Piercy Letter.

make "appropriate revisions" to Rule 2-07 to preserve what the commenter believes is the proper balance among the responsibilities of management, audit committees and auditors.

The Commission has previously considered views similar to those expressed by the commenter. Exchange Act Section 10A(k), as added by Section 204 of the Sarbanes-Oxley Act, directed the Commission to issue rules requiring timely reporting of specific information by auditors to audit committees. In response to this directive, in 2002, the Commission proposed amending Regulation S-X to require each public accounting firm registered with the Board that audits an issuer's financial statements to report, prior to the filing of such report with the Commission, to the issuer or registered investment company's audit committee:[23]

(1) All critical accounting policies and practices used by the issuer or registered investment company;

(2) All alternative accounting treatments of financial information within generally accepted accounting principles that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures and the treatment preferred by the accounting firm; and

(3) Other material written communications between the accounting firm and management of the issuer or registered investment company.

In response to this proposal, some commenters expressed a view that these communications should be the responsibility of management alone, while others expressed a view that both the accountant and management should share the responsibility for informing the audit committee about such matters. In adopting Rule 2-07, the Commission stated that "[w]hile

[23] See Release No. 33-8154 (December 2, 2002).

we understand that management has the primary responsibility for the information contained in the financial statements, since the accounting firm is retained by the audit committee, we share the view reflected in Section 205 [sic] of the Sarbanes-Oxley Act and current auditing standards, that the accounting firm has a responsibility to communicate certain information to the audit committee."[24] The Commission still holds this view and believes that the communications required by Auditing Standard No. 16 in this regard are appropriate.

Further, the Commission believes that additional changes made by the PCAOB in response to this concern are appropriate and balanced. In its adopting release, the PCAOB observed that in many companies, management might communicate matters involving management's preparation of the company's financial statements and that in many companies, management might communicate these matters or take the lead on communicating these matters to the audit committee. The PCAOB also observed that it does not have the authority to require management to communicate to the audit committee, and that certain communications are mandated by federal securities laws and Commission rules. Because of these factors, Auditing Standard No. 16 clearly recognizes and acknowledges that management might communicate to the audit committee certain matters related to the company's financial statements; and in such circumstances, the auditor does not need to communicate those matters at the same level of detail as management, as long as certain conditions are met, as specified in the standard.

4. Level of specificity of requirements in Auditing Standard No. 16

[24] See Release No. 33-8183 (March 27, 2003).

One commenter observed that Auditing Standard No. 16 is "prescriptive" in that it contains specific mandatory communication requirements.[25]

The PCAOB addressed this comment in its letter to the Commission. In that letter, the PCAOB stated that its standards, including Auditing Standard No. 16, reflect the fact that a company's size and complexity can affect the risks of material misstatement and that the Proposed Rules are designed to allow auditors to tailor the required communications to the size and level of complexity of a company's operations, accounting practices, and audit issues.

The Commission addressed a similar comment in 2010 in connection with its consideration of rules proposed by the PCAOB to establish new risk assessment standards.[26] The Commission recognizes that there should be an appropriate balance in auditing standards between providing necessary minimum requirements and allowing auditors to apply judgment in determining the nature and extent of audit procedures given the particular circumstances of an individual engagement. The Commission believes that all PCAOB standards should reflect an appropriate balance of requirements and judgments that enables auditors to perform high quality and effective audits and believes the PCAOB's approach in Auditing Standard No. 16 reflects a reasonable balance in this respect.

5. Potential regulatory conflicts

One commenter voiced concerns that the Proposed Rules may go outside of the scope of the PCAOB's jurisdiction over the audit and infringe upon the corporate governance

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[25] See Chamber Letter.

[26] See Release No. 34-63606 (December 23, 2010).

responsibilities of the Commission or under applicable state law in overseeing the audit committee.[27] This commenter asked that the Commission review the Proposed Rules "with an eye towards eliminating any potential regulatory conflict." In considering the Proposed Rules, the Commission does not believe the Proposed Rules create any potential regulatory conflicts. In its adopting release, the PCAOB recognized the scope and limits of its jurisdiction. In one place, the PCAOB states that its definition of audit committee is not intended to conflict with or affect any requirements, or the application of any requirements, under federal law, state law, foreign law, or an entity's governing documents regarding the establishment, approval, or ratification of board of directors or audit committees, or the delegation of responsibilities of such a committee or board;[28] and in another place, the Board recognized that it does not have the authority to require management to communicate to the audit committee.[29]

6. Convergence of auditing standards

One commenter expressed support for the notion of working to achieve one set of global high quality auditing standards through the convergence of PCAOB auditing standards with those of the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board of the American Institute of Certified Public Accountants ("ASB") and observed that the Proposed Rules do not adequately identify and explain the rationale for differences between the Proposed Rules and the relevant standards of the IAASB and ASB.[30]

The PCAOB has received similar comments in the past, and has observed that:

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[27] See Chamber Letter.

[28] See PCAOB Release No. 202-004 (August 15, 2012), pg. A4-2.

[29] See PCAOB Release No. 202-004 (August 15, 2012), pg. 4.

[30] See Chamber Letter.

> [B]ecause the Board's standards must be consistent with the Board's statutory mandate, differences will continue to exist between the Board's standards and the standards of the IAASB and ASB, e.g., when the Board decides to retain an existing requirement in PCAOB standards that is not included in IAASB or ASB standards. Also, certain differences are often necessary for the Board's standards to be consistent with relevant provisions of the federal securities laws or other existing standards or rules of the Board.[31]

The Commission also addressed a similar comment in connection with its consideration of the rules proposed by the PCAOB to establish new risk assessment standards.[32] As noted then, the Commission encourages the Board's efforts to consider standards issued by the IAASB and the ASB, and appreciates the reasons why it is reasonable to expect that the Board's standards may appropriately differ from such standards. In this regard, we take note of the efforts the PCAOB has taken in developing the Proposed Rules to consider the work of other standard setters.

7. The PCAOB's EGC request and the Commission's EGC determination

Section 103(a)(3)(C) of the Sarbanes-Oxley Act provides that any additional rules adopted by the PCAOB subsequent to April 5, 2012 do not apply to the audits of EGCs, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.[33] Having considered those factors, and as explained further below, the Commission finds that applying the Proposed Rules to audits of EGCs is necessary or appropriate in the public interest.

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[31] See PCAOB Release No. 2010-004, August 5, 2010, pp. A10-91 - A10-92 (internal footnotes omitted).

[32] See supra note 26.

[33] Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as amended by Section 104 of the Jumpstart Our Business Startups Act (the "JOBS Act").

The PCAOB adopted Auditing Standard No. 16 on August 15, 2012 for application to audits of all issuers, including EGCs; and the PCAOB requested that the Commission make the determination required by Section 103(a)(3)(C) such that Auditing Standard No. 16 would apply to audits of EGCs. To assist the Commission in making its determination, the PCAOB prepared and submitted to the Commission its own EGC analysis. The PCAOB's EGC analysis includes discussions of: (1) the background of and reasons for the new standard; (2) the PCAOB's approach to developing the new standard, including consideration of alternatives; (3) key changes and improvements from existing audit committee communication requirements; and (4) characteristics of EGCs and economic considerations.

In developing its analysis, the PCAOB compiled data available from entities voluntarily identifying themselves as EGCs in SEC filings. Based on data available to the PCAOB, the Board observed that one key difference between EGCs and other entities appears to be the length of time an EGC has been subject to the reporting requirements under the Exchange Act.[34] The Board also observed that the enhanced audit committee communication requirements of Auditing Standard No. 16 may be of particular benefit to EGCs given that: (1) some EGCs are companies that are relatively new to the SEC reporting process, and may have new audit committee members that may be less familiar with SEC reporting requirements and have relatively more questions regarding how to present their financial statements for SEC reporting purposes; and (2) some EGCs may also be considering, for the first time, initial choices in their accounting policies and practices that could have implications for their financial reporting.[35]

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[34] See 77 Fed. Reg. at 57448.

[35] See 77 Fed. Reg. at 57447.

The PCAOB's EGC analysis was included in the Commission's public notice soliciting comment on the Proposed Rules. Based on the analysis submitted, the comments received, and the PCAOB's response, we believe the information in the record is sufficient for us to make the EGC determination in relation to this standard. Specifically, the PCAOB's EGC analysis discussed its approach to developing the new standard and its consideration of alternatives, as well as the characteristics of EGCs and economic considerations. The Commission also takes note, in particular, of the PCAOB's overall approach to Auditing Standard No. 16, which was designed to: (1) scale the required communications to the size and complexity of the company being audited; (2) maintain flexibility (e.g., with respect to auditors communicating orally or in writing); (3) minimize duplicative or redundant communications to the audit committee from the auditor and management; (4) focus the communications on the accounting matters that are significant to the auditor and the audit committee; and (5) reduce auditors' search costs (i.e., the costs associated with researching the federal securities laws' and auditing standards' various communication requirements) by providing a list of other PCAOB standards and rules that contain audit committee communication requirements in one place. Moreover, the auditor's requirements under the new standard are focused on communicating the results of audit procedures that the auditor is already required to perform.

One commenter raised concerns about the PCAOB's EGC analysis.[36] This commenter did not assert that any specific aspect of Auditing Standard No. 16 should not apply to audits of EGCs. Rather, the commenter raised several concerns about the substance and form of the

[36] See Chamber Letter.

PCAOB's EGC analysis and whether it was sufficient to form a basis for the Commission's EGC determination. We discuss each of this commenter's main points, and set forth our responses, separately below.

- First, the commenter states that because the JOBS Act provides an automatic exemption for EGC audits from any future PCAOB rules, there is a special burden on the Commission to determine that benefits outweigh costs in order to reverse a clear Congressional directive in favor of an exemption.

As noted above, Section 103(a)(3)(C) of the Sarbanes-Oxley Act contains very specific provisions concerning the application of PCAOB rules to audits of EGCs. The statutory text of Section 103(a)(3)(C) demonstrates that where Congress intended to provide EGCs with an absolute exemption from future PCAOB rules, it did so explicitly (e.g., that any future PCAOB rules on mandatory audit firm rotation or an auditor discussion and analysis shall not apply to EGCs audits). By contrast, with respect to other future PCAOB rules, Congress indicated that new requirements may apply to EGCs, but that for them to apply, the Commission needs to make a determination that such application is "necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation." This determination is separate from the existing finding needed to approve a PCAOB proposed rule change under Section 107 of the Sarbanes-Oxley Act that the proposed rule is consistent with the requirements of the Sarbanes-Oxley Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.[37]

[37] See Section 107(b)(3) of the Sarbanes-Oxley Act. As discussed below, the Commission makes both findings. The Commission makes each finding on its own merits and does not consider either one dependent on the other.

Just as the Section 107 finding does not require the Commission to overcome a "presumption" that a proposed PCAOB rule should be disapproved, the Section 103 EGC determination does not require the Commission to overcome a "presumption" that a PCAOB proposed rule should not apply to audits of EGCs. Rather, in both instances, the statute sets forth a predicate finding that the Commission must make, after considering specified factors, in order for the rule to be approved (section 107(b)(2)) or for it to apply to EGC audits (Section 103(a)(3)(C)).

The statutory text of Section 103(a)(3)(C) requires the Commission to *consider* the protection of investors and whether the action will promote efficiency, competition, and capital formation as part of its affirmative *determination* that the application of such additional requirements is necessary or appropriate in the public interest. Plainly this involves considering the economic effects of the Proposed Rules as they relate to efficiency, competition and capital formation.

- Second, the commenter believes the PCAOB's EGC analysis is "devoid of any semblance of an analysis of the cost of compliance with the rule for all issuers or for EGCs," and asserts that the PCAOB, in its EGC analysis, cited a belief that Auditing Standard No. 16 would be less costly for EGCs.

The PCAOB did provide information regarding potential costs of the proposed rules to issuers, including EGCs. The PCAOB's analysis included qualitative factors that would affect such costs (e.g., nature or complexity of the issuer). As noted above, the PCAOB also provided an analysis of the characteristics of EGCs, including data on the number of issuers that have voluntarily disclosed their EGC status after enactment of the JOBS Act. In its analysis, the PCAOB noted that EGCs vary widely in size, and noted that one key difference between EGCs and other entities appears to be the length of time an EGC has been subject to the reporting requirements under the Exchange Act. In this regard, the PCAOB further described how this difference may in fact relate to the ability of the Proposed Rules to promote efficiency and capital formation for EGCs over other issuers.

Notwithstanding the commenter's assertion that the PCAOB believes the application of Auditing Standard No. 16 would be less costly for EGCs, no such statement is expressed in the PCAOB's EGC analysis. Rather, the PCAOB's EGC analysis reflects the Board's view that a company's size and complexity can affect the risks of material misstatement, and therefore, auditing challenges and audit strategies (matters that impact the amount of time and effort put into an audit). This point was reiterated in the PCAOB's letter to the Commission. In that letter, the PCAOB also provided examples of how communications required by Auditing Standard No. 16 could be tailored to the audit of a less complex company, which could have an impact on the overall cost of the audit and could help to avoid unnecessary costs.

Section 103(a)(3)(C) does not require the Commission to conclude that a proposed PCAOB rule would be "less costly" for EGC audits than for other issuer audits in order to find that applying the rule to EGC audits would be necessary or appropriate in the public interest. The relative impact on EGCs *vis a vis* other issuers could be a factor to consider in whether the application of the proposed rules to EGC audits is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation. However, nothing in the statutory text indicates that the Commission's public interest finding hinges on whether, on a categorical basis, the requirements of a given PCAOB rule would be less costly for EGCs.

- Third, the commenter disputes the relevance of existing audit committee communication requirements under PCAOB interim auditing standard AU sec.

380 to a discussion of the application of Auditing Standard No. 16 to audits of EGCs.

The Commission does not view the PCAOB's discussion of the Proposed Rules in relation to the existing standards as inconsistent with the proper analysis of an EGC determination. Rather, establishing a baseline for conducting an analysis of economic effects of a proposed regulatory action is an appropriate regulatory practice. Also, it is important to consider that currently, all issuers, including EGCs, are subject to the existing audit committee communication requirements of AU secs. 310 and 380 and Rule 2-07 of Regulation S-X. If the Commission determined that the Proposed Rules should not apply to audits of EGCs, AU secs. 310 and 380 and Rule 2-07 of Regulation S-X would still apply to the audits of EGCs.[38]

The Commission believes the PCAOB's EGC analysis appropriately describes the consequences of the Proposed Rules relative to the baseline. As the PCAOB notes in its submission, the impact of the Proposed Rules is largely incremental to existing requirements regarding communications between auditors and audit committees. Accordingly, this discussion of existing requirements is highly relevant to considering the impacts on efficiency, competition and capital formation that would be caused by applying the new standard to audits of EGCs. The Commission does not believe the Proposed Rules can be categorized as a major or profound change to the way auditors communicate with audit committees. In fact, the PCAOB received comments to this effect during its own due process. For example, one commenter observed that "many of the requirements [of the proposed rules] are already reflected in the best practices of

[38] Also, the Commission does not view the PCAOB's highlighting the existing baseline as the sole justification to carry forward existing requirements. Rather, throughout the PCAOB's submission describing the individual requirements of the standard, while the PCAOB notes whether the particular requirement is new or carried forward, the PCAOB also explains why it chose to include them irrespective of whether they already are included in the existing standards.

audit firms and public companies."[39] Another commenter to the PCAOB stated its "belie[f] that auditors, in most cases, are already providing meaningful communications on the financial statement and audit areas that meet the spirit of the requirements of the Proposed Standard and go beyond what is currently required by the extant standards."[40]

- Fourth, the commenter raised a concern that the public was never afforded an opportunity to comment upon the impact of the proposed rules on the audits of EGCs.

Section 103(a)(3)(C) requires the Commission to make the specified determination. The PCAOB submitted an EGC analysis that assisted the Commission in its own determination. The PCAOB's analysis was included in the Commission's notice of the Proposed Rules which provided an opportunity for the public, including the commenter, to submit comments on the analysis.[41] The PCAOB also supplemented the record with additional information after comments were received. As noted above, based on the analysis submitted, the comments received, and the PCAOB's response, we believe the information in the record is sufficient for us to make the EGC determination.

- Fifth, the commenter believes that the inspection findings cited in the PCAOB's EGC analysis do not provide any indication whether any of the audit committee communication failures involved the audits of EGCs. The commenter also criticizes the relevance of the PCAOB's citation to four year old research that

[39] See letter from The Society of Corporate Secretaries and Governance Professionals to the PCAOB (June 1, 2010). This letter may be viewed at: http://pcaobus.org/Rules/Rulemaking/Docket030/032_SCSGP.pdf.

[40] See letter from Deloitte & Touche to the PCAOB (May 28, 2010). This letter may be viewed at: http://pcaobus.org/Rules/Rulemaking/Docket030/020_DT.pdf.

[41] In addition, the commenter acknowledged that the JOBS Act was signed into law after the PCAOB's second comment period closed. The PCAOB did not re-expose the Proposed Rules again as part of its standard-setting process to seek public input on whether application of the Proposed Rules to EGC audits would be necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.

indicated that audit committee oversight was having a positive impact on the overall quality of audits.

In its EGC analysis, the PCAOB cited its inspection findings as one input into its decision to bring together in one place audit committee communication requirements;[42] and in its letter to the Commission, the PCAOB reiterated this point. The Commission believes it was appropriate for the PCAOB to consider its inspection findings in developing the Proposed Rules.

As to the PCAOB's reference in its EGC analysis to research, the Commission believes it was wholly appropriate for the PCAOB to highlight the relationship between audit committee communications and overall audit quality and improved financial reporting, given the relevance of the quality of financial reporting to considerations of efficiency and capital formation. It does not appear that the PCAOB was referencing the research identified by the commenter to justify the Proposed Rules themselves or was attempting to use research inconsistently or opportunistically to support its views. Rather, the PCAOB noted, citing to other research, that improved financial reporting quality promotes efficiency and capital formation. The PCAOB explained that the results of one of the studies cited in its EGC analysis supported its view that audit committee oversight of the auditor improves audit quality and financial reporting quality. The PCAOB then went on to discuss additional findings from its outreach and research that improved interaction between, and information shared, between the auditor and the audit committee enhances audit committee oversight and auditor performance.

IV. Conclusion

The Commission has carefully reviewed and considered the Proposed Rules and the information submitted therewith by the PCAOB, including the PCAOB's EGC analysis, the

[42] See 77 Fed. Reg. at 57441.

comment letters received, and the PCAOB's response. In connection with the PCAOB's filing and the Commission's review,

A. The Commission finds that the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors; and

B. Separately, the Commission finds that the application of the Proposed Rules to EGC audits is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that the Proposed Rules (File No. PCAOB-2012-01) be and hereby are approved.

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. 68462 / December 18, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3517 / December 18, 2012

Admin. Proc. File No. 3-13481

In the Matter of

KENNETH E. MAHAFFY, Jr.

ORDER VACATING BARS

Kenneth E. Mahaffy, Jr. seeks to vacate a Commission order entered against him on September 20, 2010 barring him from associating with any broker, dealer, or investment adviser.[1] The order was issued in an administrative proceeding instituted under § 15(b) of the Securities Exchange Act of 1934 and § 203(f) of the Investment Advisers Act of 1940 based on Mahaffy's conviction, in 2009, for participating in a conspiracy to commit securities fraud. After the Commission order was issued, on August 2, 2012, the United States Court of Appeals for the Second Circuit vacated the criminal conviction.[2]

In seeking to vacate the bar order against him, Mahaffy argues that the sole basis for the bar order was his criminal conviction and that he no longer stands convicted. The Division of Enforcement opposes Mahaffy's request, stating that, "because the court's opinion is not yet final," the Commission should "hold in abeyance its consideration of the motion to vacate until such time as the appellate order becomes final."[3] The Division's opposition brief was filed on August 28, 2012. September 14, 2012 was the deadline to seek reconsideration or en banc review by the Second Circuit. We take official notice that neither reconsideration nor review was sought and the Court of Appeals's mandate has now issued.[4]

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1 Securities Exchange Act Release No. 62937, 2010 SEC LEXIS 3079 (Sept. 20, 2010).

2 *U.S. v. Mahaffy*, 693 F.3d 113, 119 (2d Cir. 2012) (finding, among other things, that the prosecution failed to turn over investigative transcripts required to be disclosed under *Brady v. Maryland*, 373 U.S. 83 (1963), and that this failure undermined confidence in the jury verdict). The Second Circuit also vacated the conviction of David G. Ghysels, another respondent in the administrative proceeding. Ghysels has not moved to vacate the bars ordered against him in the administrative proceeding.

3 Division Response at 1.

4 *See* 17 C.F.R. ' 201.323 (rule of practice relating to official notice).

We have held that administrative bar orders will remain in place in the usual case and are vacated only in compelling circumstances.[5] We have found such compelling circumstances where, as here, the statutory basis for the bar, in this case Mahaffy's 2009 criminal conviction, has been vacated.[6] Under these circumstances, it is appropriate to vacate the order.

In light of the foregoing, IT IS ORDERED that the September 20, 2010 order entered against Kenneth E. Mahaffy is hereby vacated.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[5] *See, e.g.*, *Salim B. Lewis*, Order Granting and Denying in Part Petition to Vacate Administrative Bar Order, Exchange Act Release No. 51817, 58 SEC 491, 2005 SEC LEXIS 1360 (June 10, 2005).

[6] *See, e.g.*, *Jimmy Dale Swink, Jr.*, Exchange Act Release No. 36042, 52 SEC 379, 1995 SEC LEXIS 2033, at *2 (Aug 1, 1995) (vacating findings and administrative bar order when an appellate court reversed the criminal conviction that was the basis for the proceeding); *cf. Terry Harris*, Investment Advisers Act Release No. 2622, 2007 SEC LEXIS 1645, at *7 (July 26, 2007) (ordering dismissal of administrative proceeding after finding that "none of the three bases for proceeding under Advisers Action Section 203(f) that were alleged in the [order instituting proceedings] remains valid on the record before us on appeal").

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9376 / December 18, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 68464 / December 18, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3518 / December 18, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30307 / December 18, 2012

Admin. Proc. File No. 3-15015

In the Matter of	
MICHAEL BRESNER, RALPH CALABRO, JASON KONNER, and DIMITRIOS KOUTSOUBOS, Respondents; MICHAEL BRESNER, Movant	ORDER DENYING MOTION OF MICHAEL BRESNER TO SEVER PROCEEDINGS

On September 10, 2012, we issued an Order Instituting Proceedings that charged Ralph Calabro, Jason Konner, and Dimitrios Koutsoubos (registered representatives formerly associated with broker-dealer JP Turner & Co., LLC) with churning customer accounts in violation of the antifraud provisions of the securities laws.[1] The OIP also alleged that Michael Bresner, Executive Vice President and Head of Supervision at JP Turner, was a supervisor of two of the three representatives and that he failed to exercise that supervision reasonably within the meaning of Exchange Act § 15(b) and Advisers Act § 203(f).[2]

1 *Michael Bresner*, Securities Exchange Act Release No. 67810, 2012 WL 3903387 (Sept. 10, 2012). Specifically, the OIP alleges that registered representatives Calabro, Konner, and Koutsoubos violated Securities Act § 17(a), Exchange Act § 10(b), and Rule 10b-5 promulgated thereunder. 15 U.S.C. §§ 77q(a), 78j(b), 17 C.F.R. § 240.10b-5.

2 15 U.S.C. §§ 78o(b), 80b-3(f).

In a motion filed October 25, 2012, Bresner moved to sever the causes of action against him from those against the other named respondents. In support of his motion, Bresner states that the Division of Enforcement expects the hearing in this matter to last two to three weeks, and he projects that "the expense associated with such a proceeding will run into the hundreds of thousands of dollars"—an expense he represents he cannot afford.[3] Bresner argues that the Division will need to focus the majority of its time at trial establishing the underlying violations of his co-respondents (that is, the alleged churning of customer accounts), while the charges regarding Bresner's supervisory failure could be addressed, in Bresner's estimate, in just two or three days. Severing the proceedings would be more efficient, Bresner posits, for three reasons: first, if the Division cannot establish that Konner and Koutsoubos churned their customers' accounts, its case against Bresner necessarily fails and need not be further prosecuted; second, if the Division does prove that Konner and Koutsoubos churned their customers' accounts, it can use that evidence in Bresner's subsequent hearing; and third, the conduct of Calabro, whom Bresner is not alleged to have supervised, is wholly irrelevant to the charges against Bresner and need not be a part of any hearing related to Bresner's conduct.

Bresner represents that his co-respondents support his motion. The Division, however, opposes it. The Division asserts that judicial economy would not be served by severing this proceeding because there is substantial overlap in the conduct to be examined at trial. It anticipates that the testimony of Konner and Koutsoubos, while necessary to establish the allegations of churning, will also be relevant to the failure-to-supervise charges against Bresner, just as Bresner's testimony will be relevant to the allegations of churning and to his own failure to supervise. The Division also argues that the use of evidence from one hearing (on the churning allegations) in a subsequent hearing (on the failure to supervise allegations) would likely result in protracted disagreement over the admissibility of such evidence, eroding any gains in efficiency that Bresner suggests would result from severance.

Our Rule of Practice 201(b) states that a proceeding may be severed with respect to some or all parties upon a showing of good cause.[4] As we have stated, "considerations of adjudicatory economy carry great weight in the analysis of [a] motion [to sever]."[5] In the case before us, the allegations to be addressed at trial are substantially interrelated. First, the allegations overlap factually: all the respondents were associated with the same firm at the same time and are alleged to have engaged in misconduct related to the fraudulent churning of certain of the firm's customers' accounts. Second, the allegations overlap legally: as in all failure-to-supervise cases, the underlying violation must be proven as the first step in substantiating a charge of supervisory failure against Bresner, and, in turn, the Division alleges that Bresner's failure to supervise Konner and Koutsoubos facilitated their churning of accounts.

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3 Bresner's Mot. for Severance at 2.

4 17 C.F.R. § 201.201(b); *see also David A. Finnerty*, Exchange Act Release No. 52207, 2005 WL 1963821, at *1 (Aug. 4, 2005).

5 *John A. Carley*, Exchange Act Release No. 50695, 2004 WL 2624639, at *1 (Nov. 18, 2004).

The Division stated it expects that, while the testimony of Konner and Koutsoubos will be necessary to establish that they churned accounts, their testimony will also be necessary in a trial to establish that Bresner failed to supervise them; similarly, the testimony of Bresner is expected to be relevant to the charges against him as well as the charges against the representatives he is alleged to have supervised. As an example, the Division asserts that it intends to question all the respondents about any communications between or among Calabro, Konner, Koutsoubos, and Bresner. These communications could inform conclusions about whether Bresner supervised Konner and Koutsoubos and what steps he took as part of that supervision. Although the two types of allegations in this proceeding are legally discrete, the evidence relevant to those charges may not be neatly separable and will likely come from many of the same witnesses. Bifurcating this proceeding would require the Division to call several witnesses to testify at both proceedings, a duplication of effort and expense that would be inefficient.[6]

In fact, the Division commonly pursues combined proceedings against alleged violators of the securities laws together with their supervisor(s).[7] Bresner has not shown good cause why we should set aside the Division's prosecutorial discretion and require it to try two cases where years of experience in prosecuting failure-to-supervise cases have demonstrated that one will better serve.[8]

We are not persuaded that Bresner could eliminate this inefficiency by agreeing to be bound by the law judge's findings as to whether Konner or Koutsoubos churned their customers' accounts. First, as noted, several witnesses are likely to be asked to testify not only about whether accounts were churned, but also about facts that are relevant to conclusions regarding whether Bresner was a supervisor of Konner and Koutsoubos and whether he failed reasonably to supervise them. Second, if Bresner's co-respondents are found by the law judge to have violated the securities laws, those respondents could appeal that decision, which could further delay the proceeding against Bresner. Such a delay could compromise the proceeding against Bresner if, for example, witnesses become unavailable or have increasing difficulty remembering events with the passage of time.

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6 *Finnerty*, 2007 WL 327445, at *2 (denying severance and noting that "there are common legal, factual, and evidentiary issues in these proceedings . . . that indicate[] that a single proceeding will be more efficient than separate trials from the standpoint of judicial economy and financial resources").

7 *See, e.g, Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874 (Feb. 27, 2012); *Thomas C. Bridge*, Exchange Act Release No. 60736, 2009 WL 3100582 (Sept. 29, 2009), *aff'd sub nom., Jeffrey K. Robles*, 411 F. App'x 337 (2010) (unpublished); *Newbridge Securities Corp.*, Admin. Proc. File No. 13099, 2008 WL 2876595 (July 25, 2008).

8 *See Dolphin and Bradbury, Inc.*, Exchange Act Release No. 54143, 2006 WL 1976000, at *12 (July 13, 2006), ("[A]gency decisions about the best use of staff time are a matter for prosecutorial judgment."), *aff'd*, 512 F.3d 634 (D.C. Cir. 2008).

Accordingly, it is ordered that Bresner's motion to sever the proceedings against him from the proceedings against the other named respondents in this matter is denied.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3520 / December 19, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30309 / December 19, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15140

In the Matter of **FIDUCIARY ASSET MANAGEMENT, LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO 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**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 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") against Fiduciary Asset Management, LLC ("Respondent" or "FAMCO").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to 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"), 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 from FAMCO's conduct as a sub-adviser to the Fiduciary/Claymore Dynamic Equity Fund ("HCE" or "the Fund"). From April 2007 through October 2008, FAMCO implemented two new derivative strategies to supplement the Fund's existing covered call investment strategy. Specifically, HCE wrote out-of-the-money S&P 500 put options and entered into short variance swaps, both of which had a significant effect on HCE's performance, but which also exposed the Fund to substantial losses in the event of a steep market decline or spikes in market volatility. HCE failed to include adequate disclosure about the principal risks to the Fund arising from the Fund's use of written put options and variance swaps, either in its annual report or in an amended Fund registration statement. As a result, FAMCO managed HCE in a manner that was inconsistent with the Fund's registration statement. FAMCO also omitted any description of these strategies and their effect on HCE's return from its commentaries in the Fund's 2007 annual report and 2008 semi-annual report. In those same reports, FAMCO also claimed that it had used hedging strategies to protect the Fund from downside risk, when in fact HCE's use of written put options and short variance swaps exposed the Fund to substantial losses in periods of significant market decline or volatility. In September and October 2008, HCE realized an approximately $45.4 million loss, or 45% of the Fund's net assets as of the end of August 2008, on five written put options and variance swaps, contributing to a 72.4% two-month decline in the Fund's net asset value ("NAV").

Respondent

2. Fiduciary Asset Management, LLC is a Delaware limited liability company based in St. Louis, Missouri. FAMCO has been registered with the Commission as an investment adviser since 1994. In 2007, FAMCO was acquired by a third party. FAMCO was the sub-adviser to the Fiduciary/Claymore Dynamic Equity Fund. FAMCO received an annual sub-advisory fee of .5% of the Fund's net assets.

Other Relevant Entities

3. Fiduciary/Claymore Dynamic Equity Fund was a closed-end investment company organized in April 2005. HCE's shares were offered to the investing public pursuant to a registration statement filed with the Commission. HCE regularly filed periodic reports with the Commission as required by the Investment Company Act. The Fund was liquidated in May 2009.

4. Claymore Advisors, LLC ("Claymore") is a Delaware limited liability company based in Lisle, Illinois. Claymore has been registered with the Commission as an investment adviser since 2003, and provides portfolio management

[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

services for investment companies. Claymore also served as HCE's fund administrator from 2006 through 2009. In October 2009, Claymore was acquired by a third party and, in September 2010, changed its name to Guggenheim Funds Investment Advisors, LLC.

Background

5. According to HCE's April 2005 registration statement, the Fund's primary investment strategy was to invest in equities and write call options on a substantial portion of those equities. This strategy is commonly referred to as a covered call strategy. Covered call strategies trade upside potential in the equities held in the portfolio for current income from option premiums received. The registration statement also indicated that the Fund was allowed to utilize a variety of derivative strategies.

6. HCE informed investors in its periodic reports that this covered call strategy had the potential to protect the Fund in a downward trending market. The Fund also disclosed to investors that it had a goal of paying an annual dividend equal to an 8.5% yield on the Fund's initial public offering price.

7. Claymore provided advisory services to HCE pursuant to an investment advisory agreement, and delegated certain of its responsibilities to FAMCO through a sub-advisory agreement. Under the sub-advisory agreement, FAMCO was responsible for the management of HCE's portfolio. According to Claymore's fund policies and procedures manual, Claymore, in conjunction with HCE's counsel, was responsible for preparing and filing HCE's registration statement.

8. FAMCO was required to manage the Fund in accordance with HCE's investment objective, policies, and restrictions as stated in the Fund's registration statement. FAMCO designated two of its employees as HCE's portfolio managers.

9. In addition, FAMCO had a role in HCE's periodic reporting. For each HCE annual and semi-annual report, FAMCO provided Claymore with a signed certification that an HCE portfolio manager: (1) had reviewed the portfolio of investments contained in HCE's report and that, to the best of his knowledge, the portfolio of investments was complete and accurate; and (2) to the best of his knowledge, the securities in the portfolio were purchased in compliance with the investment parameters set forth in the registration statement.

10. Each HCE annual and semi-annual report also contained a Questions and Answers discussion with HCE's portfolio managers (also referred to as the portfolio manager commentary). A Claymore consultant interviewed one of HCE's portfolio managers for each periodic report and then, after the interview, drafted the Questions and Answers section based on his statements during the interview. Once the initial draft was completed, both of HCE's portfolio managers, and others at FAMCO and Claymore, reviewed and edited the Questions and Answers section before it was included in the report.

11. For each HCE annual and semi-annual report, FAMCO provided Claymore with a signed certification that an HCE portfolio manager had reviewed the

portfolio manager commentary contained in the report and that, to the best of his knowledge, it did not contain any material misstatement or omission that would make the report inaccurate or misleading.

FAMCO's Implementation of New Investment Strategies

12. Beginning in April 2007 and continuing through October 2008, FAMCO implemented two new investment strategies intended to supplement HCE's income and to help meet the Fund's dividend objective. More specifically, during this period FAMCO regularly caused HCE to write short duration, out-of-the-money S&P 500 put options and also to trade short variance swaps.

13. Prior to April 2007, at FAMCO's direction, HCE purchased S&P 500 put options and wrote S&P 500 call options as protection for the portfolio. Beginning in April 2007, at FAMCO's direction, HCE began writing S&P 500 put options as well, at times holding long and written put options simultaneously and at other times holding only written put options. Beginning in November 2007, at FAMCO's direction and based on internal analyses, HCE ceased holding long and written put options together and began consistently writing put options in its portfolio with no corresponding long position.

14. When FAMCO wrote put options for HCE's portfolio, HCE collected a premium from the purchaser of the option, and agreed to compensate the purchaser for any declines in the S&P 500 beyond the "strike price" of the option. HCE typically wrote put options with one- or two-month expirations, and with strike prices that were between 6% and 10% below the S&P 500's level at the time the options were written.[2] Usually, this strategy was profitable. But HCE stood to lose money on a written put position if the S&P 500 declined below the option strike price during the option period.

15. Each month HCE wrote put options during 2008, the Fund collected between $500,000 to $1.4 million in premiums, which significantly increased the Fund's return each time the options expired out-of-the-money. Between April 2007 and August 2008, HCE collected $9.6 million in premiums from written put options. However, these premiums came at a price of exposing HCE to potentially significant losses in the event of a steep market downturn.

16. Variance swaps are essentially a bet on whether the actual or realized market volatility will be higher or lower than the market's expectation for volatility (or "implied volatility"). A party with a "long variance" position profits when realized volatility for the contract period is greater than the implied volatility. A party with a "short variance" position profits whenever realized volatility is less than the implied volatility.

17. FAMCO began regularly trading short variance swaps in HCE's portfolio in July 2007. These transactions were included in daily portfolio reports that were

[2] The amount by which the option's strike price is below the current price is commonly referred to as the amount by which the option is "out-of-the-money."

provided to Claymore. HCE maintained written put options and short variance swaps in its portfolio at nearly all times from July 2007 through October 2008, except for a two-month period from April to June 2008.

18. FAMCO's use of written put options and variance swaps significantly affected HCE's performance and changed the Fund's risk profile. FAMCO's internal documents projected that writing put options and trading short variance swaps each could add hundreds of basis points to HCE's return each year, so long as there were no significant market declines or volatility. According to FAMCO's internal research and analysis, such declines were expected to be infrequent, although they were not unprecedented.

19. However, by using these strategies, FAMCO increased HCE's exposure to market declines and volatility, which exposed the Fund to significant potential losses if the S&P 500 declined rapidly or became very volatile. In so doing, FAMCO changed HCE from a fund designed to provide investors with some downside protection, to a fund that magnified investors' downside exposure.

20. When FAMCO began writing put options in HCE without any corresponding long positions, one of FAMCO's employees objected that the risks associated with this strategy outweighed the benefit received from the option premiums.

<u>Put Option and Variance Swap Performance</u>

21. FAMCO's written put options and variance swaps materially affected HCE's return in 2007 and 2008. During this period, FAMCO also caused HCE to purchase S&P 500 put options, write S&P 500 call options, and enter into long variance swaps.

22. During HCE's fiscal year ending November 30, 2007, HCE's NAV increased 12.87%, compared to the S&P 500's 7.72% return and a 5.54% return for the CBOE Buywrite Monthly Index ("BXM"), an index that simulates an S&P 500 covered call strategy. HCE's written put options, long put options, and written S&P 500 call options contributed approximately 2.0%, 1.7%, and 1.7% respectively to HCE's NAV growth; these strategies accounted for more than 40% of the Fund's NAV growth for the period, and nearly all of HCE's excess return above the S&P 500. HCE's short variance swaps reduced the Fund's return by .4% in four months of trading the products.

23. HCE's derivative strategies continued to boost return during the first half of 2008. For the six month period ending May 31, 2008, HCE's return was .37% of NAV, compared to -4.50% for the S&P 500 and 2.00% for the BXM. HCE's written put options, short variance swaps, and written call options contributed approximately 2.1%, .8%, and .7% respectively to the Fund's return. By contrast, HCE's long put options and long variance swaps decreased the Fund's return by .6% and .8%, respectively.

HCE's Collapse During the Fall of 2008

24. FAMCO continued to write put options and trade short variance swaps throughout the summer of 2008. In late August 2008, FAMCO wrote two-month, 10% out-of-the-money S&P 500 put options in HCE, which exposed the Fund to significant downside risk. On August 25, 2008, FAMCO wrote 700 put option contracts with an 1150 strike price and an October 17, 2008 expiration, when the S&P 500 was trading between 1265 and 1290. On August 28, 2008, FAMCO wrote an additional 500 put options contracts with an 1170 strike price and an October 17, 2008 expiration, when the S&P 500 was trading between 1284 and 1301.

25. FAMCO estimated this position to have a potential loss exposure of $17,630,000, or approximately 17.5% of the Fund's value, as of the end of August. FAMCO also caused HCE to enter into a one-month short variance swap in August 2008, further exposing the Fund to market volatility.

26. Beginning in early September 2008, the financial markets began declining rapidly and became very volatile. On September 19, 2008, FAMCO settled HCE's expiring one-month variance swap position for a loss of $7,025,454.

27. As of September 19, 2008, HCE also had an unrealized $1.25 million loss on its written put options. FAMCO's estimate of HCE's exposure on those options had grown to $39.7 million, or 44% of the Fund's NAV. Nevertheless, FAMCO caused HCE to roll its expiring variance swap position into two new, one-month short variance swaps that same day, despite the possibility of suffering significant losses on the outstanding put option positions if the S&P 500 continued to decline.

28. The S&P 500 continued to decline with increased volatility in late September and October 2008. FAMCO covered HCE's written put positions in early October and realized a loss of $15,527,300. HCE also lost an additional $22,844,124 on the two variance swaps entered into in September, for an aggregate loss of $29,869,578 million from both its August and September variance swaps.

29. In September and October 2008, HCE lost approximately $73.4 million, or 72.8% of its NAV. By comparison, the S&P 500 index declined 24.5%, and the BXM declined 19.9%. Approximately $45.4 million of HCE's losses during this two-month period were directly attributable to HCE's use of written put options and short variance swaps.

FAMCO's Use of Inadequately Disclosed Investment Strategies

30. Commission Form N-2 requires a registered investment company to describe in its registration statement the types of investments, investment policies, practices, and techniques that the investment company employs or intends to employ, the extent to which it may engage in investment policies, and the risks inherent in such policies. Form N-2 also requires a registered investment company to discuss the principal risk factors associated with investment in the investment company.

31. Neither HCE's registration statement nor any of its annual reports disclosed writing index put options or trading variance swaps as principal fund strategies. Neither strategy received any mention in the registration statement's sections entitled "Fund Investments" and "Portfolio Contents," where HCE described the types of investments in which the Fund would invest under normal market conditions.

32. In fact, HCE's registration statement disclosed that the Fund would pursue primarily a covered call strategy. HCE never disclosed that put options and variance swaps were primary drivers of fund performance, or that the use of those products might alter the Fund's risk profile by exposing the Fund to significant losses during significant market declines or unusual market volatility.

33. HCE's prospectus, which was part of HCE's registration statement, disclosed in a separate section entitled "Strategic Transactions" the fact that the Fund may utilize a variety of derivative strategies, including "purchas[ing] and sell[ing] exchange-listed and over-the-counter put and call options on securities, equity and fixed-income indices and other instruments, purchas[ing] and sell[ing] futures contracts and options thereon and enter[ing] into various transactions such as swaps, caps, floors or collars."

34. HCE's Statement of Additional Information ("SAI"), which was also part of HCE's registration statement, disclosed that the Fund might purchase or sell index options, but described those products as potential hedges against other portfolio securities. Although the registration statement provided for the use of swap instruments, it did not provide any specific disclosure about the use of variance swaps.

35. Further, the "Risks" section in HCE's registration statement did not discuss the risks associated with put writing or variance swaps. The registration statement made no mention of the downside risks the Fund could face by trading index put options and variance swaps, including leveraged exposure to market declines or exposure to spikes in market volatility.

36. Instead, HCE's risk disclosures relating to its use of derivatives merely contained a warning that the use of derivatives could leave the Fund worse off, depending on the adviser's ability to correctly predict movements in the securities and interest rate markets. Most of the discussion about the risks of using index options related to the possibility that such options may be imperfect hedges for HCE's portfolio securities.

37. FAMCO used put options and variance swaps in HCE's portfolio to such a degree that those strategies became an integral part of how HCE sought to achieve its investment objective, and those strategies exposed the Fund to new and material risks. In so doing, FAMCO engaged in strategies and exposed the Fund to new risks that were not adequately disclosed. HCE never amended its registration statement to include sufficient disclosure of the put-writing and variance swap strategies and the risks associated with those strategies, nor did HCE include sufficient information about those strategies and risks in its 2007 annual report.

HCE's 2007 Annual Report

38. HCE's annual report for the period ended November 30, 2007 omitted material information necessary to make the statements contained therein not misleading. The Questions and Answers section of the annual report, which was described as an interview with HCE's portfolio managers, did not disclose the impact of the written index put options and short variance swaps on Fund performance, and also did not adequately disclose the downside risk to the portfolio.

39. In the Questions and Answers section, HCE's portfolio managers answered the question "Which investment decisions most helped the Fund's performance?" by attributing HCE's strong performance to stock selection and the covered call strategy. HCE's portfolio managers highlighted particular sector and single stock investments that contributed to return, including eleven individual stock investments which contributed between approximately $(20,000) and $1 million each (net of covered call option positions) to HCE's NAV growth.

40. However, HCE's portfolio managers did not disclose that the Fund had generated significant income from alternative investment strategies outside of its covered call strategy, including writing S&P 500 put options and call options, as well as purchasing S&P 500 put options, which contributed approximately $6 million to HCE's $13.6 million NAV growth.

41. In fact, contrary to the portfolio manager commentary, stock selection accounted for a relatively small amount of the Fund's outperformance. HCE's equity portfolio outperformed the S&P 500 by only slightly more than the Fund's advisory fee. The Questions and Answers section did not provide an accurate picture of what was driving HCE's performance because it omitted any discussion of HCE's profits from S&P 500 put options and call options during the period.

42. In the Questions and Answers section, HCE's portfolio managers also failed to mention variance swaps when discussing which holdings most hurt performance in 2007.

43. HCE disclosed in its financial statements the written put options and variance swaps held at the end of the reporting period. However, HCE's portfolio managers failed to discuss specifically their written put option and variance swap strategies when explaining the Fund's hedging strategies. Instead, the portfolio managers noted that the Fund's covered call option strategy had the potential to protect the Fund in a downward trending market and stated that they had purchased index put options and had written index call options for protection. This disclosure was incomplete because it failed to acknowledge that written put options and variance swaps exposed the Fund to losses in periods of significant market decline or volatility.

44. HCE's 2007 annual report also contained a risks disclosure section prepared by Claymore, which stated that the views expressed "reflect those of the portfolio managers and Claymore only." This section omitted discussion of any of the risks

associated with writing put options and trading variance swaps, and therefore misled investors regarding the risks of investing in HCE.

45. FAMCO regularly prepared portfolio attribution reports which showed how the various investments in HCE's portfolio had performed. Both of HCE's portfolio managers followed the performance of the Fund's investments and strategies. FAMCO had a responsibility to ensure that the statements attributed to the portfolio managers were correct. Therefore, FAMCO made materially misleading statements and omissions of material fact in HCE's 2007 annual report regarding the contributors to the Fund's performance and the Fund's exposure to downside market risk.

HCE's 2008 Semi-Annual Report

46. HCE's semi-annual report for the six months ended May 31, 2008 contained many of the same deficiencies as the 2007 annual report. The Questions and Answers section, which was attributed to HCE's portfolio managers, again failed to disclose the impact of the written index puts and variance swaps on performance and failed to inform investors about the Fund's exposure to downside risk in declining or volatile markets. FAMCO had a responsibility to ensure that the statements attributed to the portfolio managers were correct. The semi-annual report's risks disclosure again omitted any discussion of the specific risks associated with written put options and variance swaps in periods of significant market decline or volatility.

47. In response to a question in the Questions and Answers section asking what investment decisions most helped the Fund's performance, HCE's portfolio managers stated that the Fund's performance benefited from "industry and stock selection, the covered call strategy, and the hedge program." The portfolio managers noted that HCE's equity portfolio outperformed the S&P 500, and identified the Fund's covered call strategy as offsetting a loss on HCE's equity portfolio. The portfolio managers also stated that "[d]uring most of this period, the portfolio was strategically hedged for additional downside protection, and that proved to be a good decision as equity markets trended downward."

48. In fact, HCE was exposed to significant downside risk as a result of the written put options and variance swaps held during this period.

49. HCE earned profits on its written put options and short variance swaps, during a period in which the markets declined modestly. But HCE was exposed to significant losses if the markets had declined more dramatically or had been more volatile. Accordingly, the disclosure regarding downside protection was misleading in light of HCE's exposure to downside risk in periods of significant market decline or volatility.

50. The option premiums that HCE collected on written put options were a major contributor to the Fund's NAV growth, generating approximately $2.4 million of income and boosting NAV growth by approximately 2.1%. HCE also profited by approximately $917,289, or .8%, from short variance positions.

51. These strategies increased HCE's return, while exposing HCE to significant loss in periods of significant market decline or volatility. Yet HCE's portfolio managers did not mention the strategies when discussing the Fund's performance. Accordingly, FAMCO's discussion regarding what most helped HCE's performance was inadequate.

52. HCE's portfolio managers also failed to identify the Fund's long put options or long variance swaps in response to a question about which holdings most hurt performance, even though those positions constituted some of the worst performers in the Fund's portfolio.

53. Like HCE's annual report, the Fund's semi-annual report did not discuss any of the specific risks associated with trading put options and variance swaps in its risks disclosure section prepared by Claymore, which stated that it reflected the views of the portfolio managers and Claymore. The risk disclosures were misleading as a result of those omissions.

54. FAMCO regularly prepared portfolio attribution reports for internal use that showed how the various investments in HCE's portfolio had performed. Both of HCE's portfolio managers followed the performance of the various investments and strategies. Therefore, FAMCO made materially misleading statements and omissions of material fact in HCE's 2008 semi-annual report regarding the contributors to the Fund's performance and regarding the portfolio being strategically hedged for downside protection, and omitted from discussion of the Fund's risks the specific risks associated with writing put options and trading short variance swaps in declining markets.

Violations

55. As a result of the conduct described above, FAMCO willfully[3] violated Section 34(b) of the Investment Company Act, which prohibits untrue statements of material fact or omissions of any fact necessary in order to prevent the statements made, in the light of the circumstances under which they were made, from being materially misleading, in any registration statement, report or other document filed under the Investment Company Act.

56. As a result of the conduct described above, FAMCO willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit the making of any untrue statement of a material fact or the omission of a material fact necessary to make statements made not misleading, or to otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in a pooled investment vehicle.

[3] 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)).

Undertakings

57. Respondent FAMCO undertakes the following:

To cooperate fully with the Commission in any judicial or administrative proceeding or investigation commenced by the Commission, or to which the Commission is a party, relating to the matters in this Order. FAMCO's cooperation shall include:

Production of Information. Upon reasonable notice, and without a subpoena, FAMCO shall truthfully and completely disclose information and documents reasonably requested by Commission staff in connection with the Commission's related investigation, litigation, or other proceedings.

Production of Cooperative Personnel. Upon reasonable notice, and without a subpoena, FAMCO shall use its best efforts to secure the attendance and truthful testimony of any current or former partner, principal, officer, agent, or employee of FAMCO, at any meeting, interview, testimony, deposition, hearing, trial, or other legal proceeding as may be reasonably requested by the Commission staff.

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

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent FAMCO cease and desist from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

B. Respondent FAMCO is censured.

C. Respondent FAMCO shall, within ten (10) days of the entry of this Order, pay disgorgement of $644,951, prejudgment interest of $134,978 and a civil penalty of $1,300,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. §3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying FAMCO as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert J. Burson, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604.

D. Such civil money penalty 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, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3522; File No. S7-23-07

RIN 3235-AL28[1]

Temporary Rule Regarding Principal Trades With Certain Advisory Clients

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is amending rule 206(3)-3T under the Investment Advisers Act of 1940, a temporary rule that establishes an alternative means for investment advisers who are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Investment Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. The amendment extends the date on which rule 206(3)-3T will sunset from December 31, 2012 to December 31, 2014.

DATES: The amendments in this document are effective December 28, 2012 and the expiration date for 17 CFR 275.206(3)-3T is extended to December 31, 2014.

FOR FURTHER INFORMATION CONTACT: Melissa S. Gainor, Attorney-Adviser, Vanessa M. Meeks, Attorney-Adviser, Sarah A. Buescher, Branch Chief, or Daniel S. Kahl, Assistant Director, at (202) 551-6787 or *IArules@sec.gov*, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

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1 Note that previous related releases used RIN 3235-AJ96.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is adopting an amendment to temporary rule 206(3)-3T [17 CFR 275.206(3)-3T] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] that extends the date on which the rule will sunset from December 31, 2012 to December 31, 2014.

I. Background

On September 24, 2007, we adopted, on an interim final basis, rule 206(3)-3T, a temporary rule under the Investment Advisers Act of 1940 (the "Advisers Act") that provides an alternative means for investment advisers that are registered with us as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients.[2] In December 2009, we extended the rule's sunset date by one year to December 31, 2010.[3] In December 2010, we further extended the rule's sunset date by two years to December 31, 2012.[4] We deferred final action on rule 206(3)-3T at that time in order to complete a study required by section 913 of the Dodd-Frank Wall Street Reform and Consumer

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2 Rule 206(3)-3T [17 CFR 275.206(3)-3T]. All references to rule 206(3)-3T and the various sections thereof in this release are to 17 CFR 275.206(3)-3T and its corresponding sections. *See also Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sep. 24, 2007) [72 FR 55022 (Sep. 28, 2007)] ("2007 Principal Trade Rule Release").

3 *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965 (Dec. 23, 2009) [74 FR 69009 (Dec. 30, 2009)] ("2009 Extension Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965A (Dec. 31, 2009) [75 FR 742 (Jan. 6, 2010)] (making a technical correction to the 2009 Extension Release).

4 See *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3118 (Dec. 1, 2010) [75 FR 75650 (Dec. 6, 2010)] (proposing a two-year extension of rule 206(3)-3T's sunset date) ("2010 Extension Proposing Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3128 (Dec. 28, 2010) [75 FR 82236 (Dec. 30, 2010)] ("2010 Extension Release").

Protection Act (the "Dodd-Frank Act")[5] and to consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers, including whether rule 206(3)-3T should be substantively modified, supplanted, or permitted to sunset.[6]

The study mandated by section 913 of the Dodd-Frank Act was prepared by the staff and delivered to Congress on January 21, 2011.[7] Since that time, we have considered the findings, conclusions, and recommendations of the 913 Study in order to determine whether to promulgate rules concerning the legal or regulatory standards of care for broker-dealers and investment advisers. In addition, since issuing the 913 Study, Commissioners and the staff have held numerous meetings with interested parties on the study and related matters.[8]

On October 9, 2012, we proposed to extend the date on which rule 206(3)-3T will sunset for a limited amount of time, from December 31, 2012 to December 31, 2014.[9]

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5 Public Law 111-203, 124 Stat. 1376 (2010). Under section 913 of the Dodd-Frank Act, we were required to conduct a study and provide a report to Congress concerning the obligations of broker-dealers and investment advisers, including standards of care applicable to those intermediaries and their associated persons. Section 913 also provides that we may commence a rulemaking concerning the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries for providing personalized investment advice about securities to retail customers, taking into account the findings, conclusions, and recommendations of the study.

6 *See* 2010 Extension Release, Section II.

7 *See Study on Investment Advisers and Broker-Dealers* ("913 Study") (Jan. 21, 2011), available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf. For a discussion regarding principal trading, *see* section IV.C.1.(b) of the 913 Study. *See also* Commissioners Kathleen L. Casey and Troy A. Paredes, *Statement by SEC Commissioners: Statement Regarding Study on Investment Advisers and Broker-Dealers* (Jan. 21, 2011), available at http://www.sec.gov/news/speech/2011/spch012211klctap.htm.

8 *See Comments on Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, File No. 4-606, available at http://sec.gov/comments/4-606/4-606.shtml.

9 *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3483 (October 9, 2012), [77 FR 62185 (October 12, 2012)] ("Proposing Release").

We received five comment letters addressing our proposal.[10] Four of these commenters generally supported extending rule 206(3)-3T for at least two years,[11] and one opposed a two-year extension.[12] The comments we received on our proposal are discussed below. After considering each of the comments, we are extending the rule's sunset date by two years to December 31, 2014, as proposed.

II. Discussion

We are amending rule 206(3)-3T only to extend the rule's sunset date by two additional years.[13] We are not adopting any substantive amendments to the rule at this time. Absent further action by the Commission, the rule would sunset on December 31, 2012. We are adopting this extension because, as we discussed in the Proposing Release,

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10 *See* Comment Letter of Chris Barnard (Oct. 26, 2012) ("Barnard Letter"); Comment Letter of fi360, Inc. (Nov. 13, 2012) ("fi360 Letter"); Comment Letter of the Financial Services Institute (Nov. 5, 2012) ("FSI Letter"); Comment Letter of the Securities Industry and Financial Markets Association (Nov. 13, 2012) ("SIFMA Letter"); Comment Letter of Wells Fargo Advisors (Nov. 13, 2012) ("Wells Fargo Letter").

11 *See* Barnard Letter; FSI Letter; SIFMA Letter; Wells Fargo Letter.

12 *See* fi360 Letter.

13 The rule includes a reference to an "investment grade debt security," which is defined as "a non-convertible debt security that, at the time of sale, is rated in one of the four highest rating categories of at least two nationally recognized statistical rating organizations (as defined in section 3(a)(62) of the Exchange Act)." Rule 206(3)-3T(a)(2) and (c). Section 939A of the Dodd-Frank Act requires that we "review any regulation issued by [us] that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and any references to or requirements in such regulations regarding credit ratings." Once we have completed that review, the statute provides that we modify any regulations identified in our review to "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness" as we determine appropriate. We believe that the credit rating requirement in the temporary rule would be better addressed after the Commission completes its review of the regulatory standards of care that apply to broker-dealers and investment advisers. One commenter addressed credit ratings and agreed with us that the issue would be better addressed after the Commission completes its review. *See* SIFMA Letter. We are not adopting any substantive amendments to the rule at this time. *See generally Report on Review of Reliance on Credit Ratings* (July 21, 2011), available at http://www.sec.gov/news/studies/2011/939astudy.pdf (staff study reviewing the use of credit ratings in Commission regulations).

we continue to believe that the issues raised by principal trading, including the restrictions in section 206(3) of the Advisers Act and our experiences with, and observations regarding, the operation of rule 206(3)-3T, should be considered as part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers in connection with the Dodd-Frank Act.[14]

Section 913 of the Dodd-Frank Act provides that we may commence a rulemaking concerning, among other things, the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries when providing personalized investment advice about securities to retail customers. Since the completion of the 913 Study in 2011, we have been considering the findings, conclusions, and recommendations of the study and the comments we have received from interested parties.[15] In addition, our staff has been working to obtain data and economic

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14 *See* Proposing Release, Section II. The 913 Study is one of several studies relevant to the regulation of broker-dealers and investment advisers mandated by the Dodd-Frank Act. *See, e.g., Study on Enhancing Investment Adviser Examinations* (Jan. 19, 2011), available at http://sec.gov/news/studies/2011/914studyfinal.pdf (staff study required by section 914 of the Dodd-Frank Act, which directed the Commission to review and analyze the need for enhanced examination and enforcement resources for investment advisers); Commissioner Elisse B. Walter, *Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act)* (Jan. 19, 2011), available at http://sec.gov/news/speech/2011/spch011911ebw.pdf. *See also Study and Recommendations on Improved Investor Access to Registration Information About Investment Advisers and Broker-Dealers* (Jan. 26, 2011), available at http://sec.gov/news/studies/2011/919bstudy.pdf (staff study required by section 919B of the Dodd-Frank Act that directed the Commission to complete a study, including recommendations (some of which have been implemented) of ways to improve investor access to registration information about investment advisers and broker-dealers, and their associated persons); *United States Government Accountability Office Report to Congressional Committees on Private Fund Advisers* (July 11, 2011), available at http://www.gao.gov/new.items/d11623.pdf (study required by section 416 of the Dodd-Frank Act, which directed the Comptroller General of the United States to study the feasibility of forming a self-regulatory organization to oversee private funds).

15 Section 913(f) of the Dodd-Frank Act requires us to consider the 913 Study in any rulemaking authorized by that section of the Dodd-Frank Act. *See also Comments on*

analysis related to standards of conduct and enhanced regulatory harmonization of broker-dealers and investment advisers to inform the Commission as it considers any future rulemaking. At this time, our consideration of the regulatory requirements applicable to broker-dealers and investment advisers and the recommendations from the 913 Study is ongoing. We will not complete our consideration of these issues before December 31, 2012, the current sunset date for rule 206(3)-3T.

If we permit rule 206(3)-3T to sunset on December 31, 2012, after that date investment advisers registered with us as broker-dealers that currently rely on rule 206(3)-3T would be required to comply with section 206(3)'s transaction-by-transaction written disclosure and consent requirements without the benefit of the alternative means of complying with these requirements currently provided by rule 206(3)-3T. This could limit the access of non-discretionary advisory clients of advisory firms that are registered with us as broker-dealers to certain securities.[16] In addition, firms would be required to make substantial changes to their disclosure documents, client agreements, procedures, and systems.

As noted above, four commenters generally supported our proposal to amend rule 206(3)-3T to extend it,[17] and one commenter opposed the two-year extension.[18] Commenters who supported the extension cited the disruption to investors that would occur if the rule expired at this time, asserting that investors would lose access to the

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Study Regarding Obligations of Brokers, Dealers, and Investment Advisers, File No. 4-606, available at http://sec.gov/comments/4-606/4-606.shtml.

16 For a discussion of the costs and benefits underlying rule 206(3)-3T, *see* 2007 Principal Trade Rule Release, Section VI.C.

17 *See* Barnard Letter; FSI Letter; SIFMA Letter; Wells Fargo Letter.

18 *See* fi360 Letter.

securities currently offered through principal trades, receive less favorable pricing on such securities, or be forced to buy such securities through brokerage accounts.[19] These commenters further explained that, if the rule were allowed to expire, firms relying on the rule would be required to make considerable changes to their operations, client relationships, systems, policies and procedures at substantial expense, without substantial benefits to investors.[20] One commenter described a recent survey it conducted that indicated reliance on rule 206(3)-3T by dual registrants in order to engage in principal trades.[21] In addition, two commenters specifically addressed Commission consideration of requests for exemptive orders as an alternative means of compliance with section 206(3). Both commenters strongly supported the two-year extension instead of Commission consideration of requests for exemptive orders.[22] One commenter expressed concern about the potential inefficiency and uncertainty created by the need to submit individual requests for exemptive relief.[23] Commenters supporting the extension agreed that extending the rule while the Commission conducted its review of the obligations of

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19 *See* FSI Letter; SIFMA Letter (noting that of seven advisory firms that responded to a recent SIFMA survey, two firms indicated that they would not be able to elicit customer consent in accordance with section 206(3) of the Advisers Act, and the other five firms indicated that although they would be able to elicit customer consent in accordance with section 206(3), they would nonetheless significantly limit their volume of principal trading); Wells Fargo Letter.

20 *See* FSI Letter; SIFMA Letter; Wells Fargo Letter.

21 *See* SIFMA Letter (SIFMA noted responses from seven dual-registrant firms that, in the aggregate, manage over $325 billion of assets in over 1.1 million non-discretionary advisory accounts. The firms indicated that 459,507 of these accounts with aggregate assets of over $125 billion are eligible to engage in principal trading in reliance on rule 206(3)-3T. These firms also indicated that, during the previous two years, they engaged in principal trades in reliance on rule 206(3)-3T with 106,682 accounts and executed an average of 12,009 principal trades per month in reliance on the rule.)

22 *See* SIFMA Letter; Wells Fargo Letter.

23 *See* SIFMA Letter.

broker-dealers and investment advisers, as mandated by the Dodd-Frank Act, would be the least disruptive option.[24]

One commenter opposed extending the rule for more than a limited period of time (no more than six months) and questioned maintaining investor choice as a rationale for extending rule 206(3)-3T.[25] This commenter also noted that although instances of "dumping" have not been discovered, the staff has observed related compliance problems in the past. The commenter asserted that a more detailed analysis of principal trades executed in reliance on rule 206(3)-3T, including spreads paid by investors and investment returns, be conducted and suggested that the Commission extend rule 206(3)-3T for no more than six months to conduct such an assessment.[26] The commenter also expressed concern about the open-ended nature of extending this temporary rule.[27]

On balance, and after careful consideration of these comments, we conclude that extending the rule for two years is the most appropriate course of action at this time. First, with respect to investors, we agree with commenters that permitting the rule to sunset before we complete our consideration of the regulatory requirements applicable to broker-dealers and investment advisers could produce substantial disruption for investors with advisory accounts serviced by firms relying on the rule.[28] These investors might lose access to securities available through principal transactions and be forced to convert their accounts in the interim, only to face the possibility of future change — and the costs

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24 *See* Barnard Letter; SIFMA Letter; Wells Fargo Letter.

25 *See* fi360 Letter. This commenter also raised concerns regarding the effectiveness of disclosure generally, including the disclosures required by the temporary rule. Such concerns are beyond the scope of this rulemaking.

26 *See* fi360 Letter.

27 *Id.*

28 *See* Barnard Letter; SIFMA Letter; Wells Fargo Letter.

and uncertainty such additional change may entail.[29] We believe that the rule benefits investors because it provides them with greater access to a wider range of securities and includes provisions designed to protect them.

Second, with respect to firms, the letters submitted by three commenters demonstrate that firms in fact do rely on the rule, and that those firms will be faced with uncertainty and disruption of operations should the rule expire just as the Commission is engaging in a comprehensive review process that may ultimately produce different regulatory requirements.[30] One commenter that represents securities firms provided data showing that a substantial number of accounts and volume of trades would be affected by a change in the rule.[31] This disruption will be avoided if the rule remains available while we engage in our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

We believe that the requirements of rule 206(3)-3T, coupled with regulatory oversight, will adequately protect advisory clients for an additional limited period of time while we consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers.[32] In the 2010 Extension Proposing Release, we discussed

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29 As discussed in each of the 2007 Principal Trade Rule Release, 2009 Extension Release and 2010 Extension Release, firms have explained that they may refrain from engaging in principal trading with their advisory clients in the absence of the rule given the practical difficulties of complying with section 206(3), and thus may not offer principal trades through advisory accounts. *See* 2007 Principal Trade Rule Release, Section I.B; 2009 Extension Release, Section I; 2010 Extension Release, Section II. *See also* SIFMA Letter.

30 *See* FSI Letter; SIFMA Letter; Wells Fargo Letter.

31 *See* SIFMA Letter.

32 In addition, rule 206(3)-3T(b) provides that the rule does not relieve an investment adviser from acting in the best interests of its clients, or from any obligation that may be imposed by sections 206(1) or (2) of the Advisers Act or any other applicable provisions of the federal securities laws.

certain compliance issues identified by the Office of Compliance, Inspections and Examinations.[33] One matter identified in the staff's review resulted in a settlement of an enforcement proceeding and other matters continue to be reviewed by the staff.[34] We are sensitive to the concerns regarding compliance issues with respect to rule 206(3)-3T raised by one commenter.[35] Since 2010 and throughout the period of the extension, the staff has and will continue to examine firms that engage in principal transactions and will take appropriate action to help ensure that firms are complying with section 206(3) or rule 206(3)-3T (as applicable), including possible enforcement action.

We received four comment letters specifically addressing the duration of our proposed extension of rule 206(3)-3T.[36] Three of these commenters expressed support for extending the rule for an additional two years, although two of these commenters suggested that an extension of five years would be more appropriate.[37] One commenter opposed extending the rule for more than a six-month period, during which the rule's effectiveness could be further assessed.[38]

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[33] *See* 2010 Extension Proposing Release, Section II (discussing certain compliance issues identified by the Office of Compliance Inspections and Examinations with respect to the requirements of section 206(3) or rule 206(3)-3T and noting that the staff did not identify any instances of "dumping" as part of its review).

[34] *See In the Matter of Feltl & Company, Inc.*, Investment Advisers Act Release No. 3325 (Nov. 28, 2011) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for certain principal transactions and section 206(4) of the Advisers Act and rule 206(4)-7 thereunder for failure to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules).

[35] *See* fi360 Letter.

[36] *See* fi360 Letter; FSI Letter; SIFMA Letter; Wells Fargo Letter.

[37] *See* FSI Letter; SIFMA Letter; Wells Fargo Letter. Two of these commenters also recommended that the rule should ultimately be made permanent. *See* FSI Letter; SIFMA Letter.

[38] *See* fi360 Letter.

As we noted in the Proposing Release, we believe that the rule's sunset date should be extended only for a limited amount of time.[39] That period of time, however, must be long enough to permit us to engage in any rulemaking prompted by our broader review of regulatory requirements applicable to investment advisers and broker-dealers. We do not believe that six months is long enough to engage in this process, and we do not believe that it is appropriate at this time to extend the temporary rule for an additional five years. We are sensitive to comments regarding the duration of the extension and the uncertainty caused by extending a temporary rule, but we believe that a two-year extension is necessary to provide investors uninterrupted access to securities available through principal trades and to provide us adequate time to engage in any rulemaking or other process.

Three commenters addressed the question of whether we should consider changing the requirements for adviser disclosures to have registered advisers provide more information to us and their clients about whether they are relying on rule 206(3)-3T.[40] Each of these commenters asserted that additional requirements for adviser disclosures are unnecessary, noting that certain additional disclosures may be redundant, and that current disclosures appear to be adequate.[41] We are not adopting amendments requiring additional adviser disclosures at this time, but will consider the need for such disclosures in future rulemakings or other processes as necessary.[42]

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39 *See* Proposing Release, Section II.

40 *See* FSI Letter; SIFMA Letter; Wells Fargo Letter. *See also* Proposing Release, Section III (requesting comment on whether we should consider changing the requirements in Form ADV for adviser disclosures to have registered advisers provide more information to us and their clients about whether they are relying on the rule).

41 *See* FSI Letter; SIFMA Letter; Wells Fargo Letter.

42 *See supra* note 25.

As noted above, one commenter suggested that there be a more detailed analysis of data, including spreads paid and investor returns.[43] These factors are relevant to principal trades in general, and are not specific to rule 206(3)-3T. This commenter also raised the concern that the Commission may ultimately apply a "uniform" fiduciary standard to broker-dealers and investment advisers in two different ways.[44] These comments pertain to our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, and we will consider these comments in conducting this broader review.

III. Certain Administrative Law Matters

The amendment to rule 206(3)-3T is effective on December 28, 2012. The Administrative Procedure Act generally requires that an agency publish a final rule in the Federal Register not less than 30 days before its effective date.[45] However, this requirement does not apply if the rule is a substantive rule which grants or recognizes an exemption or relieves a restriction, or if the rule is interpretive.[46] Rule 206(3)-3T is a rule that recognizes an exemption and relieves a restriction and in part has interpretive aspects.

IV. Paperwork Reduction Act

Rule 206(3)-3T contains "collection of information" requirements within the

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[43] *See* fi360 Letter.

[44] *See* fi360 Letter. We note that the standard of care to which advisers are subject and the duties they owe clients are in no way diminished by their reliance on rule 206(3)-3T. *See supra* note 30.

[45] 5 U.S.C. 553(d).

[46] *Id.*

meaning of the Paperwork Reduction Act of 1995.[47] The Office of Management and Budget ("OMB") last approved the collection of information with an expiration date of May 31, 2014. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for the collection of information is: "Temporary rule for principal trades with certain advisory clients, rule 206(3)-3T" and the OMB control number for the collection of information is 3235-0630. The Proposing Release solicited comments on our PRA estimates, but we did not receive comment on them.[48]

The amendment to the rule we are adopting today – to extend rule 206(3)-3T's sunset date for two years – does not affect the current annual aggregate estimated hour burden of 378,992 hours.[49] Therefore, we are not revising the Paperwork Reduction Act burden and cost estimates submitted to OMB as a result of this amendment.

V. Economic Analysis

A. Introduction

We are sensitive to the costs and benefits of our rules. The discussion below addresses the costs and benefits of extending rule 206(3)-3T's sunset date for two years, as well as the effect of the extension on the promotion of efficiency, competition, and capital formation as required by section 202(c) of the Advisers Act.[50]

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[47] 44 U.S.C. 3501 et seq.

[48] *See* Proposing Release, Section IV.

[49] *See Proposed Collection; Comment Request*, 75 FR 82416 (Dec. 30, 2010); *Submission for OMB Review; Comment Request*, 76 FR 13002 (Mar. 9, 2011).

[50] 15 U.S.C. 80b-2(c). Section 202(c) of the Advisers Act mandates that the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

Rule 206(3)-3T provides an alternative means for investment advisers that are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with their non-discretionary advisory clients. Other than extending the rule's sunset date for two additional years, we are not modifying the rule from its current form. We previously considered and discussed the economic analysis of rule 206(3)-3T in its current form in the 2007 Principal Trade Rule Release, the 2009 Extension Release, and the 2010 Extension Release.[51]

The baseline for the following analysis of the benefits and costs of the amendment is the situation in existence today, in which investment advisers that are registered with us as broker-dealers can choose to use rule 206(3)-3T as an alternative means to comply with section 206(3) of the Advisers Act when engaging in principal transactions with their non-discretionary advisory clients. The amendment, which will extend rule 206(3)-3T's sunset date by two additional years, will affect investment advisers that are registered with us as broker-dealers and engage in, or may consider engaging in, principal transactions with non-discretionary advisory clients, as well as the non-discretionary advisory clients of these firms that engage in, or may consider engaging in, principal transactions. The extent to which firms currently rely on the rule is unknown.[52] Past comment letters have indicated that since its implementation in 2007, both large and

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51 *See* 2007 Principal Trade Rule Release, Sections VI-VII; 2009 Extension Release, Sections V-VI; 2010 Extension Release, Sections V-VI.

52 As of November 1, 2012, we estimate that there are 491registered investment advisers that also are registered broker-dealers. Based on IARD data as of November 1, 2012, we estimate that there are approximately 100 registered advisers that also are registered as broker-dealers that have non-discretionary advisory accounts and that engage in principal transactions.

small advisers have relied upon the rule.[53] A recent letter submitted by one commenter describes survey results of several of its members that rely on the rule.[54]

B. Benefits and Costs of Rule 206(3)-3T

As stated in previous releases, we believe the principal benefit of rule 206(3)-3T is that it maintains investor choice among different types of accounts and protects the interests of investors. Rule 206(3)-3T also provides a lower cost and more efficient alternative for an adviser that is registered with us as a broker-dealer to comply with the requirements of section 206(3) of the Advisers Act. This, in turn, may provide non-discretionary advisory clients greater access to a wider range of securities. Non-discretionary advisory clients also benefit from the protections of the sales practice rules of the Securities Exchange Act of 1934 (the "Exchange Act") and the relevant self-regulatory organization(s) and the fiduciary duties and other obligations imposed by the Advisers Act. Greater access to a wider range of securities may also allow non-discretionary advisory clients to better allocate capital. In the long term, the more efficient allocation of capital may lead to an increase in capital formation.

We received one comment on our economic analysis.[55] The commenter questioned the importance of investor choice as the principal benefit of rule 206(3)-3T.[56] We continue to believe that providing non-discretionary advisory clients with greater access to a wider range of securities is beneficial. As we have previously stated, many

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53 *See* Comment Letter of Securities Industry and Financial Markets Association (Dec. 20, 2010); Comment Letter of Winslow, Evans & Crocker (Dec. 8, 2009) ("Winslow, Evans & Crocker Letter"); Comment Letter of Bank of America Corporation (Dec. 20, 2010) ("Bank of America Letter").

54 *See supra* notes 19, 21.

55 *See* fi360 Letter.

56 *Id.*

clients wish to access the securities inventory of a diversified broker-dealer through their non-discretionary advisory accounts.[57] We believe that it is appropriate to preserve investors' access to the securities available through principal transactions made in reliance on rule 206(3)-3T while consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing.

Also, in connection with the 2010 extension of the rule, one commenter had disagreed with a number of the benefits of rule 206(3)-3T described above, but did not provide any specific data, analysis, or other information in support of its comment.[58] That commenter argued that rule 206(3)-3T would impede, rather than promote, capital formation because it would lead to "more numerous and more severe violations…of the trust placed by individual investors in their trusted investment adviser."[59] While we understand the view that numerous and severe violations of trust could impede capital formation, we have not seen any evidence that rule 206(3)-3T has caused this result. The staff has not identified instances where an adviser has used the temporary rule to "dump" unmarketable securities or securities that the adviser believes may decline in value into an advisory account, a harm that section 206(3) and the conditions and limitations of rule 206(3)-3T are designed to redress.[60] No commenter provided any substantive or specific

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57 *See* 2007 Principal Trade Rule Release, Section I.B.

58 *See* Comment Letter of the National Association of Personal Financial Advisors (Dec. 20, 2010) ("NAPFA Letter") (questioning the benefits of the rule in: (1) Providing protections of the sales practice rules of the Exchange Act and the relevant self-regulatory organizations; (2) allowing non-discretionary advisory clients of advisory firms that are also registered as broker-dealers to have easier access to a wider range of securities which, in turn, should continue to lead to increased liquidity in the markets for these securities; (3) maintaining investor choice; and (4) promoting capital formation).

59 *See id.*

60 *See supra* note 33.

evidence to contradict our previous conclusion that the rule benefits investors, and we continue to believe that the rule provides those benefits.[61]

We also received comments on the 2007 Principal Trade Rule Release from commenters who opposed the limitation of the temporary rule to investment advisers that are registered with us as broker-dealers, as well as to accounts that are subject to both the Advisers Act and Exchange Act as providing a competitive advantage to investment advisers that are registered with us as broker-dealers.[62] Based on our experience with the rule to date, and as we noted in previous releases, we have no reason to believe that broker-dealers (or affiliated but separate investment advisers and broker-dealers) are put at a competitive disadvantage to advisers that are themselves also registered as broker-dealers.[63] Commenters on the Proposing Release did not address this specific issue, but we intend to continue to evaluate the effects of the rule on efficiency, competition, and capital formation in connection with our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

As we discussed in previous releases, there are also several costs associated with rule 206(3)-3T, including the operational costs associated with complying with the rule.[64] In the 2007 Principal Trade Rule Release, we presented estimates of the costs of each of the rule's disclosure elements, including: prospective disclosure and consent; transaction-by-transaction disclosure and consent; transaction-by-transaction confirmations; and the

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61 *See* 2007 Principal Trade Rule Release, Section VI.C; 2009 Extension Release, Section V; 2010 Extension Release, Section V.

62 *See* Comment Letter of the Financial Planning Association (Nov. 30, 2007); Comment Letter of the American Bar Association, section of Business Law's Committee on Federal Regulation of Securities (Apr. 18, 2008). *See also* 2009 Extension Release, Section VI.

63 *See* 2009 Extension Release, Section VI; 2010 Extension Release, Section VI.

64 *See supra* note 51.

annual report of principal transactions. We also provided estimates for the following related costs of compliance with rule 206(3)-3T: (i) The initial distribution of prospective disclosure and collection of consents; (ii) systems programming costs to ensure that trade confirmations contain all of the information required by the rule; and (iii) systems programming costs to aggregate already-collected information to generate compliant principal transactions reports. Although one commenter noted that the Commission's cost analysis had remained unchanged, we do not believe the extension we are adopting today materially affects the cost estimates associated with the rule.[65] The commenter did not provide supporting data discrediting the cost analysis we presented in the 2007 Principal Trade Rule Release.[66]

C. Benefits and Costs of the Extension

In addition to the benefits of rule 206(3)-3T described above and in previous releases, we believe there are benefits to extending the rule's sunset date for an additional two years. The temporary extension of rule 206(3)-3T will have the benefit of providing the Commission with additional time to consider principal trading as part of the broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers without causing disruption to the firms and clients relying on the rule.

One alternative to the extension of the rule's sunset date would be to let the temporary rule sunset on its current sunset date, and so preclude investment advisers from engaging in principal transactions with their advisory clients unless in compliance with

65 *See* 2007 Principal Trade Rule Release, Section VI.D. In the 2007 Principal Trade Rule Release, we estimated the total overall costs, including estimated costs for all eligible advisers and eligible accounts, relating to compliance with rule 206(3)-3T to be $37,205,569.

66 *See* fi360 Letter.

the requirements of section 206(3) of the Advisers Act. As explained in the 2010 Extension Release, if we did not extend rule 206(3)-3T's sunset date, firms currently relying on the rule would be required to restructure their operations and client relationships on or before the rule's current expiration date — potentially only to have to do so again later (first when the rule sunsets or is modified, and again if we adopt a new approach in connection with our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers).[67] As a result of the two-year extension of the rule's sunset date, firms relying on the rule will continue to be able to offer clients and prospective clients the same level of access to certain securities on a principal basis and will not need to incur the cost of adjusting to a new set of rules or abandoning the systems established to comply with the current rule during this two-year period. The extension of the rule will also permit non-discretionary advisory clients who have had greater access to certain securities because of their advisers' reliance on the rule to trade on a principal basis to continue to have the same level of access to those securities without disruption.

Although we did not receive any comments on the rule's compliance costs, we recognize that, as a result of our amendment, firms relying on the rule will incur the costs associated with complying with the rule for two additional years. We also recognize that a temporary rule, by nature, creates long-term uncertainty, which in turn, may result in a reduced ability of firms to coordinate and plan future business activities.[68] However, we

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67 *See* 2010 Extension Release, Section V.

68 One of the two commenters who argued that the rule should eventually be made permanent specifically noted the uncertainty caused by the need for additional extensions in the future. *See* SIFMA Letter. We also received several comments in connection with prior extensions of the rule urging us to make the rule permanent to avoid such uncertainty. *See e.g.*, Winslow, Evans & Crocker Letter; Bank of America Letter.

believe that it would be premature to allow the rule to sunset or to adopt the rule on a permanent basis while consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing. We also considered extending the rule's sunset date for a period other than two years. Two commenters suggested an extension of five years, noting that this period of time would provide greater certainty for firms and more ample time for the Commission to consider its broader regulation of broker-dealers and investment advisers.[69] Another commenter stated that the rule should be extended for no more than six months.[70] We do not believe that six months is long enough to engage in a review of the regulatory obligations of broker-dealers and investment advisers, and we do not believe that it is appropriate at this time to extend the temporary rule for an additional five years. Should our consideration of the fiduciary obligations and other regulatory requirements applicable to broker-dealers and investment advisers extend beyond the sunset date of the temporary rule, a longer period may be appropriate. On balance, however, we continue to believe that the two-year extension of rule 206(3)-3T appropriately addresses the needs of firms and clients relying on the rule while preserving the Commission's ability to address principal trading as part of its broader consideration of the standards applicable to investment advisers and broker-dealers. We will continue to assess the rule's operation and impact along with intervening developments during the period of the extension.

VI. Final Regulatory Flexibility Act Analysis

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA") regarding the amendment to rule 206(3)-3T in accordance with 5 U.S.C. 604.

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69 *See* SIFMA Letter; Wells Fargo Letter.

70 *See* fi360 Letter.

We prepared and included an Initial Regulatory Flexibility Analysis ("IRFA") in the Proposing Release.[71]

A. Need for the Rule Amendment

We are adopting an amendment to extend rule 206(3)-3T's sunset date for two years because we believe that it would be premature to require firms relying on the rule to restructure their operations and client relationships before we complete our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. The objective of the amendment to rule 206(3)-3T, as discussed above, is to permit firms currently relying on rule 206(3)-3T to limit the need to modify their operations and relationships on multiple occasions before we complete our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. Absent further action by the Commission, the rule will sunset on December 31, 2012.

We are amending rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 15 U.S.C. 80b-11(a)].

B. Significant Issues Raised by Public Comments

We did not receive any comment letters related to our IRFA.

C. Small Entities Subject to the Rule

Rule 206(3)-3T is an alternative method of complying with Advisers Act section 206(3) and is available to all investment advisers that: (i) Are registered as broker-dealers under the Exchange Act; and (ii) effect trades with clients directly or indirectly through a broker-dealer controlling, controlled by or under common control with the investment

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[71] *See* Proposing Release, Section VII.

adviser, including small entities. Under Advisers Act rule 0-7, for purposes of the Regulatory Flexibility Act an investment adviser generally is a small entity if it: (i) Has assets under management of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[72]

As noted in the Proposing Release, we estimated that as of August 1, 2012, 547 SEC-registered investment advisers were small entities.[73] As discussed in the 2007 Principal Trade Rule Release, we opted not to make the relief provided by rule 206(3)-3T available to all investment advisers, and instead have restricted it to investment advisers that also are registered as broker-dealers under the Exchange Act.[74] We therefore estimated for purposes of the IRFA that 7 of these small entities (those that are both investment advisers and registered broker-dealers) could rely on rule 206(3)-3T.[75] We did not receive any comments on these estimates.

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72 *See* 17 CFR 275.0-7.

73 IARD data as of August 1, 2012. As of November 1, 2012, based on IARD data, we estimate that 502 SEC-registered investment advisers were small entities.

74 *See* 2007 Principal Trade Rule Release, Section VIII.B.

75 IARD data as of August 1, 2012. As of November 1, 2012, based on IARD data, we estimate that 6 of these small entities could rely on rule 206(3)-3T.

D. Projected Reporting, Recordkeeping, and other Compliance Requirements

The provisions of rule 206(3)-3T impose certain reporting or recordkeeping requirements and our amendment will extend the imposition of these requirements for an additional two years. The two-year extension will not alter these requirements.

Rule 206(3)-3T is designed to provide an alternative means of compliance with the requirements of section 206(3) of the Advisers Act. Investment advisers taking advantage of the rule with respect to non-discretionary advisory accounts are required to make certain disclosures to clients on a prospective, transaction-by-transaction and annual basis.

Specifically, rule 206(3)-3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client a confirmation statement for each principal trade that discloses the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. Advisers are already required to communicate the content of many of the disclosures pursuant to their fiduciary obligations to clients. Other disclosures are already required by rules applicable to broker-dealers.

Our amendment will only extend the rule's sunset date for two years in its current form. Advisers currently relying on the rule already should be making the disclosures described above.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.[76] Alternatives in this category would include: (i) Establishing different compliance or reporting standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

We believe that special compliance or reporting requirements or timetables for small entities, or an exemption from coverage for small entities, may create the risk that the investors who are advised by and effect securities transactions through such small entities would not receive adequate disclosure. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small investment advisers have different conflicts of interest with their advisory clients in connection with principal trading than larger investment advisers. We believe, therefore, that it is important for the disclosure protections required by the rule to be provided to advisory clients by all advisers, not just those that are not considered small entities.

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[76] *See* 5 U.S.C. 603(c).

Further consolidation or simplification of the proposals for investment advisers that are small entities would be inconsistent with our goal of fostering investor protection.

We have endeavored through rule 206(3)-3T to minimize the regulatory burden on all investment advisers eligible to rely on the rule, including small entities, while meeting our regulatory objectives. It was our goal to ensure that eligible small entities may benefit from our approach to the rule to the same degree as other eligible advisers. The condition that advisers seeking to rely on the rule must also be registered with us as broker-dealers and that each account with respect to which an adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which the broker dealer is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor protection objectives.[77] Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

VII. Statutory Authority

The Commission is amending rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 80b-11(a)].

LIST OF SUBJECTS IN 17 CFR PART 275

Investment advisers, Reporting and recordkeeping requirements.

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77 *See* 2007 Principal Trade Rule Release, Section II.B.7 (noting commenters that objected to this condition as disadvantaging small broker-dealers (or affiliated but separate investment advisers and broker-dealers)).

TEXT OF RULE AMENDMENT

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

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

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

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

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§275.206(3)-3T [Amended]

2. In § 275.206(3)-3T, amend paragraph (d) by removing the words "December 31, 2012" and adding in their place "December 31, 2014."

By the Commission. Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: December 20, 2012

Commissioner Walter not participating

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 68505 / December 20, 2012

Admin. Proc. File No. 3-14711

In the Matter of the Application of

ASENSIO & COMPANY, INC.

For Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DENIAL OF MEMBERSHIP APPLICATION

Registered securities association denied application for membership on the ground that firm failed to demonstrate that it meets the standards of membership contained in registered securities association's rules. *Held*, review proceeding is *dismissed.*

APPEARANCES:

Manuel P. Asensio, for Asensio & Company, Inc.
Alan Lawhead and *Michael J. Garawski* for FINRA.

Appeal filed: January 20, 2012
Last brief received: May 18, 2012

I.

Asensio & Company, Inc. (the "Firm"), a Delaware corporation based in New York, New York, appeals from the denial by FINRA of the Firm's application for FINRA membership.[1]

[1] FINRA is a private, not-for-profit, self-regulatory organization ("SRO") registered with, and overseen by, the Securities and Exchange Commission. It was created in July 2007 following the consolidation of the National Association of Securities Dealers, Inc. and the member regulation, enforcement, and arbitration functions of the NYSE Regulation, Inc. [*No Name in Original]*, Exchange Act Release No. 56751, 2007 WL 4302651, at *3 (Nov. 6, (continued...)

Manuel P. Asensio, the Firm's chairman, chief executive officer, president, chief financial officer, chief compliance officer, executive representative, general securities principal, financial and operations principal ("FINOP"), anti-money laundering officer, and only representative, is subject to a statutory disqualification as a result of a 2006 FINRA decision that barred Asensio from associating with any FINRA member firm in any capacity. FINRA denied the new membership application ("NMA") on the basis that the Firm had failed to demonstrate that: (i) it was capable of complying with the federal securities laws, the rules and regulations thereunder, and FINRA Rules, as required by NASD Rule 1014(a)(3); (ii) it has a supervisory system designed to prevent and detect violations of the federal securities laws, the rules and regulations thereunder, and FINRA Rules, as required by NASD Rule 1014(a)(10); and (iii) it and its associated persons had all required licenses and registrations, as required by NASD Rule 1014(a)(2). We base our findings on an independent review of the record.

II.

A. In 2006, FINRA barred Asensio from associating with any FINRA member.

On July 28, 2006, FINRA barred Asensio from associating with any FINRA member firm. The 2006 FINRA Bar Decision resulted from an investigation of the FINRA member firm with which Asensio was then associated, Asensio Brokerage Services, Inc. ("ABSI"). ABSI, which was founded in 1993, was wholly owned by another firm called Asensio & Company, Inc. ("A&C"), which was not a FINRA member firm.[2] The investigation centered on investment research reports that A&C had issued and whether the reports contained misleading facts and omitted certain information required under FINRA Rules. In connection with the investigation, FINRA requested that Asensio and ABSI provide it with information, including brokerage account statements and copies of some of the research reports at issue. Asensio and ABSI provided some of the information that FINRA requested, but refused to provide other requested information. At a subsequent on-the-record interview ("OTR") with FINRA staff, Asensio answered some of the questions posed, but refused to answer others because he claimed that they did not involve matters "directly related to [his] activities that are regulated [by FINRA]." Given an additional chance to answer FINRA's questions in written form after the OTR, Asensio and ABSI once again answered certain questions, but did not respond to others.

(...continued)
2007); *Order Approving Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accomm. the Consol. of the Member Firm Regulatory Functions of NASD and NYSE Reg., Inc.*, Exchange Act Release No. 56145, 2007 WL 5185330, at *1 (July 26, 2007). The consolidation of the two self-regulatory organizations eliminated their overlapping jurisdiction and set in motion the writing of a uniform set of rules to be administered by the surviving entity—a process that continues to this day. Though the case at hand was instituted after the consolidation, some of the conduct at issue took place before then. Accordingly, this opinion refers to those conduct rules that were in place at the time.

[2] Asensio was the chairman, chief executive officer, and president of A&C. It is not the same firm that filed the NMA at issue in this proceeding.

FINRA found that Asensio had failed to respond to FINRA's requests for information in violation of NASD Rules 8210 and 2110.[3] On this basis, FINRA barred Asensio from association in any capacity with a FINRA member firm.[4] Pursuant to § 3(a)(39)(A) of the Securities Exchange Act of 1934,[5] the FINRA bar disqualifies Asensio from membership or participation in, or association with a member of, an SRO, such as FINRA.[6] As a statutorily disqualified individual, Asensio became ineligible to associate with a FINRA member firm without FINRA's consent.[7] FINRA's By-Laws allow a member firm to request relief from ineligibility to associate with a statutorily disqualified person on behalf of the prospective associated person.

On August 12, 2008, FINRA denied a Membership Continuance Application Form MC-400 filed by member firm ISI Capital, LLC with FINRA's Department of Member Regulation, requesting permission for Asensio to associate with ISI notwithstanding Asensio's statutory disqualification. ISI's Form MC-400 stated that Asensio would be subject to heightened supervision if he were permitted to associate with ISI. FINRA, however, found that Asensio "did everything within his power to obstruct [NASD]'s attempts to gather information concerning potentially misleading research reports" and "demonstrated a wanton disregard for FINRA's regulatory authority." FINRA also expressed concern that ISI's proposed supervision plan was "fragmented" and "d[id] not place the primary daily responsibility for Asensio squarely in the hands of one capable and available supervisor."

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3 NASD Rule 8210 requires persons associated (or formerly associated) with a member firm to provide information with respect to any matter related to an investigation, complaint, or proceeding. NASD Rule 2110 requires members and associated persons to observe "high standards of commercial honor and just and equitable principles of trade."

4 The 2006 FINRA Bar Decision also found that Asensio and ABSI committed other violations related to the research reports that were the initial basis of the investigation. Among other things, the 2006 FINRA Bar Decision found that Asensio and ABSI had violated NASD Rule 2210, which requires that public communications, including research reports, "be based on principles of fair dealing and good faith," "be fair and balanced," and "provide a sound basis" for evaluating a security. Rule 2210 prohibits making "any false, exaggerated, unwarranted, or misleading statement or claim" in a research report or omitting "any material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading." For these violations, FINRA found that it would have fined ABSI, of which Asensio was the majority shareholder, president, chairman, and chief executive officer, $20,000, and imposed a 60-day suspension, but it found it unnecessary to do so in light of the bar it imposed against Asensio for the violations of Rules 8210 and 2110.

5 15 U.S.C. § 78c(a)(39)(A).

6 Asensio and A&C also have been the subject of three separate Letters of Acceptance, Waiver, and Consent ("AWCs") for violating governing rules. On May 23, 1994, Asensio and A&C were censured and fined $7500, jointly and severally, for failure to obtain a required amendment to the firm's restriction agreement related to A&C's net capital level. On October 13, 1998, Asensio and A&C were censured and fined $2500, jointly and severally, for failing to comply with NASD Rules requiring them to develop and maintain a written training plan and a continuing and current education plan for the firm's registered persons. On November 13, 2000, Asensio and A&C were censured and fined $75,000, jointly and severally, and Asensio was ordered to requalify as a principal, because of several different violations of NASD Rules related to firm advertising, short selling, trade reporting, supervision, recommendations made in firm research reports, and related compliance procedures, among other things.

7 FINRA By-Laws, Art. III, § 3(d).

By letters dated December 9, 2009, and January 4, 2010, Asensio sought Commission review of the 2006 FINRA Bar Decision and the 2008 FINRA Membership Continuance Denial. On June 17, 2010, we dismissed that appeal on the grounds that it was not timely filed.[8] The 2010 Commission Decision addressed numerous procedural and constitutional arguments by Asensio concerning the fairness of the FINRA disciplinary proceeding against him. We found that Asensio failed to demonstrate any extraordinary circumstances that would justify his failure to file a timely appeal of the FINRA actions.[9] Asensio appealed to the United States Court of Appeals for the Eleventh Circuit, which affirmed the 2010 Commission Decision.[10]

B. While appealing his bar, Asensio acquired the Firm, which applied to operate as a FINRA-registered broker-dealer with Asensio performing all supervisory functions.

The Firm was formed on July 31, 2009, as Horizon Securities, Inc. and later changed its name to Battersea Park Investments, Inc. On April 9, 2010, Asensio purchased a 100% interest in the Firm from its original founder and changed the Firm's name to Asensio & Company, Inc.

On June 14, 2010, the Firm filed an NMA with FINRA requesting permission to operate as a broker-dealer.[11] In the NMA, the Firm stated that it intended to engage in the business of selling diversified equity mutual funds on a subscription or application basis to Asensio's family, friends, and clients of his investment advisory firm, Mill Rock Investment Advisors.[12] The Firm proposed that Asensio would "devote a minimum of 100 hours per month to the operations of [the Firm]." The Firm proposed that Asensio would serve in all principal executive capacities (i.e., chairman, chief executive officer, president, chief financial officer, chief compliance officer, executive representative, general securities principal, FINOP, and anti-money-laundering officer). The NMA stated that Asensio alone would: (i) supervise the Firm's operations, "including monitoring email, enforcing anti-money laundering rules, etc.," (ii) "perform due

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8 *Manuel P. Asensio*, Exchange Act Release No. 62315, 2010 WL 2468111, at *13 (June 17, 2010), *reconsideration denied*, Exchange Act Release No. 62645, 2010 WL 3043628 (Aug. 4, 2010).

9 *See* Commission Rule of Practice 420(b), 17 C.F.R. § 201.420(b) (stating that the Commission will not extend the thirty-day deadline for filing an application for review of a determination by an SRO "absent a showing of extraordinary circumstances").

10 *Asensio v. SEC*, 447 F. App'x 984 (11th Cir. 2011).

11 In April and May 2010, the Firm applied to register Asensio with FINRA as a general securities principal, FINOP, and general securities representative, and with the State of New York as a securities agent. Asensio's qualifications in those capacities had lapsed because he was last registered in September 2003, and he had not taken the relevant examinations in the previous two years. *See* NASD Rule 1021(c) (setting forth examination requirements for registered principals) and NASD Rule 1031(c) (setting forth examination requirements for registered representatives). The Firm requested an exemption from the qualification examination requirements, which FINRA denied. As of December 2010, the Firm had not received a response to its New York examination waiver request. The record does not indicate that New York ever approved the request.

12 Asensio owns and operates Mill Rock, and the NMA stated that the Firm would share an office suite with Mill Rock. The Firm estimated that it would have "approximately 100 retail customers within the first twelve months of operations."

diligence on prospective mutual funds whose funds [the Firm] might distribute;" and (iii) "ensure accuracy and currency of [the Firm's] books and records and file all regulatory reports in a timely manner."

The NMA attached a seventy-four-page proposed Supervisory System, which included sections pertaining to the Firm's supervision of Asensio, its sole proposed executive officer and registered representative. The Supervisory System included the following statement:

> In general, the Firm does not hire registered representatives with a history of customer complaints, disciplinary actions, or arbitrations, or employ a registered representative who develops such a record during his employment. Should such registered representatives become employed, the Chief Compliance Officer will develop heightened supervisory procedures that will require, at a minimum, the [Chief Compliance Officer] to examine the circumstances of each such case and make a reasonable determination whether the Firm's current supervisory and educational programs are adequate to address the issues. . . .

The Firm did not disclose any procedures to provide heightened supervision of Asensio.[13]

The NMA represented that the Firm had made tentative arrangements for Carrie Wisniewski to take over the supervisory roles of Asensio should he become unable to do so for any reason. Wisniewski was employed at the time of the NMA by B/D Compliance Associates, Inc., a firm based in Norcross, Georgia. An agreement, which was executed by the Firm and B/D Compliance on September 14, 2010, stated that, "in the event either [the Firm] or Manuel Asensio are statutorily disqualified, this agreement is null and void" and that Wisniewski would fulfill Asensio's duties only "on a temporary basis." The NMA does not identify any other personnel who would have supervisory responsibilities besides Asensio as the Firm's sole executive officer.

C. FINRA denied the NMA.

On December 14, 2010, Member Regulation issued a decision denying the NMA on the basis that the Firm had failed to demonstrate that: (i) it was capable of complying with the federal securities laws, the rules and regulations thereunder, and FINRA Rules, as required by NASD Rule 1014(a)(3); (ii) it has a supervisory system designed to prevent and detect violations of the federal securities laws, the rules and regulations thereunder, and FINRA Rules, as required by NASD Rule 1014(a)(10); and (iii) it and its associated persons had all required licenses and

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[13] The only information that the Firm provided regarding supervision of Asensio was in a September 2, 2010, Membership Continuance Application (the "MC-400") requesting permission to associate with Asensio notwithstanding his statutory disqualification. The MC-400 stated that "[Asensio] proposes to employ an individual at the Firm who qualifies as an expert in FINRA compliance, and whose sole job responsibility will be to ensure that the Firm and [Asensio] comply with FINRA Rules." But the MC-400 did not identify any individual who would serve in this capacity.

registrations, as required by NASD Rule 1014(a)(2). Based on these findings, Member Regulation concluded that the Firm did not meet the standards of membership contained in its Rules. The Firm appealed Member Regulation's decision to FINRA's National Adjudicatory Council, which affirmed Member Regulation's decision. This appeal followed.

III.

Exchange Act § 19(f) governs our review of this appeal.[14] In general, § 19(f) requires us to dismiss such an appeal if we find that: (i) the specific grounds on which FINRA based its denial of the Firm's NMA exist in fact; (ii) FINRA's action was in accordance with its rules; and (iii) FINRA's rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[15]

A. The specific grounds on which FINRA based its denial of the Firm's new membership application exist in fact.

Prospective new FINRA member firms are required to meet each of the fourteen standards set forth in NASD Rule 1014(a). In addition, FINRA also considers the public interest and the protection of investors. The applicant firm carries the burden of demonstrating that it meets each of the admission standards. Further, under NASD Rule 1014(b), where a prospective member firm or an associated person is subject to certain events set forth in the Rule,[16] including a statutory disqualification as is the case here, "a presumption exists that the application should be denied." NASD Rule 1014(b) provides that an applicant "may overcome the presumption [of denial] by demonstrating that it can meet each of the standards in [NASD Rule 1014(a)]."

1. The Firm has not met the NASD Rule 1014(a)(3) standard.

Under NASD Rule 1014(a)(3), the Firm had the burden of establishing that it and its associated persons are capable of complying with the federal securities laws, the rules and regulations thereunder, and NASD Rules, including observing high standards of commercial honor and just and equitable principles of trade. In determining whether the standard set forth in Rule 1014(a)(3) is met, FINRA considers, among other things, whether any associated persons of the applicant firm are subject to a statutory disqualification. The FINRA bar against Asensio,

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[14] 15 U.S.C. § 78s(f).

[15] *See, e.g.*, *Frank Kufrovich*, Exchange Act Release No. 45437, 55 SEC 616, 2002 WL 215446, at *4 (Feb. 13, 2002); *William J. Haberman*, Exchange Act Release No. 40673, 53 SEC 1024, 1998 WL 786945, at *2 (Nov. 12, 1998), *aff'd*, 205 F.3d 1345 (8th Cir. 2000) (Table).

[16] The applicable events are listed in NASD Rule 1014(a)(3)(A) and (C)-(E). The relevant provisions applicable to the Firm here are Rule 1014(a)(3)(A) (". . . a self-regulatory organization has taken permanent or temporary adverse action with respect to a registration or licensing determination regarding the Applicant or an Associated Person") and Rule 1014(a)(3)(C) ("an Applicant or Associated Person is the subject of a pending, adjudicated, or settled regulatory action or investigation by . . . a self-regulatory organization").

imposed as a result of his failure to cooperate with a FINRA investigation, makes him subject to a statutory disqualification.

The Firm contends that "Asensio was never the subject of a suspected violation of securities laws or a Commission disciplinary proceeding and, of course, was never the subject of a sanction imposed by the Commission,"[17] but Asensio has a significant disciplinary history. The 2006 FINRA Bar Decision barred Asensio for failure to comply with NASD Rule 8210. We have found that violations of Rule 8210 are serious. Rule 8210, which applies to all FINRA member firms, "provides a means, in the absence of subpoena power, for [FINRA] to obtain from its members information necessary to conduct investigations. The rule is at the heart of the self-regulatory system for the securities industry."[18] We have further found that "[t]he failure to respond to [FINRA] information requests frustrates [FINRA]'s ability to detect misconduct, and such inability in turn threatens investors and markets."[19] We have concluded that individuals who violate Rule 8210 "present too great a risk to the markets and investors to be permitted to remain in the securities industry."[20] Similarly, we have found that "removing those who present such a risk is necessary to further 'the Exchange Act's basic purpose of protecting public investors.'"[21] In light of our consistent position that Rule 8210 serves important regulatory purposes that warrant strong enforcement to ensure compliance with the rule, we agree with FINRA that an individual who is statutorily disqualified as a result of a bar imposed for violations of Rule 8210 must meet a "highly demanding standard" before being permitted to re-enter the industry.[22]

The Firm's claim on appeal that "Asensio has a stellar record of Rule 8210 compliance,"[23] notwithstanding that he has been barred for violating that provision, indicates that the Firm does not appreciate the seriousness and importance of compliance with Rule 8210. This increases the risk of future violations. Moreover, Asensio's permanent bar was imposed relatively recently,

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17 Firm's Br. of Applicant at 35.

18 *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 WL 4899010, at *4 (Nov. 14, 2008), *petition for review denied*, 347 F. App'x 692 (2d Cir. 2009).

19 *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 WL 1697153, at *4 (Apr. 11, 2008), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009).

20 *Id.*

21 *Id.* (citing *Dennis A. Pearson, Jr.*, Exchange Act Release No. 54913, 2006 WL 3590274, at *7 (Dec. 11, 2006) (quoting *Gershon Tannenbaum*, Exchange Act Release No. 31080, 50 SEC 1138, 1992 WL 213844, at *3 (Aug. 24, 1992)); *Jay Alan Ochanpaugh*, Exchange Act Release No. 54363, 2006 WL 2482466, at *5 (Aug. 25, 2006) ("Rule 8210 is an essential cornerstone of NASD's ability to police the securities markets and should be rigorously enforced.")).

22 *See* FINRA's Br. in Opp'n to Appl. for Review at 14. We also agree with FINRA's previous statement that "a FINRA-barred applicant is required to make an extremely strong showing" to justify a finding "that approval of an application for re-entry would serve the public interest." *See Ass'n of X as a Gen. Sec. Rep.*, Redacted Decision No. SD08004, at 6 (FINRA NAC 2008), available at http://www.finra.org/web/groups/industry/@ip/@enf/@adj/.

23 Firm's Br. of Applicant at 39.

which calls into question whether sufficient time has passed to deter Asensio from committing similar violations again.[24]

In addition to Asensio's Rule 8210 violations, the 2006 FINRA Bar Decision found that Asensio and ABSI had violated FINRA Rules related to public communications such as research reports. Asensio and A&C also agreed to three AWCs for other violations of FINRA Rules.[25] Asensio's disciplinary history indicates a pattern of non-compliance with, and disregard for, regulatory requirements and investor protection that further supports FINRA's finding that the Firm has not met the burden of showing that it is able to comply with applicable regulatory requirements, as set forth in Rule 1014(a)(3).

The Firm argues that it meets the Rule 1014(a)(3) standard because its proposed business plan shows that it will comply with relevant securities laws and FINRA Rules. The Firm described its proposed business as "the simplest possible form of FINRA membership—selling mutual funds on an application basis."[26] The Firm stated that it "would not publicly solicit new customers" and would sell mutual funds only to Mill Rock's existing advisory clients, "who are sophisticated investment professionals, and Asensio's friends and family."[27]

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[24] *See, e.g., Timothy P. Pedregon, Jr.*, Exchange Act Release No. 61791, 2010 WL 1143089, at *8 (Mar. 26, 2010) (denying membership continuance application, among other reasons, because of the recent and serious nature of the disqualifying event).

[25] *See supra* note 6. The Firm suggests that we should not consider the AWCs because they "were not adjudicated and entailed no admission of wrongdoing by Asensio." But both the October 1998 and November 2000 AWCs expressly stated that "this AWC will become part of [Asensio's and A&C's] permanent disciplinary records and may be considered in any future actions brought by the [NASD] against us." *See Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *20 & n.85 (Dec. 19, 2009) (considering settled AWCs, which included no admission of wrongdoing, as part of respondent's disciplinary history) (citing *Consol. Inv. Servs., Inc.*, Exchange Act Release No. 36687, 52 SEC 582, 1996 WL 20829, at *6 (Jan. 5, 1996)). In reviewing disciplinary history, we have considered orders in both settled and litigated proceedings. *Russo Sec., Inc.*, Exchange Act Release No. 44186, 55 SEC 58, 2001 WL 379064, at *10 & n.61 (Apr. 17, 2001); *see also, e.g., Pagel, Inc. v. SEC*, 803 F.2d 942, 948 (8th Cir. 1986) (holding that the Commission did not abuse its discretion in revoking broker-dealer's registration and barring it from association with any broker-dealer where, *inter alia*, broker-dealer previously had been sanctioned for other securities violations pursuant to offer of settlement).

While FINRA also cites a May 1994 AWC entered into by Asensio and A&C, our review of the record indicates that it failed to introduce into evidence the related settlement documents. The only evidence regarding this prior disciplinary settlement is a Central Registration Depository Information Report. We have held that an offer of settlement may not be considered for purposes of disciplinary history where "the plain language of the consent order unequivocally states that it cannot be used in another proceeding." *See R.B. Webster Invs., Inc.*, Exchange Act Release No. 34659, 51 SEC 1269, 1994 WL 512475, at *6 & n.37 (Sept. 13, 1994); *Howard R. Perles*, Exchange Act Release No. 45691, 55 SEC 686, 2002 WL 507029, at *10 & n.41 (Apr. 4, 2002). In the absence of the actual settlement documents for the May 1994 AWC, we are unable to determine whether the terms of the prior disciplinary settlement preclude its use in this proceeding. As a result, we have not considered the May 1994 AWC in evaluating the Firm's compliance with Rule 1014(a)(3).

[26] Firm's Br. of Applicant at 4.

[27] *Id.* at 38.

We find that the Firm's arguments do not overcome the presumption of denial that applies to the Firm's NMA as a result of Asensio's statutory disqualification. The bar that led to Asensio's statutory disqualification was imposed for his failure to cooperate with a FINRA investigation pursuant to Rule 8210. Rule 8210 applies to all FINRA member firms, regardless of their specific business plans or the sophistication of their investors. Thus, the Firm's proposed business plan does not reduce the likelihood of future violations of this critical investor protection provision.

The Firm also claims that the likelihood of Asensio committing future violations of Rule 8210 is "speculative" and "unsubstantiated"[28] because, according to the Firm, the underlying investigation that led to Asensio's bar and statutory disqualification was a "frivolous use of regulatory authority in asking unanswerable questions that served no regulatory purpose."[29] The doctrine of collateral estoppel precludes the Firm from challenging in this proceeding the underlying bar against Asensio as well as factual and procedural issues that were actually litigated in connection with the 2010 Commission Decision, which was affirmed by the Eleventh Circuit.[30] Moreover, associated persons of FINRA member firms cannot unilaterally decide when they will respond to FINRA requests for information depending on their personal view of the merits of the investigation at issue.[31] The Firm's continued attempts to attack the merits of the underlying bar against Asensio on the basis that Asensio believed that FINRA's information requests were improper are evidence of a strong likelihood of future violations of Rule 8210.

The Firm further claims that "Asensio has conducted activities as an investment adviser substantially similar to those of a broker-dealer without any accusation of customer harm or

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28 *Id.* at 31.

29 *Id.* at 33.

30 As the Supreme Court has stated, collateral estoppel "preclude[s] parties from contesting matters that they have had a full and fair opportunity to litigate" and thereby "protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions." *Montana v. United States*, 440 U.S. 147, 153-54 (1979).

We have consistently rejected attempts by respondents to avail themselves of an appeal to the Commission in one proceeding to attack collaterally a prior administrative decision by an SRO in another proceeding. *David C. Ho*, Exchange Act Release No. 54481, 2006 WL 2959662, at *7 & n.27 (Sept. 22, 2006) (citing *Clyde J. Bruff*, Exchange Act Release No. 40583, 53 SEC 880, 1998 WL 730586, at *4 & n.23 (Oct. 21, 1998) (refusing to consider respondent's complaint that NASD improperly considered his disciplinary history in assessing sanctions because respondent's arguments were simply "an extensive collateral attack" on a prior NASD order)); *Schield Mgmt. Co.*, Exchange Act Release No. 53201, 58 SEC 1197, 2006 WL 231642, at *6 & n.36 (Jan. 31, 2006) (finding that, where respondents consent to an injunction, they may not dispute the factual allegations of the injunctive complaint in a subsequent administrative proceeding) (citing *Marshall E. Melton*, Investment Advisers Act Release No. 2151, 56 SEC 695, 2003 WL 21729839, at *3 (July 25, 2003), *reconsideration denied*, Exchange Act Release No. 50600, 2004 WL 2413296 (Oct. 28, 2004), *aff'd*, 148 F. App'x 58 (2d Cir. 2005) (unpublished)).

31 *See Berger*, 2008 WL 4899010, at *4 & n.21 ("The language of Rule 8210 . . . is 'unequivocal' with respect to an associated person's obligation to cooperate with NASD information requests") (citing *Michael Markowski*, Exchange Act Release No. 32562, 51 SEC 553, 1193 WL 243654, at *4 (June 30, 1993), *aff'd*, 34 F.3d 99 (2d Cir. 1994)).

other misconduct" and that this is "germane to an informed determination on whether Asensio would cause investor harm in conducting brokerage activities."[32] Asensio, however, has not been subject to the requirements of Rule 8210 and other FINRA Rules since 2006, as a result of his bar. Therefore, the Firm's claim that Asensio and Mill Rock have maintained a clean disciplinary record during the period following his bar is irrelevant in assessing the likelihood of future violations of those provisions.

2. The Firm has not met the NASD Rule 1014(a)(10) standard.

Under NASD Rule 1014(a)(10), a prospective applicant for FINRA membership must show that it has a supervisory system, including written supervisory procedures, internal operating procedures (including operational and internal controls), and compliance procedures designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and FINRA Rules. When a firm proposes to employ a statutorily disqualified individual, we have held that "stringent supervision" is required.[33] We have stated that, "[i]n determining whether to permit the employment of a statutorily disqualified person, the quality of the supervision to be accorded that person is of utmost importance. We have made it clear that such persons must be subject to stringent oversight by supervisors who are fully qualified to implement the necessary controls."[34]

To enable meaningful evaluation of the adequacy of a proposed supervisory system, it is important that the member firm identify a specific individual responsible for the supervision of a statutorily disqualified person, so that the proposed supervisor's experience and qualifications can be assessed. NASD Rule 1014(a)(10)(A) requires FINRA, in evaluating an NMA, to consider whether the "experience" and "qualifications" of supervisory personnel are adequate in light of the disciplinary history of a statutorily disqualified person at the applicant firm. NASD Rule 1014(a)(10)(B) requires FINRA to consider whether the applicant firm "has identified specific Associated Persons to supervise and discharge each of the functions in the Applicant's business plan." We have sustained an NASD denial of a member firm's request to associate with a statutorily disqualified individual where the proposed supervisor of the individual "not only lacked the necessary supervisory experience, but also the requisite industry experience to supervise a statutorily disqualified person."[35] We have also sustained a FINRA denial of a membership continuance application where the proposed supervisors identified by the member

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32 Firm's Reply Br. of Applicant at 9.

33 *See, e.g., Leslie A. Arouh*, Exchange Act Release No. 62898, 2010 WL 3554584, at *10 & n.49 (Sept. 13, 2010) (citing *Haberman*, 1998 WL 786945, at *4 ("We require . . . stringent supervision for a person subject to a statutory disqualification."); *Kufrovich*, 2002 WL 215446, at *6 (rejecting a proposed supervisory plan as lacking "a key component—stringent supervision").

34 *Citadel Sec. Corp.*, Exchange Act Release No. 49666, 57 SEC 502, 2004 WL 1027581, at *4 & n.20 (May 7, 2004) (quoting *Morton Kantrowitz*, Exchange Act Release No. 44239, 55 SEC 98, 2001 WL 435668, at *2 (May 1, 2001)).

35 *Kantrowitz*, 2001 WL 435668, at *1.

firm did not possess the licenses and training necessary to operate in the capacities set forth in the proposed supervisory system.[36]

In evaluating the adequacy of a proposed supervisory system for a statutorily disqualified person, we have also found that it is especially "difficult for employees to supervise effectively the activities of the owner of a firm."[37] The owner of the firm will almost certainly continue to exercise control over the firm's operations, including the ability to fire an employee charged with the responsibility to supervise the firm's owner.[38] This problem is exacerbated if the owner of the firm continues to serve in executive capacities, such as the firm's president, that are responsible for the firm's compliance with regulatory requirements and rules.[39]

The NMA failed to provide for adequate supervision of Asensio. In the NMA, the Firm proposed to employ Asensio, its sole owner, in all of its principal executive capacities, with no specific plan to provide heightened supervision. The Supervisory System included in the NMA stated that the Firm would devise a system of heightened supervision if any employees became subject to a statutory disqualification, but the Firm had no such system in place even though its sole owner and holder of all executive positions was subject to a statutory disqualification. The MC-400 stated an intention to hire personnel who would be responsible for supervising Asensio, but identified no such individual and, therefore, provided no information about any such individual's relevant supervisory experience or qualifications.

The proposed agreement with B/D Compliance for Wisniewski to assume Asensio's responsibilities at the Firm should he become unable to fulfill them also supports FINRA's finding that the NMA did not comply with Rule 1014(a)(10). The agreement was contingent on Asensio *not* being subject to a statutory disqualification, but Asensio *was* statutorily disqualified. In addition, the agreement provided that Wisniewski would only serve as a replacement for Asensio "on a temporary basis" should he become unable to do his jobs at the Firm, not that Wisniewski would supervise Asensio's proposed work at the Firm. This does not constitute the stringent supervision required by FINRA's Rules and our precedent.

The 2006 FINRA Bar Decision also found that Asensio had violated provisions pertaining to member firm communications with the public. Although the NMA stated that the Firm "will not advertise itself" and would sell only to Mill Rock's existing clients, the written supervisory procedures included in the NMA have no such restrictions. And the Firm's proposed

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36 *Citadel*, 2004 WL 1027581, at *4.

37 *Id.*

38 *See, e.g., Kirk A. Knapp*, Exchange Act Release No. 31556, 51 SEC 115, 1992 WL 365568, at *10 (Dec. 3, 1992) (owner of over 90% of firm barred from acting as general securities principal still exercised control and fired new president of firm when president disagreed with owner).

39 *See Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 WL 169138, at *13 (Jan. 20, 2012) (finding that "the president of a brokerage firm is responsible for the firm's compliance with all applicable requirements," absent a delegation of authority).

supervisory procedures contain provisions covered by Rule 2210, which governs communications with the public, including firm advertising, institutional sales literature, and correspondence. Given Asensio's past violations of these FINRA Rules, the failure of the Firm to establish heightened supervisory procedures to prevent similar violations in the future is further evidence that the Firm has not met its burden under Rule 1014(a)(10). We find that the Firm has not satisfied the Rule 1014(a)(10) standard by showing that it has a supervisory system designed to prevent and detect future violations of applicable regulatory provisions.

3. The Firm has not met the NASD Rule 1014(a)(2) standard.

Under NASD Rule 1014(a)(2), the Firm was required to show that it and its associated persons have all licenses and registrations required by state and federal authorities. Although the Firm admits that Asensio has not taken the qualification examinations necessary for him to be registered as a general securities principal, FINOP, and general securities representative, the Firm contends that Asensio was entitled to ignore this requirement because FINRA's denial of his request for a waiver of the examination requirements has not been reviewed by the Commission. The Firm further asserts that Asensio is "ready, willing and able to take the exams should the Commission deny the waiver or at any time it is necessary."[40] But neither Asensio nor the Firm appealed FINRA's decision to deny the examination waiver to the Commission, and the Firm cannot now collaterally attack FINRA's determination nearly two years after it was made.[41]

The Firm argues that requiring Asensio to take examinations "that might expire before membership is achieved is illogical[] and unnecessary."[42] FINRA's Rules expressly state that FINRA will evaluate whether an applicant firm and its associated persons *have* all licenses and registrations required to perform as the NMA proposed. These Rules permit FINRA to assess whether the associated persons of an applicant firm have the current competence required to operate a FINRA member firm. This goal would be substantially frustrated if prospective associated persons could wait until after a decision was reached on the NMA to take required qualification examinations.

We find that the Firm has not shown, as required by NASD Rule 1014, that: (i) it and its associated persons are capable of complying with all relevant securities laws and regulations and FINRA Rules; (ii) it has implemented a plan of heightened supervision designed to prevent and detect future such violations; and (iii) it and its associated persons have all necessary licenses. The Firm's arguments in opposition to FINRA's findings do not overcome the presumption that its NMA should be denied due to Asensio's statutory disqualification. Therefore, we find that all of the grounds supporting FINRA's decision exist in fact.

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40 Firm's Br. of Applicant at 45 n.55.

41 *See, e.g., James Lee Goldberg*, Exchange Act Release No. 66549, 2012 WL 759397, at *9 (Mar. 9, 2012) (reviewing FINRA's denial of member firm's request for waiver of examination requirements with respect to a proposed associated person).

42 Firm's Br. of Applicant at 45 n.55.

B. The denial of the NMA was in accordance with FINRA's rules.

We also find that FINRA's denial of the NMA was in accordance with FINRA's rules, which include the presumption that a prospective member firm's NMA will be denied where that firm proposes to associate with a statutorily disqualified individual. Upon the filing of the NMA, Member Regulation requested additional information from the Firm and conducted a membership interview. FINRA conducted a new membership hearing in accordance with its rules, during which it afforded the Firm an opportunity to be heard.[43]

As discussed above, FINRA expressly considered each of the factors set forth in NASD Rule 1014, and its opinion set forth the reasons for its determination to deny the NMA. On appeal from the decision of Member Regulation, the NAC followed all of the required procedures for an appeal of this type, as set forth in NASD Rule 1015. The NAC allowed the parties to submit briefs in support of their positions, and it considered numerous motions submitted by the Firm. The NAC's decision included all of the required elements under NASD Rule 1015(j).[44] Accordingly, we find that FINRA's decision to deny the NMA was conducted in accordance with its Rules.

C. FINRA applied its rules in a manner consistent with the Exchange Act.

We also find that FINRA applied its rules in a manner consistent with the purposes of the Exchange Act. § 15A(g)(3)(A) of the Exchange Act authorizes registered securities associations such as FINRA to "examine and verify the qualifications of an applicant to become a member and the natural persons associated with such an applicant."[45] FINRA acts consistently with this statutory provision by conducting a review of the fourteen admission standards contained in Rule 1014. We have previously found that those rules and admission standards are "consistent with the [Exchange] Act."[46] We have further supported, as consistent with the Exchange Act, FINRA's membership application process, stating, "because [FINRA] is a member organization charged with the protection of investors and the public interest, it is fair to require applicants to show why membership should be granted."[47] Here, FINRA conducted its Rule 1014 review of the NMA in accordance with the authority that the Exchange Act grants it.[48]

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43 *See* NASD Rule 1013(a)(4) & (b) (setting forth the procedures to be followed after the filing of an NMA).

44 *See* NASD Rule 1015(j) (requiring the NAC's decision to include: (i) a description of the Department's decision, including its rationale; (ii) a description of the principal issues raised in the NAC's review; (iii) a summary of the evidence on each issue; and (iv) a statement whether the Department's decision is affirmed, modified, or reversed, and a rationale therefor that references the applicable standards in Rule 1014).

45 15 U.S.C. § 78*o*-3(g)(3)(A).

46 *See Order Approving Proposed Rule Change*, 62 Fed. Reg. 43,385, 43,398-43,400 (Aug. 13, 1997).

47 *Order Granting Approval of Proposed Rule Change*, 68 Fed. Reg. 75,681, 75,682 (Dec. 31, 2003).

48 *See* 15 U.S.C. § 78*o*-3(g)(3)(A) (authorizing FINRA to "deny membership to . . . a registered broker or dealer if (i) . . . such broker or dealer or any natural person associated with such broker or dealer does not meet such standards of training, experience, and competence as are prescribed by the rules of the association or (ii) such broker

(continued...)

We have recognized that, in order to ensure protection of investors, an SRO such as FINRA "may demand a high level of integrity from securities professionals."[49] We have also afforded FINRA discretion in determining whether persons subject to statutory disqualification should be permitted to associate with a member firm.[50] Similar concerns apply in the context of a prospective new FINRA member that proposes to associate with a statutorily disqualified individual. The requirement in NASD Rule 1014(a)(3) that a prospective new member firm show that it is capable of complying with relevant federal securities laws and FINRA Rules ensures that FINRA has oversight of the proposed re-entry of a statutorily disqualified individual into the industry via association with the new member.

The heightened supervision requirements in NASD Rule 1014(a)(10) are also consistent with the purposes of the Exchange Act. In assessing a supervisory plan, "we require . . . stringent supervision for a person subject to a statutory disqualification."[51] Here, the Firm proposed that Asensio would serve in all principal executive capacities, did not propose a specific plan for heightened supervision of Asensio, and did not identify any personnel who would be responsible for supervising him. The lack of attention to Asensio's supervision made it impossible for FINRA to evaluate the Firm's ability to detect and prevent future violations of the relevant securities laws and FINRA Rules. Likewise, the failure to identify specific individuals responsible for Asensio's supervision made it impossible to evaluate whether the supervisory personnel had the necessary qualifications and incentives to conduct effectively their supervisory duties. We have previously found that, where FINRA member firms have failed to establish heightened supervisory plans for statutorily disqualified individuals, those firms and the statutorily disqualified individuals failed to meet their burden "to show that . . . continued employment in the securities industry would be in the public interest."[52]

Rule 1014(a)(2)'s requirement that Asensio obtain the necessary licenses to operate in the capacities proposed in the NMA is also consistent with the purposes of the Exchange Act. Exchange Act § 15(b)(7) authorizes the Commission to regulate persons associated with broker-dealers by establishing qualification standards.[53] Among these standards is Exchange Act Rule 15b7-1, which requires associated persons to "pass[] any required examinations" established by

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(...continued)
or dealer or person associated with such broker or dealer has engaged and there is a reasonable likelihood he will engage again in acts or practices inconsistent with just and equitable principles of trade").

9 *Kufrovich*, 2002 WL 215446, at *5.

E.g., *Am. Inv. Servs., Inc.*, Exchange Act Release No. 43991, 54 SEC 1265, 2001 WL 167861, at *3 & n.16 eb. 21, 2001); *Halpert & Co., Inc.*, Exchange Act Release No. 28615, 50 SEC 420, 1990 WL 322213, at *2 (Nov. , 1990).

Haberman, 1998 WL 786945, at *4 (finding fault with a supervisory plan where sole compliance officer would e insufficient contact with statutorily disqualified individual).

Timothy H. Emerson, Jr., Exchange Act Release No. 60328, 2009 WL 2138439, at *6 & n.23 (July 17, 2009).

15 U.S.C. § 78*o*(b)(7).

the rules of SROs.[54] In adopting that rule, we stated that "[SRO] qualification of associated persons of broker-dealers is of substantial importance in promoting compliance with the substantive requirements of the federal securities laws," that we "rely principally on the [SROs] in the formulation and administration of qualification standards, subject to [our] review and oversight," and that requiring compliance with such standards advances "investor protection."[55]

Asensio does not currently possess the licenses that are required by FINRA Rules in order for him to operate as a member firm's general securities principal, FINOP, and general securities representative. Requiring such licenses is consistent with the purposes of the Exchange Act because it helps to ensure that Asensio possesses the minimum standards of competency and awareness of his responsibilities before acting in those capacities for a FINRA member firm.[56]

Based on Asensio's disciplinary history, the Firm's failure to provide for adequate supervision of Asensio if the NMA had been granted, and Asensio's failure to obtain the requisite licenses and take the necessary qualification examinations to serve in the capacities set forth in the NMA, FINRA determined that it was in the public interest and in the interest of protecting investors to deny the NMA. We find that FINRA made this determination in a manner consistent with the purposes of the Exchange Act.

IV.

Under the Exchange Act, FINRA is required to "provide a fair procedure for . . . the denial of membership to any person seeking membership."[57] The Firm makes numerous arguments alleging that FINRA did not satisfy this requirement in denying the NMA. We find the Firm's arguments to be without merit.

A. The Firm is collaterally estopped from challenging Asensio's underlying bar.

The Firm challenges the merits of the underlying bar against Asensio. For example, the Firm requests that we "order that FINRA make available to the Applicant another process to

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54 17 C.F.R. § 240.15b7-1.

55 *Requirement of Broker-Dealers to Comply with SRO Qualification Standards*, Exchange Act Release No. 32261, 1993 WL 141070, at *2 (May 4, 1993).

56 *See Michael Stegawski*, Exchange Act Release No. 59326, 2009 WL 223618, at *6 (Jan. 30, 2009) (finding that requiring applicant "to retake the qualification examination for the Series 7 license" after over four years away since his last Series 7 terminated "is fully consistent with the Exchange Act's statutory goal of ensuring the requisite levels of knowledge and competency of associated persons"); *see also Report of the Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. 1, 54 (1963) ("The way should be left open to newcomers to enter the securities business, as with any other business, but the public interest demands that newcomers meet minimum standards of competency and show an awareness of their responsibilities before being allowed to approach the public as brokers, dealers, or underwriters.").

57 15 U.S.C. § 78*o*-3(b)(8).

address the grievances over which the Commission declined to accept jurisdiction."[58] It also claims that it does not seek to re-litigate the sanction imposed, but rather wants to "examine the facts and circumstances surrounding the sanction" to show "that Asensio posed no threat of customer or investor harm, and that the investigation did not serve any significant regulatory purpose."[59]

In the 2010 Commission Decision, we declined jurisdiction over Asensio's appeal of the 2006 FINRA Bar Decision because we found that Asensio had not shown the requisite extraordinary circumstances necessary to justify his failure to file a timely application for review.[60] Collateral estoppel prevents the Firm from re-litigating both the factual findings and legal conclusions of the 2006 FINRA Bar Decision in this appeal.[61]

B. There is no merit to the Firm's fairness arguments related to the MC-400.

The Firm argues that FINRA's consideration of the NMA was unfair because it did not first consider the MC-400, stating that "the MC-400 process could have informed a determination on whether Asensio's association would be appropriate notwithstanding the bar."[62] According to the Firm, this alleged procedural failure "circumvented review of the issue that is most central—whether Asensio's association should be allowed in light of the circumstances surrounding the bar sanction, Asensio's work aiding investor protection . . . , and Asensio having conducted an investment business for many years since the imposition of the sanction without regulatory issues."[63] The Firm takes the position that FINRA was obligated to consider the MC-400 prior to considering the NMA because the MC-400 review process would enable the Firm to make its case that there was no risk of harm to investors if Asensio associated with the Firm. In general, the Firm's chief complaint is that "if an MC-400 is not evaluated during the pendency of an NMA, no 'applicant for membership' [that is sponsoring an MC-400] could have an NMA approved."[64]

None of these contentions has merit. For the reasons discussed above, the MC-400 process, like the NMA review process, does not permit the Firm to collaterally attack Asensio's

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58 Firm's Br. of Applicant at 4.

59 *Id.* at 34.

60 *See Asensio*, 2010 WL 2468111, at *7 & n.26 (citing *Warren B. Minton, Jr.*, Exchange Act Release No. 46709, 55 SEC 1170, 2002 WL 32140276, at *3 & n.12 (Oct. 23, 2002) (quoting *Lance E. Van Alstyne*, Exchange Act Release No. 40738, 53 SEC 1093, 1998 WL 830817, at *4 (Dec. 2, 1998) (holding that adherence by a self-regulatory organization to its procedures rebuts a claim of 'extraordinary circumstances'))).

61 *See supra* note 30.

62 Firm's Reply Br. of Applicant at 16.

63 Firm's Br. of Applicant at 32.

64 *Id.* at 23.

bar or the facts and legal analysis that led to it.[65] Further, contrary to the Firm's arguments, FINRA considered the relevant portions of the MC-400 in reaching its decision to deny the NMA (i.e., the Firm's insufficient proposed business and supervisory plans, and its management structure). And there was nothing about the NMA review process that prevented the Firm from making additional arguments that might have been germane to both application processes. In any event, the Firm cites nothing in the MC-400 that calls into question the facts on which FINRA based its denial of the NMA (i.e., Asensio's statutory disqualification and disciplinary history, the Firm's failure to implement an adequate heightened supervisory plan, and Asensio's failure to obtain the required licenses to operate in the capacities described in the NMA). This illustrates the deficiency of the NMA, rather than a failure by FINRA to provide a fair procedure.

The Firm raises a number of complaints related to FINRA's handling of the MC-400 application. For example, the Firm repeatedly claims that FINRA did not respond to inquiries regarding the status of the MC-400 application. But on August 5, 2010, prior to the submission of a signed MC-400 by the Firm as required under FINRA Rules,[66] FINRA informed the Firm that it would make a determination on the MC-400 "upon conclusion of the NMA process."[67] The Firm claims further that the "intention of FINRA rules" is that Forms NMA and MC-400 will be considered concurrently.[68] But the only authority the Firm cites in support of its position is FINRA Rule 9522, which allows an applicant for membership to file an MC-400. Although an applicant firm may file an MC-400, there is nothing in FINRA's Rules that requires FINRA to consider an MC-400 prior to or concurrently with a pending NMA. On the contrary, as FINRA notes, the Rules governing NMAs contain specific time deadlines by which a decision must be reached, unlike the Rules governing consideration of membership continuance applications. This indicates that FINRA contemplated that NMA determinations may be made within a shorter period of time than MC-400 determinations would be made.

Furthermore, it seems illogical that FINRA would consider the MC-400, which is a membership *continuance* application, prior to consideration of a new membership application,

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65 *See supra* note 30.

66 The record indicates that the Firm and FINRA differed as to the date the Firm filed an MC-400 that was fully compliant with FINRA's Rules. Because the MC-400 is not directly at issue in this proceeding, the specifics of the MC-400 application proceeding are not included in the record of this proceeding. The record, however, appears to contradict the Firm's claim that FINRA "mishandled or destroyed the first filed copy of Applicant's MC-400." Firm's Br. of Applicant at 24. On August 13, 2010, FINRA informed the Firm that it had received the MC-400 by email, but that the MC-400 was deficient due to the lack of a signed copy and the absence of an authorization for FINRA to deduct the $1500 application fee from the Firm's accounts.

67 This letter undermines the Firm's contention that it was unaware of the status of the MC-400 for over a year after it first submitted the MC-400 and its complaint that the Firm allegedly received the "first formal acknowledgment of receipt of the MC-400" in an August 3, 2011, letter from FINRA staff. Given FINRA's clear statement in August 2010 that it would consider the MC-400 only after it had made its decision with respect to the NMA, even if FINRA had failed to provide regular communication to the Firm during the intervening period about the status of the MC-400, this caused the Firm no harm.

68 Firm's Br. of Applicant at 22.

where the firm submitting the MC-400 is not yet a FINRA member firm. As FINRA argues, under different circumstances (where, for example, an applicant firm's NMA indicates that it has developed an internal business plan and supervisory system that will adequately address any concerns caused by the firm's association with a statutorily disqualified individual), it is possible that an NMA could be approved prior to approval of that firm's MC-400. Thus, it is not necessary, as the Firm argues, for FINRA to reach a determination on the MC-400 before an NMA for a firm that seeks to associate with a statutorily disqualified person could be approved. Accordingly, we find that it was fair and consistent with the Exchange Act for FINRA to consider the NMA prior to the MC-400.

C. The Firm's allegations that FINRA staff was biased provide no basis for overturning FINRA's decision.

During the pendency of FINRA Member Regulation's NMA decision, Asensio initiated an *ex parte* email dialogue with two attorneys in FINRA's Offices of the General Counsel. The Firm now claims that the emails that the FINRA attorneys sent to Asensio in response to these communications establish that these FINRA officials interfered with the normal NMA review process and caused FINRA to make a "drastic change" to an alleged "agreement" by Member Regulation to consider the NMA and the MC-400 concurrently.[69]

The record contradicts the Firm's claims that the emails in question show that the FINRA attorneys had "influenced the staff" of Member Regulation, including instructing it "to be reticent."[70] One of the attorneys stated in her email that she was not "involved in the [NMA] or MC-400 processes," and there is no evidence to indicate that she had any communications with Member Regulation staff with respect to the Firm's NMA. The other attorney, one of FINRA's General Counsels at the time, provided detailed responses to inquiries made by Asensio regarding the overall NMA and MC-400 review processes. Although the General Counsel copied certain Member Regulation staff on his reply emails to Asensio, the emails do not indicate any bias. The General Counsel reiterated the necessity that FINRA consider the NMA prior to its consideration of the MC-400. He further noted that the process is not inherently biased, and pointed out that FINRA has, in the past, granted member firm requests to associate with statutorily disqualified individuals where the facts and circumstances of the application warranted such a decision. In a September 8, 2010, email, the General Counsel stated that he had "no idea whether or not [the Firm has completed the NMA process], this office will make no inquiry in this regard, and that process is the sole province of Member Regulation." In addition, neither the General Counsel nor the other attorney with whom Asensio communicated played any role in the NAC's de novo review of Member Regulation's decision. Finally, we have conducted an independent review of the record and determined that the Firm has failed to meet

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[69] *Id.* at 18.

[70] *Id.* at 26.

its burden of establishing that it satisfies each of the admission standards of NASD Rule 1014. Our de novo review cures whatever bias, if any, that may have existed.[71]

D. The Firm's futility/ constitutional claims lack merit.

The Firm argues that the "considerable discretion" afforded to FINRA by the Commission—discretion which, the Firm asserts, entails being allowed to operate with "no definitive standards for MC-400s"—renders the appeals process futile.[72] The Firm further claims that the discretion afforded to FINRA allows it to "deny an application on any basis whatsoever."[73] Asensio raised similar claims in the appeal that resulted in the 2010 Commission Decision. As the Eleventh Circuit stated in connection with Asensio's appeal of that decision, "a deferential standard of review does not mean that filing an appeal is futile."[74]

Moreover, we find no merit in the Firm's claim that FINRA may deny an NMA on any basis whatsoever. To the contrary, as discussed above, NASD Rule 1014 sets forth a set of fourteen standards that FINRA evaluates in the NMA decision-making process, and FINRA followed that process here. The Firm's arguments confuse its inability to meet its burden under Rule 1014 with its assertion of an inherently unfair and futile process for reviewing NMAs.

E. FINRA's proposed rulemaking relating to NMAs did not unfairly impact the Firm's NMA.

The Firm claims that a proposed FINRA rulemaking, made while the Firm's NMA was pending before Member Regulation, constitutes a source of impermissible bias in FINRA's evaluation of the NMA. The proposed rulemaking would have required FINRA to "reject an application for FINRA membership . . . in which either the applicant or an associated person . . . is subject to a statutory disqualification."[75] But the proposed rule expressly stated that it did not apply to NMA proceedings pending at the time, such as this one. And the proposed rule never became effective because, after initial approval of the rule by our Division of Trading and Markets,[76] Asensio filed a petition for Commission review of the rulemaking. Pursuant to our Rules of Practice,[77] the effectiveness of the order was stayed, and the rulemaking has not taken

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71 *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *19 & n.79 (May 27, 2011), *aff'd*, No. 11-2247, 2012 WL 3871561 (1st Cir. Sept. 7, 2012).

72 Firm's Br. of Applicant at 45.

73 *Id.* at 47.

74 *Asensio*, 447 F. App'x at 987.

75 *See Notice of Filing of Proposed Rule Change*, Exchange Act Release No. 63316, 2010 WL 4622446, at *2 (Nov. 15, 2010).

76 See *Order Approving a Proposed Rule Change*, Exchange Act Release No. 63933, 2011 WL 635921, at *4 (Feb. 18, 2011).

77 Rule of Practice 431(e), 17 C.F.R. § 201.431(e).

effect. Moreover, the Firm has pointed to nothing in the record that suggests that Member Regulation was biased by the existence of the rulemaking in making its initial decision to deny the NMA.

The Firm contends that the NAC was also biased because NAC members "are appointed and employed by the same FINRA executives" as the FINRA staff that instituted the rulemaking.[78] The Firm argues that the NAC was biased because it is "guided and influenced [by] [FINRA's Office of General Counsel], the same FINRA office that advise[d] the [FINRA] Board [on the proposed rulemaking]."[79] The NAC's decision, however, does not provide any evidence that it was affected by the rulemaking. For example, the NAC expressly considered many factors, including the Firm's complete failure to provide any form of heightened supervision for Asensio and Asensio's failure to take the required qualification examinations, in making its decision. It did not simply rely on the existence of Asensio's statutory disqualification as the proposed rulemaking would have permitted.

F. The Firm has not shown that Asensio's purported exposure of stock fraud led to bias in FINRA's consideration of the Firm's NMA.

The Firm alleges that FINRA was biased because "FINRA executives' substantial financial interests were and continue to be harmed by Asensio's work to expose stock fraud."[80] The Firm cites Asensio's asserted exposure of stock fraud involving the American Stock Exchange, Inc. ("AMEX"), Citigroup, Inc., and several Chinese companies involved in reverse mergers. The Firm alleges that certain individuals, including current and former FINRA executives, had financial interests that were negatively affected by Asensio's efforts to uncover these frauds.

Specifically, the Firm claims that Asensio's actions biased a former FINRA Vice Chairman, who was also formerly the Chairman and CEO of the AMEX. But this individual has not been employed by FINRA for a number of years and played no part in FINRA's consideration of the NMA.[81] The Firm also claims that Asensio's actions biased FINRA's current Chairman, who was previously employed at Citigroup. These allegations, too, are

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[78] Firm's Br. of Applicant at 28.

[79] *Id.*

[80] *Id.* at 9. Asensio raised similar arguments during the prior Commission proceeding. We found that the arguments did not constitute extraordinary circumstances that warranted permitting Asensio's untimely appeal of the bar against him.

[81] This individual, Salvatore F. Sodano, became subject to a Commission administrative proceeding, which found that Sodano had failed to enforce compliance with the Exchange Act, the rules and regulations thereunder, and AMEX's rules. *Salvatore F. Sodano*, Order Making Findings Pursuant to § 19(h) of the Securities Exchange Act of 1934, Exchange Act Release No. 61562, 2010 WL 616371, at *4 (Feb. 22, 2010).

unsubstantiated and, in any event, the record establishes that FINRA's current Chairman played no role at any level in FINRA's consideration of the Firm's NMA.[82]

The Firm also alleges that Asensio's efforts to expose fraudulent conduct involving Chinese reverse mergers created a conflict because FINRA shares financial interests with the NASDAQ Stock Market, on which some companies involved in such mergers are listed. While FINRA provides certain regulatory services to NASDAQ, this does not, on its own, establish the kind of financial connection that would create a conflict of interest in the consideration of FINRA regulatory matters such as an applicant's NMA. We have stated that FINRA's structure "provides for the autonomy and independence of the regulatory staff . . . such that the staff . . . is generally insulated from the commercial interests of its members and the NASDAQ market."[83] There is nothing in the record that would substantiate the Firm's claims that any potential conflict arising from FINRA's relationship with the NASDAQ market affected FINRA's consideration of the NMA here.

The Firm argues that it should be granted the right to discovery in pursuit of evidence that would prove its allegations of bias. The Firm claims that the Eleventh Circuit's decision, which required proof that the allegedly biased individuals influenced or participated in the FINRA action at issue, established a standard that could never be met unless litigants against FINRA are afforded discovery.[84] We have previously rejected similar requests for discovery related to alleged but unsubstantiated claims of bias by FINRA.[85] Given that the Firm has failed to substantiate any of its claims of bias, we deny the Firm's request for discovery.

The Firm further claims that "Asensio's actions to expose stock fraud aided investors and the public."[86] The Firm objects to FINRA's finding, in denying the NMA, that Asensio's work exposing fraud was "hardly altruistic."[87] The Firm argues that "[t]he apparent unannounced rule for FINRA is that securities work benefitting the public is of interest only if one's motives are altruistic."[88] However, even if we accept that Asensio's work "substantially aided investor

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82 *See Asensio*, 447 F. App'x at 987 (referring to Asensio's alleged claims of the FINRA Chairman's bias in relation to the bar proceeding and stating, "even if such bias existed, Asensio would still have to prove that the CEO influenced or participated in the NASD investigation, which he has not done").

83 *Order Approving Proposed Rule Change*, 62 Fed. Reg. at 43385-86.

84 Firm's Br. of Applicant at 48.

85 *See, e.g., John Montelbano*, Exchange Act Release No. 47227, 56 SEC 76, 2003 WL 147562, at *12 (Jan. 22, 2003) (rejecting discovery request because respondent is "not entitled to go on a fishing expedition in the hope that something might turn up to aid his defense"); *Stratton Oakmont, Inc.*, Exchange Act Release No. 38390, 52 SEC 1170, 1997 WL 112329, at *5 (Mar. 12, 1997) (finding no obligation to compel NASD staff testimony regarding "alleged, but wholly unsubstantiated" contacts between NASD staff and members of the District Committee).

86 Firm's Br. of Applicant at 14.

87 NAC Decision at *13.

88 Firm's Br. of Applicant at 42.

protection and the public interest,"[89] this would not address the risk presented by the NMA as proposed. Efforts to expose stock fraud, regardless of motive, do not indicate a greater likelihood of compliance with Rule 8210, which pertains to an associated person's cooperation with FINRA investigations. Nor would any such benefit from Asensio's work in this area justify the approval of an NMA in which a statutorily disqualified person serves as the sole executive officer of the proposed member firm without any proposed plan of heightened supervision and without obtaining the necessary licenses.

We find that Asensio's claims that his purported exposure of various stock frauds caused FINRA to be biased against him in its NMA decision are unsubstantiated and without merit. The Firm's deficient NMA, which proposed that Asensio alone would be in charge of the Firm, without identifying any personnel or specific plan dedicated to supervising him in a way that would address the concerns raised by his statutory disqualification, as well as Asensio's failure to obtain the necessary licenses to operate in the capacities set forth in the NMA, provided ample justification for FINRA's denial of the Firm's NMA.

G. The Firm's claim that FINRA's decision has hurt Mill Rock's business does not bear on FINRA's rationale for denying the NMA.

The Firm argues that FINRA's denial of the NMA is unfair because it has caused "negative collateral effects [on Asensio] . . . as an advisor and even as a private investor (for instance, in attempting to open brokerage accounts)."[90] The Firm contends that Asensio has suffered such alleged harm "based upon a vague, inferred threat to investors."[91] To the contrary, FINRA's finding that the proposed NMA entailed a significant risk of harm to investors was based on its consideration of each of the relevant factors under NASD Rule 1014. The denial of the NMA protects investors from the potential harm that would be caused were Asensio permitted to associate with the Firm without heightened supervision and without having passed the required qualification examinations.

There is likewise no merit to the Firm's claim that Asensio has been denied due process because he "has been deprived of livelihood and property by a private party, which acted under authority conferred by statute."[92] It is well established that the requirements of constitutional due process do not apply to FINRA because FINRA is not a state actor.[93] In any event, the risks presented by the NMA as proposed clearly outweigh the claims by the Firm that FINRA's denial

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89 *Id.*

90 Firm's Reply Br. of Applicant at 8.

91 *Id.* at 9.

92 *Id.* at 22.

93 *See, e.g., D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162 (2d Cir. 2002); *Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *15 (Jan. 30, 2009), *appeal filed*, No. 09-1550 (3d Cir. Feb. 24, 2009); *Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 WL 3306105, at *4 (Nov. 8, 2007); *Mark H. Love*, Exchange Act Release No. 49248, 57 SEC 315, 2004 WL 283437, at *3 & n.13 (Feb. 13, 2004).

of the NMA caused harm to Asensio personally and to Asensio's separate investment advisory business.

We have considered all of the Firm's claims related to the fairness of FINRA's procedures in determining to deny the NMA. For the reasons discussed above, we find that FINRA provided the requisite fair procedure under the Exchange Act.

V.

After the completion of briefing in this appeal, both the Firm and FINRA filed Motions for Leave to Adduce Additional Evidence (the "Motions to Adduce"). Pursuant to Commission Rule of Practice 452, we "may allow the submission of additional evidence" upon a motion that "show[s] with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously."[94]

The Firm's Motion to Adduce attached five exhibits. The first two exhibits relate to whether the Firm paid the required $1500 application fee for the MC-400. The Firm claims that this evidence rebuts FINRA's assertion that "the Firm cannot be heard to complain about the fact that FINRA did not process its MC-400 considering that [the Firm] never paid the required processing fee."[95] But the Firm's NMA, not the MC-400, is at issue in this appeal. As we found above, FINRA's determination to consider the NMA prior to the MC-400 was in accordance with FINRA's Rules and did not unfairly prejudice the Firm. And FINRA expressly considered the relevant provisions of the MC-400 in making its determination on the NMA. For these reasons, we deny the Firm's Motion to Adduce with respect to the first two exhibits, because the Firm failed to show that the additional evidence is material.[96]

Exhibit Three to the Firm's Motion to Adduce includes a series of correspondence between Asensio and a FINRA staff member. The correspondence covered numerous topics, but the Firm asserts that, "most importantly," it included "information provided by Asensio to [the FINRA staff member] and others at FINRA concerning stock fraud among Chinese reverse mergers and the sudden resignation of a NASDAQ official in China after Asensio discussed evidence of improper conduct by the same official with a NASDAQ regulatory executive."[97] Although the Firm states that "this evidence was adduced in part in the record of the prior Commission appeal proceeding"[98] and all of the email messages included in Exhibit Three are

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94 17 C.F.R. § 201.452.

95 FINRA's Br. in Opp'n to Appl. for Review at 31.

96 We likewise deny as immaterial FINRA's Motion to Adduce, which sought to introduce a declaration by the FINRA staff member responsible for maintaining records of the Firm's payment of required fees, which stated that the $1500 payment indicated in the Firm's Motion to Adduce covered other fees owed by the Firm, and not the MC-400 processing fee.

97 Firm's Mot. of Applicant for Leave to Adduce Add'l Evidence at 2.

98 *Id.* at 3.

dated in July and August 2009, considerably in advance of the Firm's filing of the NMA, the Firm does not explain its failure to adduce this evidence previously.[99] In any event, even if we accept the Firm's contention that it had sought to incorporate the record of the earlier Commission proceeding into the record of this proceeding and that FINRA had improperly failed to include these documents in the record,[100] the evidence contained in Exhibit Three is immaterial. As discussed above, we reject the Firm's argument that Asensio's work attempting to expose fraud related to Chinese reverse merger transactions created a bias against him in FINRA's NMA decision-making process. Proposed Exhibit Three does not contain any evidence of bias on the part of FINRA staff and specifically fails to establish bias by anyone who was directly involved in its review of the Firm's NMA.[101]

Proposed Exhibit Four to the Firm's Motion to Adduce is a document styled as a "Report and Determination" by an attorney who entered an appearance on behalf of the Firm before the NAC. Proposed Exhibit Five is a separate document listing what it describes as fourteen "key extracts" from proposed Exhibit Four. These documents contain numerous legal arguments covering topics such as the merits of the 2006 FINRA Bar Decision, our review process in connection with the 2010 Commission Decision, FINRA's analysis of collateral estoppel in the context of its evaluation of the NMA and related portions of the MC-400, the Firm's argument regarding the futility of FINRA and Commission review proceedings, and several other topics that the Firm addressed in detail in its two briefs on appeal to the Commission and elsewhere in the underlying FINRA proceeding.

Under Rule of Practice 450(a), "[n]o briefs in addition to those specified in the briefing schedule order may be filed except with leave of the Commission."[102] Although the Firm claims that the "Report and Determination" includes the findings of a "securities law expert,"[103] it merely repeats or restates legal arguments that the Firm has already made in its briefs on appeal and at other stages in this proceeding. Therefore, we find that it is an impermissible additional brief. In addition, it contains no new information that was otherwise unavailable prior to the filing of the Motion to Adduce, and the Firm has failed to establish that there were reasonable grounds for its failure to adduce this evidence previously. Therefore, we deny the Motion to Adduce with respect to Exhibits Four and Five. Accordingly, we also deny FINRA's request for

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99 *See John Edward Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at *14 & n.60 (Feb. 10, 2012) (rejecting additional evidence where the applicant "has not explained why these documents were not introduced at earlier stages in this proceeding"); *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 WL 5001956, at *8 (Oct. 20, 2011) (declining to accept additional evidence that was dated "well over a year before the Panel Hearing date").

100 As FINRA notes, FINRA served the Firm with the certified record on February 6, 2012, and the Firm did not raise the absence of this evidence until it filed the Motion to Adduce on May 22, 2012.

101 Instead of showing bias, it shows that FINRA seriously considered Asensio's claims about Chinese reverse mergers.

102 17 C.F.R. § 201.450(a).

103 Firm's Mot. of Applicant for Leave to Adduce Add'l Evidence at 3.

permission to file an additional brief responding to the arguments raised in Exhibits Four and Five.

In accordance with § 19(f) of the Exchange Act, we find that the specific grounds on which FINRA based its denial of the NMA exist in fact, that FINRA's determination to deny the Firm's NMA is in accordance with FINRA's Rules, and that FINRA's Rules were applied in a manner consistent with the purposes of the Exchange Act. We therefore dismiss this review proceeding.

An appropriate order will issue.[104]

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

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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[104] 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
Release No. 68505/December 20, 2012

Admin. Proc. File No. 3-14711

In the Matter of the Application of

ASENSIO & COMPANY, INC.

For Review of Action Taken by

FINRA

ORDER DISMISSING REVIEW PROCEEDING

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

ORDERED that the application for review filed by Asensio & Company, Inc. is dismissed.

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. 68506 / December 20, 2012

Admin. Proc. File No. 3-14770

In the Matter of

AMS HOMECARE, INC.

ORDER REMANDING PROCEEDING TO ADMINISTRATIVE LAW JUDGE

I.

AMS Homecare, Inc., a British Columbia corporation with stock registered with the Commission pursuant to § 12(g) of the Securities Exchange Act of 1934,[1] appeals from the initial decision of an administrative law judge.[2] The law judge revoked the company's registration based on her finding that it had violated § 13(a) of the Exchange Act,[3] and Rules 13a-1 and 13a-13 promulgated thereunder,[4] in that the company failed to file any of its required periodic reports since October 17, 2007, when it filed a Form 20-F for the period ended February 28, 2007.[5] The law judge issued the initial decision without holding a hearing in the case and without any motion for summary disposition having been filed by either party.

The relevant chronology is as follows. On February 24, 2012, we issued an Order Instituting Proceedings against AMS Homecare, which directed "that a public hearing for the purpose of taking evidence on the questions set forth in [the OIP] shall be convened" to determine whether the company had violated the periodic reporting requirements of the federal securities laws and whether it was "necessary and appropriate for the protection of investors" to suspend or revoke AMS

1 15 U.S.C. § 78l(g).

2 *Amer. United Gold Corp., et al.*, Initial Decision Release No. 460, 2012 WL 2179124 (June 14, 2012).

3 Exchange Act § 13(a), 15 U.S.C. § 78m(a), requires issuers of securities registered pursuant to Exchange Act § 12 to file periodic reports in accordance with Commission rules.

4 Rule 13a-1, 17 C.F.R. § 240.13a-1, requires registrants to file annual reports, and Rule 13a-13, 17 C.F.R. § 240.13a-13, requires registrants to file quarterly reports.

5 AMS is a foreign private issuer, as defined by Exchange Act Rule 3b-4(c). 17 C.F.R. § 240.3b-4(c). As such, the company has filed its required annual reports on Form 20-F. 17 C.F.R. § 249.220f. Form 20-F is similar to Form 10, filed by U.S. corporations.

Homecare's registration.[6] After two prehearing conferences in which both AMS Homecare and the Division of Enforcement participated,[7] the law judge issued an initial decision finding that AMS Homecare had violated the reporting requirements, as alleged, and revoked its registration. Thereafter, the company filed a timely appeal, and the parties filed briefs in accordance with the briefing schedule that was issued.

II.

A. AMS Homecare appealed the law judge's decision to revoke its registration.

In its briefs, AMS Homecare did not dispute the underlying factual allegations of the OIP (*i.e.*, that it had failed to comply with Exchange Act reporting requirements for a multi-year period), but argued that, because of various circumstances, "the sanctions are not necessary . . . ."[8] The Division, in its brief, argued that the company's failure to file periodic reports since 2007 justified the law judge's decision to revoke the registration of its securities. The Division further identified filing deficiencies not mentioned in the OIP (or addressed by the law judge) that, according to the Division, provided additional support for its claim that revocation was necessary to protect investors.[9] These include the Division's allegation that AMS Homecare's sole officer failed to make required filings related to his personal holdings of the company's stock.[10] The Division also argued,

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6 *Amer. United Gold Corp., et al.*, Exchange Act Release No. 66456, 2012 WL 1028961, at *2 (Feb. 24, 2012).

7 *See* 17 C.F.R. § 201.221 (setting forth procedures applicable to prehearing conferences).

8 AMS Homecare's Opening Br. in Support of Pet. for Review at 6. Among other things, AMS Homecare argues that the company was not given enough time to return to compliance and provides "much needed assistance to the community as a whole." *Id.* at 4-5.

9 Although AMS Homecare admits that it failed to make the required filings as alleged in the OIP, Exchange Act § 12(j) authorizes revocation for violations of Exchange Act filing requirements only if, as indicated above, it is "necessary or appropriate for the protection of investors." 15 U.S.C. § 78l(j). In determining whether sanctions further the protection of investors, we consider, among other things, the following: (i) the seriousness of the issuer's violations; (ii) the isolated or recurrent nature of the violations; (iii) the degree of culpability involved; (iv) the extent of the issuer's efforts to remedy its past violations and ensure future compliance; and (v) the credibility of its assurances, if any, against further violations. *Gateway Int'l Holdings, Inc.*, Exchange Act Release No. 53907, 2006 WL 1506286, at *4 & n.27 (May 31, 2006) (citing *Steadman v. SEC*, 603 F.2d 1126, 1139-40 (5th Cir. 1979) (citation omitted), *aff'd on other grounds*, 450 U.S. 91 (1981)). Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive." *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007) (quoting *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *4 (Sept. 26, 2007), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008)).

10 *See* Exchange Act § 13(d), 15 U.S.C. § 78m(d) (requiring any beneficial owner of more than five percent of any Exchange Act registered securities to disclose the extent of his or her ownership stake); Exchange Act § 16(a), 15 U.S.C. § 78p(a) (requiring officers and directors to disclose their initial ownership stake in the registrant and any changes in their ownership stake).

for the first time on appeal, that the company's 2007 annual report (the last one it filed) lacked required audited financial statements.[11]

B. The Commission requested additional briefing by the parties.

In their merits briefs in this appeal, neither party directly addressed the unusual procedural posture of the case, *i.e.*, that the initial decision was issued without a hearing and without either party filing a motion for summary disposition. As a result, the parties were asked to file additional briefs regarding the procedural posture of the appeal, specifically addressing whether the Rules of Practice authorize issuance of an initial decision in the absence of a hearing or a motion for summary disposition and, consequently, whether the proceeding should be remanded for the purpose of conducting a hearing in the matter (during which motions for summary disposition may be made).[12]

In its response to the additional briefing order, the Division argues that the law judge acted appropriately, citing Rules of Practice 111 and 250(b), which, respectively, authorize hearing officers to "do all things necessary and appropriate to discharge his or her duties"[13] and to grant motions for summary disposition filed by either party, under certain circumstances.[14] According to the Division, the law judge's disposition of the case "was, in essence, a modified summary disposition procedure consented to by the parties which benefited all involved."[15] Noting that the "violation was uncontested" and that the law judge had given the company the opportunity to cure its delinquency, the Division claims that there was no prejudice to AMS Homecare and that the law judge's approach appropriately "conserved the resources of the respondent," the Division, and the law judge because the parties did not have to file "summary disposition briefs, declarations, and exhibits."[16]

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11 The OIP did not allege any deficiency with respect to this 2007 filing. The Division, however, attached to its brief a declaration that supports the new allegations. The Division introduced no evidence to support these allegations before the law judge, presumably because the initial decision was issued at such an early stage in the proceeding.

12 *AMS Homecare, Inc.*, Order Directing the Filing of Additional Briefs, Exchange Act Release No. 68078, 2012 WL 5197254, at *1 (Oct. 22, 2012).

13 17 C.F.R. § 201.111.

14 17 C.F.R. § 201.250 (permitting either party in an administrative proceeding to file, after the respondent's answer to the OIP has been filed and before a hearing is held, a motion for summary disposition of allegations in the OIP).

15 The Division's Br. in Opp'n to AMS Homecare, Inc.'s Pet. for Review at 1.

16 *Id.* at 4-6. In its response to the additional briefing order, which was filed late, AMS Homecare asserts that the procedure followed by the law judge was not "appropriate" and argues in favor of remanding the proceeding for a hearing to permit the company to introduce evidence in support of its public interest arguments against revocation. AMS Homecare's Br. in Response to the Commission's Oct. 22, 2012 Order Directing the Filing of Additional Briefs with Regards to AMS Homecare Inc.'s Pet. for Review of July 31, 2012, at 7. *See infra* note 9.

C. Remanding the proceeding to the law judge is appropriate under the circumstances.

We conclude that a remand for further proceedings before the law judge is warranted. Both the OIP and the Rules of Practice contemplate the holding of a hearing prior to the issuance of an initial decision in the absence of a successful motion for summary disposition by one of the parties, and we see no justification for departing from those procedural requirements here.[17] In reaching this conclusion, we note that it is not clear that AMS Homecare consented to the procedures adopted by the law judge.[18] Moreover, it appears that there are issues in this case that were not developed below, such as the additional filing deficiencies (identified by the Division subsequent to issuance of the initial decision) that the Division cites as further support for its argument that revocation is necessary for the protection of investors.[19] As provided by our rules, evidence regarding these issues should first be submitted to and considered by the law judge, with the opportunity given to the opposing party to challenge such evidence. Summary disposition, provided the applicable procedural provisions are followed, may eliminate the need for a hearing but only "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."[20] We cannot determine, at this point, whether summary disposition is appropriate here, nor, under our rules, is that an appropriate determination for us to make.[21]

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[17] We have previously remanded cases because of a failure to comply with procedures set forth in our Rules of Practice even when the non-compliance was unlikely to have resulted in prejudice. *See, e.g., Byron S. Rainner*, Exchange Act Release No. 59040, 2008 WL 5100855, at *2 (Dec. 2, 2008) (remanding proceeding where respondent denied adequate opportunity to review investigative file, as required by Rule of Practice 230(a)); *Jose P. Zollino*, Exchange Act Release No. 51632, 2005 WL 1006826, at *3 (Apr. 29, 2005) (remanding proceeding where no prehearing conference was held, as required by Rule of Practice 221, and where respondent did not receive an adequate opportunity to review investigative file).

[18] At the second prehearing conference, after the law judge stated her intention to revoke the company's registration, AMS Homecare's CEO objected, arguing that the company should have received additional time to make its filings prior to the issuance of an initial decision. In its petition for review, the company argued, "[w]hen the pre-hearing [conference] for May 16, 2012 was set the requirement was not necessarily to present audited financial statements and [an annual report] but only to determine how much progress had been made if they were not ready by this May 16, 2012 date." AMS Homecare's Pet. for Review at 3.

[19] *Cf. Gravatt v. The Paul Revere Life Ins. Co.*, 101 F. App'x 194, 196, 2004 WL 1257716, at *2 (9th Cir. 2004) (discussing FED. R. CIV. P. 56, which provides for summary judgment) (unpublished), where the court noted:

> there is a big difference between considering the motion [for summary judgment] sua sponte and doing so with the benefit of adversarial briefing. Counsel often will raise issues that may not be evident to the court, and even introduce additional evidence that might not yet be in the record, to survive an opponent's summary judgment motion.

We note that, although Rule 56 "does not govern Commission administrative proceedings," *Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 WL 294717, at *6 & n.26 (Feb. 4, 2008), our Rule 250 was modeled on Rule 56. *Kornman v. SEC*, 592 F.3d 173, 182 (D.C. Cir. 2010).

[20] 17 C.F.R. § 201.250(b). In considering such a motion, the facts of the pleadings of the non-moving party are accepted as true, "except as modified by stipulations or admissions made by that party, by uncontested affidavits, or by facts officially noted by Rule 323." 17 C.F.R. § 201.250(a).

[21] The Division asks that, if we determine that a remand is necessary, we order the ALJ to summarily dispose of this case based on the pleadings already filed. For the reasons discussed herein, we deny that request. We take no position at

(continued...)

Accordingly, it is ORDERED that the proceeding against AMS Homecare be, and is, remanded for further consideration in accordance with the preceding discussion.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

(...continued)
this time whether a proper motion for summary disposition that complies with the procedural requirements of Rule 250 should be granted.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68498; File No. AN-FICC-2012-09)

December 20, 2012

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Advance Notice and Notice of No Objection Relating to the Replacement of the Prepayment Component of the Value-at-Risk Charge

Pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2012 ("Clearing Supervision Act")[1] and Rule 19b-4(n)(1)(i),[2] notice is hereby given that on November 14, 2012, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") the advance notice described in Items I and II below, which Items have been prepared primarily by FICC. This publication serves as notice of no objection to the advance notice and solicits comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

FICC is proposing to replace the prepayment model component ("Prepayment Model Change") of the Mortgage-Backed Securities Division ("MBSD") Value-at-Risk charge ("VaR Charge").

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, FICC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the proposed rule change and advance notice. The text of these statements may be examined at the places

1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

specified in Item IV below. FICC has prepared summaries, set forth in sections A and B below, of the most significant aspects of such statements.[3]

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

Description of Change

(i) Overview

A key component of each MBSD clearing member's Required Fund Deposit (e.g., margin) is the VaR Charge.[4] The VaR Charge is based on simulating to-be-announced ("TBA") price returns which are dependent on projecting interest rates and prepayment levels. FICC maps TBA eligible pools into TBA CUSIPS for cash flow calculations. The cash flow of a TBA CUSIP is the sum of all discounted future monthly cash flows. The future cash flows include the projected monthly principal payment (both scheduled payment and prepayment) and interest rate expense on the estimated outstanding balance.

The MBSD currently uses a prepayment model developed by the Office of Thrift Supervision ("OTS"); this particular model is no longer being supported with parameter updates. Therefore, the MBSD is proposing to replace the current model it is using with a new one which it has developed.

(ii) Structure of the New Model

The proposed new prepayment model would rely on market-observed data that would allow calibration to occur on a regular basis to capture the prepayment risk of the mortgage pools underlying the TBAs. Model parameters will be updated daily using a rolling window of 252-day historical two-year swap rates, ten-year swap rates, and mortgage current coupons for a given product category.

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3 The Commission has modified the text of the summaries prepared by FICC.

4 See MBSD Rule 4.

The two-year benchmark would allow FICC to estimate the potential prepayment impact from refinance opportunities offered by the adjustable rate mortgage market. The ten-year swap rate is a standard benchmark for fixed rate mortgages. The current coupon rates are implied from the TBA market prices. Therefore, the FICC believes that the new model will be more responsive to changing market conditions than the current prepayment model.

A key component of any prepayment model is a mortgage rate model which estimates the current coupon (the secondary mortgage rate) for the TBA mortgage pools under various interest rate scenarios. The monthly prepayment speed will be estimated based on intensity function based on the refinancing incentive, loan age, and burnout (percentage of loans that fail to prepay despite apparent refinance incentives). This monthly prepayment speed is used to simulate TBA price returns for the VaR Charge component of the MBSD margin calculation. In the OTS model, the concept of "seasonality" is directly incorporated into the prepayment model. The factor is less of a driver of mortgage prepayment activity and FICC does not believe that it is necessary to incorporate this as a distinct assumption in the new prepayment model. There is a minor effect of seasonality through the pool factor.

During the analysis and design phase of the new prepayment model, FICC considered whether to utilize a "security level" model versus a "loan level" model. Loan level models focus on loan-to-value ratio, credit score, and spread at origination, which are aspects of hedging and risk assessment – particularly in evaluating exposure to involuntary prepayments (foreclosure, work-outs, etc.) that typically arise beyond TBA settlement cycle (less than 90 days). Loan level models are generally used by firms that trade and initiate mortgage-backed securities. FICC, whose processing activity at the MBSD spans a short horizon, chose a security level prepayment model which measures security level attributes that can measure short-term prepayment speed, i.e., the spread between the current coupon and the TBA coupon, seasoning, and average maturity. These are key attributes of voluntary prepayments that can impact TBA prices during the settlement cycle. FICC's external model validation team concluded that the proposed prepayment model is appropriate in measuring short-term prepayment speeds.

Anticipated Effect on and Management of Risks

FICC believes that the proposed Prepayment Model Change will enhance the risk management of the positions cleared at the MBSD. First, FICC believes that the proposed Prepayment Model Change will enhance risk management because the current prepayment model is no longer being supported with parameter updates, and thus relies on stale information and produces possibly inaccurate results. Second, as part of the migration to the new model, several steps were taken to reduce the potential risks to FICC and its members, including: validation of the proposed model by an external party, back-testing to validate model performance and analysis to determine the impact of the changes to the VaR requirements for the MBSD Members. Results of FICC's analysis indicate that the proposed Prepayment Model Change will be more responsive to changing market dynamics and FICC believes it will not negatively impact FICC and its members.

(B) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed change.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed changes contained in the advance notice may be implemented pursuant to Section 806(e)(1)(G) of Clearing Supervision Act[5] if the Commission does not object to the proposed changes within 60 days of the later of (i) the date that the Commission receives the notice of the proposed changes or (ii) the date the Commission receives any further information it requests for consideration of the notice. The clearing agency shall not implement the proposed

[5] 12 U.S.C. 5465(e)(1)(G).

changes contained in the advance notice if the Commission objects to the proposed changes.[6]

The Commission may extend the period for review by an additional 60 days if the proposed changes raise novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension.[7] Proposed changes may be implemented in fewer than 60 days from the receipt of the advance notice, or the date the Commission receives any further information it requested, if the Commission notifies the clearing agency in writing that it does not object to the proposed changes and authorizes the clearing agency to implement the proposed changes on an earlier date, subject to any conditions imposed by the Commission.[8]

The clearing agency shall post notice on its web site of proposed changes that are implemented.[9]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

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

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6 12 U.S.C. 5465(e)(1)(F).

7 12 U.S.C. 5465(e)(1)(H).

8 12 U.S.C. 5465(e)(1)(I).

9 17 CFR 240.19b-4(n)(1)(i).

- Send an e-mail to rule-comments@sec.gov. Please include File Number AN-FICC-2012-09 on the subject line.

Paper Comments:

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

All submissions should refer to File Number AN-FICC-2012-09. 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/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice 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, N.E., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of FICC and on FICC's website at http://www.dtcc.com/downloads/legal/rule_filings/2012/ficc/FICC-AN-2012-09.pdf.

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. All submissions should refer to File Number AN-FICC-2012-09 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Commission Findings and Notice of No Objection

(A) Standard of Review

Although Title VIII does not specify a standard that the Commission must apply to determine whether to object to an advance notice, the Commission believes that the purpose of Title VIII, as stated under Section 802(b),[10] is relevant to the review of advance notices.

The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability, by (among other things) authorizing the Federal Reserve Board to promote uniform risk management standards for systemically important FMUs, and providing an enhanced role for the Federal Reserve Board in the supervising of risk management standards for systemically important FMUs.[11] Therefore, the Commission believes that when reviewing advance notices for FMUs, the consistency of an advance notice with Title VIII may be judged principally by reference to the consistency of the advance notice with applicable rules of the Federal Reserve Board governing payment, clearing, and settlement activity of the designated FMU.[12]

Section 805(a) requires the Federal Reserve Board and authorizes the Commission to prescribe standards for the payment, clearing, and settlement activities of FMUs designated as systemically important, in consultation with the supervisory agencies. Section 805(b) of the

10 12 U.S.C. 5461(b).

11 12 U.S.C. 5461(b).

12 See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

Clearing Supervision Act[13] requires that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- Promote robust risk management;
- Promote safety and soundness;
- Reduce systemic risks; and
- Support the stability of the broader financial system.

The relevant rules of the Federal Reserve Board prescribing risk management standards for designated FMUs by their terms do not apply to designated FMUs that are clearing agencies registered with the Commission.[14] Therefore, the Commission believes that the objectives and principles by which the Federal Reserve Board is required and the Commission is authorized to promulgate such rules, as expressed in Section 805(b) of Title VIII,[15] are the appropriate standards at this time by which to evaluate advance notices.[16] Accordingly, the analysis set forth below is organized by reference to the stated objectives and principles in Section 805(b).

(B) Discussion of Advance Notice

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13 12 U.S.C. 5464(b).

14 12 CFR 234.1(b).

15 12 U.S.C. 5464(b).

16 The risk management standards that have been adopted by the Commission in Rule 17Ad-22 are substantially similar to those of the Federal Reserve Board applicable to designated FMUs other than those designated clearing organizations registered with the CFTC or clearing agencies registered with the Commission. See Clearing Agency Standards, Exchange Act Release No. 34-68080 (Oct.22, 2012). To the extent such Commission standards are in effect at the time advance notices are reviewed in the future, the standards would be relevant to the analysis. Moreover, the analysis of clearing agency rule filings under the Exchange Act would incorporate such standards directly.

The modeling of Prepayment Risk could significantly affect the risk management functions of the clearing agency that are related to systemic risk. The output of a prepayment model becomes an input into the calculation of the VaR Charge, which in turn determines a member's required clearing fund deposit. Weaknesses in the model could lead to the clearing fund being inappropriately low, and thus exposing the clearing agency to greater risk should a member default.

The OTS Model is no longer supported by parameter updates and has not been supported by such updates since December 31, 2011. The current model's reliance on stale parameters results in a potentially inaccurate determination of the speed of prepayments and thus a potentially inaccurate VaR Charge. This lack of calibration makes the OTS Model unreliable and increases the risk that MBSD is not collecting sufficient margin given market conditions. Moving to the FICC Model that can be updated as the economic environment changes promotes robust risk management and reduces systemic risk because these changes can be more accurately reflected in margin calculations.

The Commission is conditioning its notice of no objection on FICC implementing policies and procedures reasonably designed to ensure that FICC timely analyzes and monitors the performance and appropriateness of the FICC Model. As discussed above, the OTS model directly incorporates the concept of seasonality, while the FICC model does not. In addition, the FICC model relies on market-observed data to capture the prepayment risk of the mortgage pools underlying the TBAs. The Commission understands that the OTS and many industry models use historical data on actual prepayments to determine the level of prepayment risk. The Commission believes it is important for both FICC and the Commission to observe how the FICC model compares to actual seasonality and prepayment history, two parameters that had previously informed the OTS model. As a result, the Commission would expect such policies and procedures to assess the performance of the FICC Model as compared to other published or calculated prepayment rate forecasts and to analyze the VaR coverage resulting from the use of the FICC Model as compared to the coverage that would be obtained after applying alternate VaR methodologies, such as the index-based haircut methodology already utilized by FICC. The Commission expects that this analysis would be disseminated to the Commission on a monthly basis.

The Commission believes that the replacement of the OTS Model with the FICC Model, subject to the conditions described above, meets the objectives and principles for the risk management standards prescribed under Section 805(a). The ability for FICC to update the FICC Model in response to changing economic conditions allows FICC to more appropriately calculate and collect margin, which better enables FICC to respond in the event that a member defaults. This in turn promotes robust risk management and safety and soundness, reduces systemic risk and supports the stability of the broader financial system.

Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[17] that, the Commission DOES NOT OBJECT to the Prepayment Model Change (File No. AN-FICC-2012-09) and that FICC be and hereby is AUTHORIZED to implement the Prepayment Model Change (File No. AN-FICC-2012-09) subject to FICC implementing policies and procedures reasonably designed to ensure that FICC timely analyzes and monitors the performance and appropriateness of the FICC Model.

By the Commission.

Kevin M. O'Neill

Kevin O'Neill
Deputy Secretary

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17 12 U.S.C. 5465(e)(1)(I).

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9377 / December 21, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 68524 / December 21, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3526 / December 21, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30315 / December 21, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15154

In the Matter of Top Fund Management, Inc. and Barry C. Ziskin, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 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") against Top Fund Management, Inc. ("TFM") and pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act against Barry C. Ziskin ("Ziskin", and together with TFM, "Respondents").

8 of 15

II.

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

III.

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

Summary

These proceedings arise out of TFM's management of the Z Seven Fund, Inc. ("ZSF" or the "Fund"), a mutual fund. ZSF's prospectuses and statements of additional information described ZSF as a stock fund seeking long-term capital appreciation, and restricted the Fund's use of options. Beginning in September 2009, TFM and its principal, Ziskin, pursued a strategy of buying options for speculative purposes contrary to ZSF's stated investment policy that was only changeable by shareholder vote ("fundamental investment policy"). ZSF had net assets of $5.3 million on October 1, 2009, but over the next fifteen months realized $3.7 million in losses from options. These losses, and the ensuing redemptions, ultimately led to ZSF's liquidation in December 2010. By deviating from ZSF's fundamental investment policy, TFM and Ziskin breached their fiduciary duty to ZSF. TFM and Ziskin also misled investors by misrepresenting in a shareholder report that the options trading was for hedging purposes.

Respondents

1. **TFM** is a New York corporation based in Mesa, Arizona that registered with the Commission as an investment adviser on December 28, 1983. During all relevant periods, TFM had only one client, ZSF, which had net assets of $3 million as of March 2010, the date of TFM's last Form ADV filing. TFM withdrew its registration with the Commission effective February 17, 2011.

2. **Ziskin**, age 60, resides in Mesa, Arizona. Ziskin is TFM's founder, president, and sole control person. At all relevant times, Ziskin was responsible for the

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

management of TFM's business and held Series 2 and 65 licenses. In addition to his role at TFM, Ziskin served as president, treasurer, and interested director of ZSF. In 1987, the Commission brought administrative proceedings against Ziskin and TFM's predecessor, The Opportunity Prospector, Inc. ("TOP"), charging Ziskin with aiding and abetting TOP's violations of Sections 204 and 205(2) of the Advisers Act and Rule 204-2(a) thereunder. *See Barry Ziskin*, Advisers Act Release No. 1084, 1987 SEC LEXIS 3596 (Sept. 29, 1987); *The Opportunity Prospector, Inc.*, Advisers Act Release No. 1087, 1987 SEC LEXIS 3570 (Sept. 30, 1987).

Other Relevant Entity

3. **ZSF**, incorporated in Maryland on July 29, 1983, became registered as an investment company on October 13, 1983. From its inception until August 1, 2007, ZSF operated as a closed-end management company and listed its shares under the ticker symbol "ZSEV." Thereafter, ZSF operated as a non-diversified, open-end management company and sold its shares under the ticker symbol "ZSEVX." During all relevant periods, ZSF's stated investment objective was "long-term capital appreciation." ZSF was administratively dissolved by the Maryland Department of Assessments and Taxation on October 2, 2009, and ceased trading on December 29, 2010.

Background

A. ZSF's Disclosure Documents Limited Options Trading in the Fund

4. Since 2008, ZSF's prospectuses and statements of additional information described ZSF's investment objective as long-term capital appreciation and its principal investment strategy as investing, under normal market conditions, at least 80% of its total assets in common stocks and securities immediately convertible into common stocks of domestic and foreign issuers. ZSF's principal investment strategy, as described in its prospectuses, made no mention of options trading and none of the principal risks involved options.

5. Disclosures in ZSF's prospectuses and statements of additional information, which ZSF's Board had approved and by which TFM was bound pursuant to the advisory agreement, provided that options trading was to be used for hedging purposes only. In addition, the statements of additional information specified, both as one of ZSF's investment restrictions and as a policy that cannot be changed without shareholder authorization, that the fund may not purchase options other than for hedging purposes.

6. Ziskin was responsible for the statements contained in ZSF's certified shareholder report for the period ending June 30, 2010 ("Shareholder Report") that was filed with the Commission. The Shareholder Report similarly described the use of options as a means of hedging. Specifically, the Shareholder Report included statements such as: "Because of the unusual market risks faced during a secular bear market, it has been our intention to rely not only on our risk-adverse 7 stock selection criteria but to also hedge our portfolio through the use of put options. . ."; and "Should the secular bear market continue and intensify as we expect, the hedging program has the potential to greatly reduce market risk . . ."

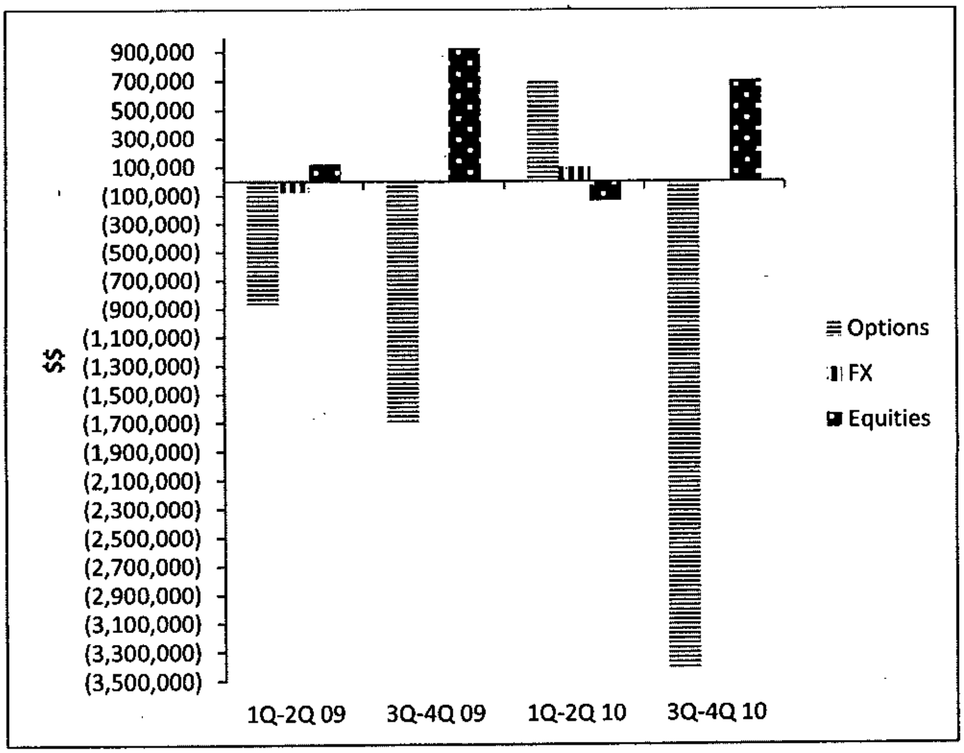
B. During 2009 and 2010, the Fund's Options Trading Deviated from Its Disclosures

7. Notwithstanding ZSF's disclosures about the use of options for hedging purposes, TFM and Ziskin committed a large amount of the fund's assets to purchases of put options on stock index ETFs or stock index futures (collectively, "securities indexes") - $22 million in 2009 and $27 million in 2010, whereas ZSF's equity purchases in those years amounted to only $646,062 and $194,091, respectively. With respect to sales over these two years, ZSF sold $44 million in options but only $7.7 million in equities.

8. Similarly, the market value of ZSF's options portfolio, when analyzed on a month-end basis, was significant when compared to ZSF's total net assets – as high as 21% of total net assets in 2009 and 75% in 2010. When compared to ZSF's common stock assets, ZSF's options portfolio constituted an even higher percentage – as high as 44% of common stock assets in 2009 and 161% in 2010.

9. ZSF's options trading had a significant – and detrimental – effect on its performance. In 2009 and 2010, ZSF lost $2,573,730 and $2,715,149, respectively, from options trading. In the same periods, ZSF gained $949,213 and $659,466 from investments in other assets. As a result, ZSF's options trading had a more significant effect on its performance than did any other investment class. Furthermore, the poor performance was primarily attributable to losses from trading in options.

Gains and Losses From Options vs. Other Asset Classes



10. Contrary to ZSF's disclosures, the Fund's options trading went well beyond hedging and amounted to speculation because the quantity of put options purchased was incompatible with a hedging strategy when considering the size of ZSF's equity portfolio. For example, on September 30, 2009, ZSF's equity portfolio had a market value of $4,747,385. At the same time, ZSF held enough option contracts to protect a portfolio worth (hereinafter "notional value") $12,334,000, or 2.6 times the value of the equity portfolio. In 2010, TFM and Ziskin expanded ZSF's option investments. On May 17, 2010, ZSF's equity portfolio had a market value of $2,276,790 but the notional value of the option positions was $19,412,400, or 8.53 times the value of the equity portfolio. Just two months later, on July 6, 2010, ZSF's equity portfolio had a market value of $1,835,607, but the notional value of the option positions was $32,858,000, or 17.9 times the value of the equity portfolio.

11. Not only did the magnitude of the option investments exceed what would be required to hedge the equity portfolio, the amount spent on option purchases was also incompatible with a hedging strategy. For example, ZSF's equity portfolio on December 31, 2009 had a cost basis of $1,936,328, while ZSF spent $307,658 for its option positions, or 16% of the cost of the equity portfolio for options that expired the following month. Similarly, ZSF's equity portfolio on June 30, 2010 had a cost basis of $1,645,143, but ZSF spent $932,416 for its option positions, or 57% of the cost of the equity portfolio. Because of the amount spent on option purchases, ZSF's assets were quickly depleted.

Violations

12. As a result of the conduct described above, TFM and Ziskin willfully violated Sections 206(1) and 206(2) of the Advisers Act by employing devices, schemes or artifices to defraud clients or engaging in transactions, practices or courses of business that defrauded clients or prospective clients.

13. As a result of the conduct described above, TFM and Ziskin willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8(a) thereunder, which prohibit fraudulent conduct by advisers to "pooled investment vehicles" with respect to investors or prospective investors in those pools.

14. As a result of the conduct described above, TFM and Ziskin willfully violated Section 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

15. As a result of the conduct described above, TFM and Ziskin willfully violated Section 34(b) of the Investment Company Act, which prohibits any person from making any untrue statement of a material fact in any report filed pursuant to the Investment Company Act.

16. As a result of the conduct described above, TFM and Ziskin caused violations of Section 13(a)(3) of the Investment Company Act by ZSF, which provides that no registered investment company, unless authorized by the vote of a majority of its outstanding

voting securities, shall deviate from any policy which it considers changeable only if authorized by shareholder vote.

Civil Penalties

17. Respondent TFM has submitted a sworn Statement of Financial Condition dated July 1, 2012 and other evidence and has asserted its inability to pay a civil penalty.

18. Respondent Ziskin has submitted a sworn Statement of Financial Condition dated July 1, 2012 and other evidence and has asserted his inability to pay a civil penalty.

IV.

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

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

A. Respondents TFM and Ziskin cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8(a) thereunder, and Sections 13(a)(3) and 34(b) of the Investment Company Act.

B. Respondent TFM is censured.

C. Respondent Ziskin 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
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Any reapplication for association by Respondent Ziskin 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. Based upon Respondent TFM's sworn representations in its Statement of Financial Condition dated July 1, 2012 and other documents submitted to the Commission, the Commission is not imposing a penalty against TFM.

F. Based upon Respondent Ziskin's sworn representations in its Statement of Financial Condition dated July 1, 2012 and other documents submitted to the Commission, the Commission is not imposing a penalty against Ziskin.

G. 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 TFM or Respondent Ziskin 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. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondents was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondents may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68508 / December 21, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15151

In the Matter of New Generation Biofuels Holdings, 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 New Generation Biofuels Holdings, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. New Generation Biofuels Holdings, Inc. (CIK No. 1268236) was a Florida corporation, headquartered in Columbia, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g).

B. DELINQUENT PERIODIC FILINGS

2. New Generation 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, 2011, which reported a net loss of $1,896,050 for the prior three months. New Generation has failed to file four Forms 10-Q and one Form 10-K. New Generation has failed to file its 9/30/11, 3/31/12, 6/30/12 and 9/30/12 Forms 10-Q and its 12/31/11 Form 10-K. Its common stock (symbol "NGBF") is quoted on OTC Link (formerly, "Pink Sheets") operated by OTC Markets Group Inc.

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 21, 2012

In the Matter of	:	
New Generation Biofuels Holdings, Inc.	:	**ORDER OF SUSPENSION**
File No. 500-1	:	**OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of New Generation Biofuels Holdings, Inc. because it has not filed any periodic reports since the period ended June 30, 2011.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EST, on December 21, 2012 through 11:59 p.m. EST, on January 7, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68510; File No. 4-657]

Decimalization Roundtable

AGENCY: Securities and Exchange Commission.

ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: The staff of the Securities and Exchange Commission will host a one day roundtable to discuss the impact of tick sizes on small and mid-sized companies, market professionals, investors, and U.S. securities markets.

The roundtable discussion will be held in Room L-006 (the multi-purpose room) of the Securities and Exchange Commission headquarters at 100 F Street, NE, in Washington, DC. The public is invited to observe the roundtable discussion. Seating will be available on a first-come, first-served basis. The roundtable discussion also will be available via webcast on the Commission's website at www.sec.gov.

DATES: The roundtable discussion will take place on February 5, 2013 from 10:00 a.m. to approximately 4:00 p.m.

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-657 on the subject line.

Paper Comments:

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

All submissions should refer to File Number 4-657. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Ilya Fradkin, Attorney Advisor, at (202) 551-5783, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The roundtable will consist of three panels. The participants in the first panel will address the impact of tick sizes on small and middle capitalization companies, the economic consequences (including the costs and benefits) of increasing or decreasing minimum tick sizes, and whether other policy alternatives might better address the concerns animating Section 106(b) of the JOBS Act. The participants in the second panel will address the impact of tick sizes on the securities market in general, including what benefits may have been achieved, and what, if any, negative effects have resulted. The participants in the third panel will address potential methods for analysis of the issues, including whether and how to conduct a pilot for alternative minimum tick sizes.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Dated: December 21, 2012

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3529 / December 27, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30331 / December 27, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15157

In the Matter of **1st Financial Services, LLC and Jeffry C. Eisnaugle, a/k/a Jeff Chapman,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND 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 Sections 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against 1st Financial Services, LLC ("1st Financial") and 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Jeffry C. Eisnaugle ("Eisnaugle") a/k/a Jeff Chapman, collectively ("Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) 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 Respondents' Offers, the Commission finds[1] that:

RESPONDENTS

1. 1st Financial Services, LLC is a currently inactive investment adviser based in Denver, Colorado, which has been registered with the Commission since January 10, 2006. 1st Financial's fiscal year-end was December 31. 1st Financial had discretionary authority over advisory clients' accounts and charged those clients a quarterly advisory fee in advance. The Secretary of State for the State of Colorado's website lists 1st Financial's corporate status as delinquent. On July 12, 2010, 1st Financial filed for Chapter 11 reorganization bankruptcy, and on September 10, 2012, a final decree closing 1st Financial's bankruptcy was issued.

2. Jeffry C. Eisnaugle, age 52, a resident of Denver, Colorado, was the sole owner and managing member of 1st Financial Services, LLC beginning in September 2003. From September 1986 through March 2008, Eisnaugle was a registered representative for four different broker-dealers, but has not been registered as a broker or dealer or associated person of a broker or dealer since March 2008. On December 30, 2011, Eisnaugle filed for Chapter 7 liquidation bankruptcy. Eisnaugle is also known as Jeff Chapman.

FAILURE TO DISCLOSE PRECARIOUS FINANCIAL CONDITION

3. 1st Financial and Eisnaugle failed to disclose to their discretionary clients that 1st Financial was in a precarious financial condition from at least January 31, 2009 to June 30, 2010. 1st Financial's precarious financial condition resulted from a reduction in advisory fees collected in the declining securities market, which reduced the cash available to pay certain increased liabilities from client guarantees. The guarantees obligated 1st Financial and/or Eisnaugle to pay certain clients the amount of any decline in their account values by a specified date.

INELIGIBILITY TO REMAIN REGISTERED AND
FAILURE TO FILE CERTAIN REQUIRED REPORTS

4. 1st Financial has not yet withdrawn its registration as an investment adviser. 1st Financial did not withdraw its registration within 180 days after the end of its fiscal year after it was no longer eligible to register with the Commission when its assets under management fell below the requisite level (at the relevant time, $25 million). 1st Financial remains registered as an investment adviser with the Commission despite not

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

having the requisite amount of assets under management and not otherwise being eligible to register with the Commission.

5. 1st Financial has failed to file its 2010 or 2011 annual registration amendment, which was due within 90 days of its fiscal year-end, or by March 31, 2011 and 2012, respectively.

VIOLATIONS

6. As a result of the conduct described above, 1st Financial and Eisnaugle willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Advisers Act Rule 206(4)-4(a)(1), as in effect during the relevant period.

7. As a result of the conduct described above, 1st Financial willfully violated Sections 203A and 204 of the Advisers Act and Advisers Act Rules 203A-1(b)(2) and 204-1(a)(1).

8. As a result of the conduct described above, Eisnaugle willfully aided and abetted and caused 1st Financial's violations of Sections 203A and 204 of the Advisers Act and Advisers Act Rules 203A-1(b)(2) and 204-1(a)(1).

DISGORGEMENT AND PENALTIES

9. Eisnaugle has submitted a sworn Statement of Financial Condition dated November 8, 2012, and other evidence and has asserted his inability to pay disgorgement, prejudgment interest, or a civil penalty.

IV.

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

Accordingly:

Pursuant to Section 203(e) of the Advisers Act, the registration of Respondent 1st Financial is revoked.

Pursuant to Sections 203(f), 203(i), 203(j), and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act:

A. Respondent Eisnaugle shall cease and desist from committing or causing any violations and any future violations of Sections 203A, 204, 206(1) and 206(2) of the Advisers Act and Rules 203A-1(b)(2) and 204-1(a)(1) promulgated thereunder.

B. Respondent Eisnaugle be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; 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 affiliated person of such investment adviser, depositor, or principal underwriter;

with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

D. Respondent Eisnaugle is ordered to pay disgorgement of $588,000 and prejudgment interest of $48,867 but payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated November 8, 2012, and other documents submitted to the Commission. Based upon Respondent's sworn representations in his Statement of Financial Condition and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. 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 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
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68543 / December 27, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15158

In the Matter of STEWART A. MERKIN, Esq., Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i)(B) OF THE COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Stewart A. Merkin, Esq. ("Respondent" or "Merkin") pursuant to Rule 102(e)(3)(i)(B)[1] of the Commission's Rules of Practice [17 C.F.R. 200.102(e)(3)(i)(B)].

II.

The Commission finds that:

1. Stewart A. Merkin was, at all relevant times, an attorney licensed in Forida, who acted as outside counsel for StratoComm Corporation ("StratoComm") during the Commission's investigation of that company for possible federal securities violations. In that capacity, Merkin communicated with Commission staff, requested and received a copy of the Commission's Formal Order of Investigation, accepted service of subpoenas, forwarded documents to the Commission, and represented StratoComm during six days of investigative testimony. Merkin

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, temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: (B) [f]ound by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party . . . to have violated (unless the violation was found not to have been willful) . . . any provision of the Federal securities laws or of the rules and regulations thereunder.

also represented StratoComm's CEO, and a number of its employees, in connection with the investigation.

2. During the time that the Commission's investigation of StratoComm was ongoing, Merkin prepared and signed four "Attorney Letters" that were submitted to Pink OTC Markets, Inc. (now known as OTC Markets Group Inc.). Those Attorney Letters falsely stated that StratoComm was not under investigation for possible violations of securities laws.

3. On October 3, 2011, the Commission filed a complaint against Merkin in the United States District Court for the Southern District of Florida (the "Court") charging that Merkin had violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, by making false public statements in connection with the purchase or sale of the stock of StratoComm. SEC v. Stewart A. Merkin, Case No. 11-23585-CIV-Graham/Goodman (S.D. Fla.). Specifically, the complaint alleged that on April 8, 2008, June 17, 2010, September 15, 2010, and December 17, 2010, Merkin made false statements in Attorney Letters addressed to Pink OTC Markets, Inc. that appeared on the Pink OTC Markets, Inc. website, to the effect that StratoComm was not under investigation for violations of securities laws, when in fact, as Merkin knew when he prepared and signed those letters, StratoComm was under investigation by the Commission.

4. On October 3, 2012, the Court found that Merkin violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. On that date, the Court issued an order that granted the Commission's motion for summary judgment on the issue of whether Merkin had violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that contained factual findings establishing that Merkin intentionally violated those provisions.

III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has found that Merkin, an attorney, violated the Federal securities laws within the meaning of Rule 102(e)(3)(i)(B) of the Commission's Rules of Practice. In view of this finding, the Commission deems it appropriate and in the public interest that Merkin be temporarily suspended from appearing or practicing before the Commission.

IT IS HEREBY ORDERED that Merkin be, and hereby is, temporarily suspended from appearing or practicing before the Commission. This Order will be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Merkin may, within thirty days after service of this Order, file a petition with the Commission to lift the temporary suspension. If the Commission receives no petition within thirty days after service of the Order, the suspension will become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission will, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Merkin personally or by certified mail at his last known address.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 68544 / December 28, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15160

In the Matter of Desert Mining, Inc., Eagle Broadband, Inc., Endovasc, Inc., Environmental Oil Processing Technology Corp., Falcon Ridge Development, Inc., Fellows Energy Ltd., Forster Drilling Corp. (n/k/a Phoenix Drilling Corporation), and Golden Autumn 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 the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Desert Mining, Inc. ("DSRM")[1] (CIK No. 1129916) is a revoked Nevada corporation located in Longmont, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DSRM 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, 2009, which reported a net loss of $147,411 for the prior nine months. As of December 26, 2012, the common stock of DSRM was quoted on OTC Link

[1]The short form of each issuer's name is also its stock symbol.

NEWS DIGEST

SECURITIES AND EXCHANGE COMMISSION SUSPENDS TRADING IN THE SECURITIES OF EIGHT ISSUERS FOR FAILURE TO MAKE REQUIRED PERIODIC FILINGS

The U.S. Securities and Exchange Commission announced the temporary suspension of trading in the securities of the following issuers, commencing at 9:30 a.m. EST on December 28, 2012 and terminating at 11:59 p.m. EST on January 11, 2013.

- Desert Mining, Inc. (DSRM)
- Eagle Broadband, Inc. (EAGB)
- Endovasc, Inc. (EVSC)
- Environmental Oil Processing Technology Corporation (EVOPQ)
- Falcon Ridge Development, Inc. (FCNR)
- Fellows Energy Ltd. (FLWE)
- Forster Drilling Corp. (n/k/a Phoenix Drilling Corporation) (FODL)
- Golden Autumn Holdings, Inc. (GAHI)

The Commission temporarily suspended trading in the securities of these eight issuers due to a lack of current and accurate information about the companies because they have not filed periodic reports with the Commission in over two years. This order was entered pursuant to Section 12(k) of the Securities Exchange Act of 1934 (Exchange Act).

The Commission cautions brokers, dealers, shareholders and prospective purchasers that they should carefully consider the foregoing information along with all other currently available information and any information subsequently issued by these companies.

Brokers and dealers should be alert to the fact that, pursuant to Exchange Act Rule 15c2-11, at the termination of the trading suspensions, no quotation may be entered relating to the securities of the subject companies unless and until the broker or dealer has strictly complied with all of the provisions of the rule. If any broker or dealer is uncertain as to what is required by the rule, it should refrain from entering quotations relating to the securities of these companies that have been subject to a trading suspension until such time as it has familiarized itself with the rule and is certain that all of its provisions have been met. Any broker or dealer with questions regarding the rule should contact the staff of the Securities and Exchange Commission in Washington, DC at (202) 551-5720. If any broker or dealer enters any quotation which is in violation of the rule, the Commission will consider the need for prompt enforcement action.

If any broker, dealer or other person has any information which may relate to this matter, they should immediately communicate it to the Delinquent Filings Branch of the Division of Enforcement at (202) 551-5466, or by e-mail at DelinquentFilings@sec.gov.

Commission Orders Hearings on Registration Suspension or Revocation Against Eight Companies for Failure to Make Required Periodic Filings

In conjunction with this trading suspension, the Commission today also instituted public administrative proceedings to determine whether to revoke or suspend for a period not exceeding twelve months the registration of each class of the securities of eight companies for failure to make required periodic filings with the Commission:

In the Matter of Desert Mining, Inc., et al., Administrative Proceeding File No. 3-15160

- Desert Mining, Inc. (DSRM)
- Eagle Broadband, Inc. (EAGB)
- Endovasc, Inc. (EVSC)
- Environmental Oil Processing Technology Corporation (EVOPQ)
- Falcon Ridge Development, Inc. (FCNR)
- Fellows Energy Ltd. (FLWE)
- Forster Drilling Corp. (n/k/a Phoenix Drilling Corporation) (FODL)
- Golden Autumn Holdings, Inc. (GAHI)

In this Order, the Division of Enforcement (Division) alleges that the eight issuers are delinquent in their required periodic filings with the Commission.

In this proceeding, instituted pursuant to Exchange Act Section 12(j), a hearing will be scheduled before an Administrative Law Judge. At the hearing, the judge will hear evidence from the Division and the Respondents to determine whether the allegations of the Division contained in the Order, which the Division alleges constitute failures to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder, are true. The judge in the proceeding will then determine whether the registrations pursuant to Exchange Act Section 12 of each class of the securities of these Respondents should be revoked or suspended for a period not exceeding twelve months. The Commission ordered that the Administrative Law Judge in this proceeding issue an initial decision not later than 120 days from the date of service of the order instituting proceedings.

For further information contact:

- Gregory G. Faragasso, Assistant Director, (202) 551-4734

- See also the Order Instituting Administrative Proceedings, *In the Matter of Desert Mining, Inc., et al.,* Administrative Proceeding File No. 3-15160 (December 28, 2012).

- See also the Order of Suspension of Trading, *In the Matter of Desert Mining, Inc., et al.,* File No. 500-1.

(formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Eagle Broadband, Inc. ("EAGB") (CIK No. 1023139) is a Texas corporation located in League City, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EAGB is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2007, which reported a net loss of $15,072,000 for the prior nine months. On November 14, 2007, EAGB filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Texas, which was converted to a Chapter 7 petition on February 4, 2009. A Final Decree was entered in the bankruptcy proceeding on August 3, 2012. As of December 26, 2012, the common stock of EAGB 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. Endovasc, Inc. ("EVSC") (CIK No. 1040415) is a revoked Nevada corporation located in Montgomery, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EVSC 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, 2007. On February 3, 2008, EVSC filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of Texas, which was still pending as of December 26, 2012. As of December 26, 2012, the common stock of EVSC was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Environmental Oil Processing Technology Corporation ("EVOPQ") (CIK No. 1106928) is an expired Utah corporation located in Nampa, Idaho with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EVOPQ 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 $1,057,463 for the prior nine months. On December 6, 2002, EVOPQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Idaho, which was converted to a Chapter 7 petition on January 14, 2003, and was closed on July 23, 2010. As of December 26, 2012, the common stock of EVOPQ 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. Falcon Ridge Development, Inc. ("FCNR") (CIK No. 1065659) is a revoked Nevada corporation located in Albuquerque, New Mexico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FCNR 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, 2009, which reported a net loss of $2,381,707 for the prior six months. As of December 26, 2012, the common stock of FCNR 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. Fellows Energy Ltd. ("FLWE") (CIK No. 1144439) is a revoked Nevada corporation located in Louisville, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FLWE is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the

period ended December 31, 2008, which reported a net loss of $1,143,798 for the prior year. As of December 26, 2012, the common stock of FLWE was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Forster Drilling Corp. (n/k/a Phoenix Drilling Corporation) ("FODL") (CIK No. 744667) is a revoked Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FODL is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended February 29, 2008, which reported a net loss of $5,352,948 for the prior three months. On December 1, 2008, FODL was the subject of an involuntary Chapter 7 petition in the U.S. Bankruptcy Court for the Western District of Texas which was closed on June 15, 2009. As of December 26, 2012, the common stock of FODL was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

8. Golden Autumn Holdings, Inc. ("GAHI") (CIK No. 1303163) is a revoked Nevada corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GAHI 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, 2007, which reported a net loss of $3,219,039 for the prior nine months. As of December 26, 2012, the common stock of GAHI was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

December 28, 2012

In the Matter of **Desert Mining, Inc.,** **Eagle Broadband, Inc.,** **Endovasc, Inc.,** **Environmental Oil Processing Technology Corp.,** **Falcon Ridge Development, Inc.,** **Fellows Energy Ltd.,** **Forster Drilling Corp.** **(n/k/a Phoenix Drilling Corporation), and** **Golden Autumn Holdings, 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 Desert Mining, Inc. because it has not filed any periodic reports since the period ended September 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Eagle Broadband, Inc. because it has not filed any periodic reports since the period ended May 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Endovasc, Inc. 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 Environmental Oil Processing Technology Corp. because it has not filed any periodic reports since the period ended September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Falcon Ridge Development, Inc. because it has not filed any periodic reports since the period ended March 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Fellows Energy Ltd. because it has not filed any periodic reports since the period ended December 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Forster Drilling Corp. (n/k/a Phoenix Drilling Corporation) because it has not filed any periodic reports since the period ended February 29, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Golden Autumn Holdings, Inc. because it has not filed any periodic reports since the period ended June 30, 2007.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on December 28, 2012, through 11:59 p.m. EST on January 11, 2013.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary